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Loblaw Companies Limited 2008 Annual Report – Financial Review



## 2008 Annual Report – Financial Review

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### Financial Highlights<sup>(1)</sup>

For the years ended January 3, 2009 and December 29, 2007  
(millions except where otherwise indicated)

	2008 (53 weeks)	2007 (52 weeks)
<b>Operating Results</b>		
Sales	\$ 30,802	\$ 29,384
Operating expenses	29,756	28,648
Operating income	1,046	736
Interest expense and other financing charges	263	252
Net earnings	545	330
<b>Cash Flow</b>		
Cash flows from operating activities	989	1,245
Free cash flow <sup>(2)</sup>	(49)	402
Fixed asset purchases	750	613
<b>Per Common Share (\$)</b>		
Basic and diluted net earnings	1.99	1.20
Dividend rate at year end	0.84	0.84
Cash flows from operating activities <sup>(2)</sup>	3.61	4.55
Book value	21.26	20.22
Market price at year end	35.23	34.07
<b>Financial Ratios</b>		
EBITDA <sup>(2)</sup>	1,631	1,324
EBITDA margin <sup>(2)</sup>	5.3%	4.5%
Operating margin	3.4%	2.5%
Return on average total assets <sup>(2)</sup>	8.2%	5.8%
Return on average shareholders' equity	9.4%	6.0%
Interest coverage	3.7:1	2.7:1
Net debt <sup>(2)</sup> to equity	.54:1	.67:1
<b>Operating Statistics</b>		
Retail square footage (in millions)	49.8	49.6
Corporate square footage (in millions)	37.7	38.2
Franchise square footage (in millions)	12.1	11.4
Average corporate store size (square feet)	61,900	60,800
Average franchise store size (square feet)	28,400	28,000
Corporate stores sales per average square foot (\$)	624	591
Same-store sales growth	4.2%	2.4%
Number of corporate stores	609	628
Number of franchised stores	427	408
Percentage of corporate real estate owned	74%	73%
Percentage of franchise real estate owned	48%	46%

(1) For financial definitions and ratios refer to the Glossary of Terms on page 83.

(2) See Non-GAAP Financial Measures on page 33.

# Management's Discussion and Analysis

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## Management's Discussion and Analysis

The following Management's Discussion and Analysis ("MD&A") for Loblaw Companies Limited and its subsidiaries (collectively, the "Company" or "Loblaw") should be read in conjunction with the consolidated financial statements and the accompanying notes on pages 36 to 81 of this Financial Report. The consolidated financial statements and the accompanying notes have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and are reported in Canadian dollars. The consolidated financial statements include the accounts of the Company and its subsidiaries and variable interest entities ("VIEs") that the Company is required to consolidate in accordance with Accounting Guideline ("AcG") 15, "*Consolidation of Variable Interest Entities*". A glossary of terms used throughout this Financial Report can be found on page 83. The information in this MD&A is current to March 12, 2009, unless otherwise noted.

### 1. Forward-Looking Statements

This Annual Report – Financial Review for Loblaw contains forward-looking statements about the Company's objectives, plans, goals, aspirations, strategies, financial condition, results of operations, cash flows, performance, prospects and opportunities. Words such as "anticipate", "expect", "believe", "foresee", "could", "estimate", "goal", "intend", "plan", "seek", "strive", "will", "may" and "should" and similar expressions, as they relate to the Company and its management, are intended to identify forward-looking statements. These forward-looking statements are not historical facts but reflect the Company's current expectations concerning future results and events.

These forward-looking statements are subject to a number of risks and uncertainties that could cause actual results or events to differ materially from current expectations, including the possibility that the Company's plans and objectives will not be achieved. These risks and uncertainties include, but are not limited to: changes in economic conditions; changes in consumer spending and preferences; heightened competition, whether from new competitors or current competitors; changes in the Company's or its competitors' pricing strategies; failure of the Company's franchised stores to perform as expected; risks associated with the terms and conditions of financing programs offered to the Company's franchisees; failure to realize sales growth, anticipated cost savings or operating efficiencies from the Company's major initiatives, including investments in the Company's information technology systems, supply chain investments and other cost reduction and simplification initiatives; increased costs relating to utilities, including electricity, and fuel; the inability of the Company's information technology infrastructure to support the requirements of the Company's business; the inability of the Company to manage inventory to minimize the impact of obsolete or excess issues and to control shrink; failure to execute successfully and in a timely manner the Company's major initiatives, including the implementation of strategies and introduction of innovative and reformulated products; unanticipated results associated with the Company's strategic initiatives, including those related to compensation costs; the inability of the Company's supply chain to service the needs of the Company's stores; deterioration in the Company's relationship with its employees, particularly through periods of change in the Company's business; failure to achieve desired results in labour negotiations, including the terms of future collective bargaining agreements which could lead to work stoppages; changes to the regulatory environment in which the Company operates; the adoption of new accounting standards and changes in the Company's use of accounting estimates including in relation to inventory valuation; fluctuations in the Company's earnings due to changes in the value of stock-based compensation and equity forward contracts relating to common shares; changes in the Company's tax liabilities resulting from changes in tax laws or future assessments; detrimental reliance on the performance of third-party service providers; public health events; the inability of the Company to obtain external financing; changes in interest and currency exchange rates; the inability of the Company to collect on its credit card receivables; any requirement of the Company to make contributions to its registered funded defined benefit pension plans in excess of those currently contemplated; the inability of the Company to attract and retain key executives; and supply and quality control issues with vendors. These and other risks and uncertainties are discussed in the Company's materials filed with the Canadian securities regulatory authorities from time to time, including the Risks and Risk Management section of the MD&A found on pages 18 to 26 of this Annual Report – Financial Review. These forward-looking statements reflect management's current assumptions regarding these risks and uncertainties and their respective impact on the Company.

Other risks and uncertainties not presently known to the Company or that the Company presently believes are not material could also cause actual results or events to differ materially from those expressed in its forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect the Company's expectations only as of the date of this Annual Report – Financial Review. The Company disclaims any intention or obligation to update or revise these forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

## 2. Overview

Loblaw, a subsidiary of George Weston Limited (“Weston”), is Canada’s largest food distributor and a leading provider of drugstore, general merchandise and financial products and services. Loblaw is one of the largest private sector employers in Canada. With more than 1,000 corporate and franchised stores from coast to coast, Loblaw and its franchisees employ approximately 139,000 full-time and part-time employees. Through its portfolio of store formats, Loblaw is committed to providing Canadians with a wide, growing and successful range of products and services to meet the everyday household demands of Canadian consumers. Loblaw is known for the quality, innovation and value of its food offering. It offers Canada’s strongest control (private) label program, including the unique *President’s Choice*, *no name* and *Joe Fresh Style* brands. In addition, the Company makes available to consumers *President’s Choice Financial* services and offers the *PC points* loyalty program.

The following is a summary of selected consolidated annual information extracted from the Company’s audited consolidated financial statements. This information was prepared in accordance with Canadian GAAP and is reported in Canadian dollars. The analysis of the data contained in the table focuses on the trends affecting the financial condition and results of operations over the latest three year period.

(\$ millions except where otherwise indicated)	<b>2008</b> (53 weeks)	2007 (52 weeks)	2006 (52 weeks)
Sales	<b>\$ 30,802</b>	\$ 29,384	\$ 28,640
Net earnings (loss) <sup>(1)</sup>	<b>545</b>	330	(219)
Net earnings (loss) per common share(\$) Basic and diluted <sup>(1)</sup>	<b>1.99</b>	1.20	(.80)
Total assets	<b>13,985</b>	13,674	13,486
Long term debt and capital securities	<b>4,454</b>	4,284	4,239
Dividends declared per common share(\$)	<b>\$ 0.84</b>	\$ 0.84	\$ 0.84

Total sales increased 4.8% and same-store sales growth increased 4.2% in 2008 compared to 2007. In 2007 compared to 2006, sales increased 2.6% and same-store sales growth increased 2.4%. During this three-year period, the number of corporate stores decreased to 609 (2007 – 628, 2006 – 672) whereas the number of franchised stores increased to 427 (2007 – 408, 2006 – 405). In 2008, the change is primarily as a result of store conversions, as the Company converted corporate owned stores to franchises. The decrease in the number of corporate stores in 2007 relative to 2006 was due to the targeted closure of underperforming stores in 2007. Also, during this three-year period corporate stores sales per average square foot increased to \$624 (2007 – \$591, 2006 – \$585) while the retail square footage remained flat during this period (2008 – 49.8 million, 2007 – 49.6 million, 2006 – 49.7 million).

Net earnings and basic net earnings per common share increased by \$215 million and \$0.79 in 2008 compared to 2007, respectively. The increase is a result of the increase in operating income which is described on page 6 of this MD&A, and a decrease in the effective tax rate to 29.1% from 31.0%. In 2007 net earnings and basic net earnings per common share increased by \$549 million and \$2.00, respectively compared to 2006. Net earnings in 2007 and 2006 were negatively impacted by the costs associated with the Company’s restructuring initiatives and goodwill impairment charge, respectively.

Total assets in 2008 increased by 2.3% compared to 2007 primarily as a result of an increase in cash balances, an increase in inventories as a result of the Company’s on-shelf availability program, and an increase in fixed assets. In 2007, total assets increased by 1.4% compared to 2006 as a result of an increase in net credit card receivables and an increase in other assets.

(1) During 2008, the Company implemented Canadian Institute of Chartered Accountants Handbook Section 3031, “Inventories” retroactively without restatement of prior periods. For additional information refer to note 2 to the consolidated financial statements.

## Management's Discussion and Analysis

Long term debt and capital securities increased by 4.0% in 2008 compared to 2007 as a result of the 2008 issuance of capital securities. Cash flows from operating activities cover a large portion of the Company's funding requirements and in 2008 exceeded the capital investment program.

### 3. Vision and Strategies

The Company's mission is to be Canada's best food, health and home retailer by exceeding customer expectations through innovative products at great prices. This will be achieved by transforming into a centralized, marketing-led organization with an unrelenting focus on customers, stores and products, while leveraging scale and developing capacity for consistent execution to drive profitable growth.

2007 marked the introduction of Loblaw's three to five year turnaround plan based on Simplify, Innovate and Grow. There were challenges, as would be expected, with an organizational change of such magnitude, but Loblaw made good progress in 2007. Net earnings in 2007 were pressured by Loblaw's investment in lower retail prices and increased costs including significant expenses in restructuring and consulting.

In 2008, Loblaw continued to refine and simplify its processes and systems, initiated several innovation efforts and made measured progress on key growth opportunities. Some of Loblaw's key accomplishments in 2008 include:

- continued to improve price position by format and effectively embed pricing index management in the organization;
- leveraged national scale to negotiate cost of goods sold and goods not for resale reductions to offset planned margin investment;
- successfully piloted a food renewal and enhanced customer service program in 18 "Back to Best" Ontario great food stores;
- enhanced local merchandising focus by appointing a small number of local market merchants;
- initiated the revitalization and redesign of *President's Choice* and *no name* control label brands;
- commenced the western Canada store refurbishment program;
- continued to embed the new store operations model across the country to improve shrink, labour, store expenses and availability;
- progressed in efforts to rebuild supply chain and information technology infrastructure; and
- completed three key management changes, appointing a new President, Chief Merchandising Officer and a new Chief Financial Officer.

The Company remains confident in its strategy. In 2009, the Company will build upon the foundation that was laid in 2008, while focusing on cost control, conserving cash and managing capital expenditures. It will continue to concentrate on growing the business through the Formula for Growth, while focusing on its immediate priorities of food renewal, store enhancements, product innovation, infrastructure and customer value, including:

- an event driven marketing calendar;
- a 300-store renovation program, that will enhance meat, seafood, produce and grocery offerings to customers;
- a renewed focus on in-store customer service;
- the celebration of *President's Choice* 25th anniversary, which includes the rollout of 250 improved and 1000 repackaged products;
- the relaunch of the Company's value-based *no name* brand, introducing more than 750 redesigned products; and
- dedicated investment to support information technology and supply chain infrastructure improvements.

#### 4. Key Performance Indicators

The Company has identified specific key performance indicators to measure the progress of short and long term strategies. The Company believes that if it successfully implements and executes its various strategic imperatives in support of its long term operating and financial strategies, it will be well positioned to pursue its vision of providing sustainable returns to its shareholders.

Key financial performance indicators are set out below:

	<b>2008</b> <b>(53 weeks)</b>	2007 (52 weeks)
Sales growth	4.8%	2.6%
Same-store sales growth	4.2%	2.4%
EBITDA <sup>(1)</sup> (\$ millions)	<b>\$ 1,631</b>	\$ 1,324
EBITDA Margin <sup>(1)</sup>	5.3%	4.5%
Basic net earnings per common share increase	65.8%	250.0%
Cash flows from operating activities (\$ millions)	<b>\$ 989</b>	\$ 1,245
Free cash flow <sup>(1)</sup> (\$ millions)	<b>\$ (49)</b>	\$ 402
Net debt <sup>(1)</sup> (\$ millions)	<b>3,287</b>	3,728
Net debt <sup>(1)</sup> to equity ratio	<b>.54:1</b>	.67:1
Return on average shareholders' equity	<b>9.4%</b>	6.0%

#### 5. Financial Performance

Financial results for 2008 continued to edge forward. The Company's overall financial performance reflects the benefits of its turnaround efforts. In 2007, the restructuring initiatives were completed, which has permitted the Company to make good progress in 2008 towards achieving its goal of conducting business as a centralized, national organization.

##### 5.1 Results of Operations

###### Sales

Sales in 2008 (53 weeks) increased \$1.4 billion, or 4.8%, to \$30.8 billion compared to \$29.4 billion in 2007 (52 weeks).

Total Sales, Sales Growth and Same-Store Sales Growth

For the years ended January 3, 2009 and December 29, 2007 (\$ millions)	<b>2008</b> <b>(53 weeks)</b>	2007 (52 weeks)
Total sales	<b>\$ 30,802</b>	\$ 29,384
Total sales growth	<b>4.8%</b>	2.6%
Same-store sales growth	<b>4.2%</b>	2.4%

(1) See Non-GAAP Financial Measures on page 33.

## Management's Discussion and Analysis

The following factors further explain the major components in the change in sales over the prior year:

- same-store sales growth of 4.2% (2007 – 2.4%) including an increase in sales and same-store sales growth of 1.9% due to the extra selling week in 2008;
- on an equivalent 52 week basis:
  - total sales growth in both food and drugstore were moderate, with strong growth in the fourth quarter;
  - general merchandise sales growth was negative. Unseasonable weather, the mark down of merchandise to sell through seasonal inventory, and reductions in assortment and square footage contributed to the decline;
  - apparel sales growth was strong largely due to improvements in availability and product offering;
  - customer count growth increased marginally while item count growth remained flat versus 2007;
  - gas bar sales growth was strong as a result of fuel price inflation and volume growth;
- the Company's analysis indicated that internal retail food price inflation was higher than 2007, but lower than the national food price inflation of 4.0% (2007 – 2.7%) as measured by "The Consumer Price Index for Food Purchased from Stores" ("CPI"). This measure of inflation does not necessarily reflect the effect of inflation on the specific mix of goods sold in Loblaw stores; and
- 37 (2007 – 34) new stores, net of 37 (2007 – 79) store closures, each category including stores which underwent conversions and major expansion, increased net retail square footage 0.2 million square feet (2007 – net decrease of 0.1 million square feet) or 0.5%.

Sales of control label products for 2008 amounted to \$7.4 billion compared to \$6.9 billion in 2007. In 2008, the Company introduced over 800 new food and non food control label products and redesigned over 1,000 products. The Company's control label program, which includes *President's Choice*, *no name*, *President's Choice Organics*, *President's Choice Blue Menu*, *President's Choice G.R.E.E.N.*, *Joe Fresh Style*, and *PC Home* provide additional sales growth potential.

### Operating Income

Operating income of \$1,046 million for 2008 increased \$310 million, or 42.1% compared to \$736 million in 2007 resulting in an increase in operating margin to 3.4% in 2008 from 2.5% in 2007.

The following items influenced operating income in 2008 compared to 2007:

- income of \$1 million (2007 – charge of \$222 million) related to lower than anticipated restructuring costs. Additional information is in note 4 to the consolidated financial statements;
- charge of \$7 million (2007 – \$72 million) related to stock-based compensation net of the equity forwards. A non-cash gain on equity forwards resulted from an increase in the Company's share price in 2008; and
- gain of \$22 million on the sale of the Company's food service business in the fourth quarter of 2008.

Included in 2008 operating income was a \$14 million gain from the sale of financial investments by *President's Choice Bank* ("PC Bank"), a wholly owned subsidiary of the Company and a \$29 million fixed asset impairment charge. Included in 2007 operating income is an \$11 million gain related to the sale of an office building in Calgary, Alberta, a \$33 million fixed asset impairment charge, and a \$24 million charge as a result of adjustments in estimates related to post-employment and long term disability benefits, deferred product development and information technology costs.

Excluding the impact of restructuring and other charges, stock-based compensation net of equity forwards, and the gain on sale of the Company's food service business, operating income was flat in 2008 compared to 2007.

In the third and fourth quarters of 2007, the Company made an investment in pricing in specific markets. The investments negatively impacted operating income and margins.

Restructuring activities were substantially completed in 2007, which positively impacted operating income in 2008. Project Simplify charges in 2008 were \$3 million (2007 – \$197 million) which related to the restructuring and streamlining of merchandise and store operations. In 2008, as actual costs were less than the amounts estimated, \$4 million (2007 – charge of \$25 million) was included in operating income related to supply chain and store closure restructuring initiatives. Additional information is in note 4 to the consolidated financial statements.



The Company's focus on cost reduction, including shrink initiatives has improved margins in 2008 compared to 2007. Buying synergies and more disciplined vendor management are resulting in lower purchase costs for both merchandise and not-for-resale items.

The Company experienced higher store labour costs in 2008 as a result of higher sales. Labour productivity improved slightly in 2008 compared to 2007 despite investments in training and the Company's commitment to improve customer service.

#### **EBITDA<sup>(1)</sup>**

2008 EBITDA<sup>(1)</sup> increased by \$307 million, or 23.2%, to \$1,631 million compared to \$1,324 million in 2007. EBITDA margin<sup>(1)</sup> increased to 5.3% compared to 4.5% in 2007. The increase is a result of the increase in operating income which is described above.

#### **Interest Expense and Other Financing Charges**

Interest expense and other financing charges increased \$11 million, or 4.4%, to \$263 million from \$252 million in 2007. The components include:

- interest on long term debt of \$286 million (2007 – \$285 million). The 2008 weighted average fixed interest rate on long term debt (excluding capital lease obligations) was 6.6% (2007 – 6.6%) and the weighted average term to maturity was 16 years (2007 – 16 years);
- interest income on financial derivative instruments of \$4 million (2007 – charge of \$12 million), which includes the net effect of the Company's interest rate swaps, cross currency swaps and equity forwards. The change was primarily a result of a decrease in United States short term interest rates;
- net short term interest expense of \$2 million (2007 – income of \$6 million) due to a decrease in United States interest rates partially offset by a decrease in short term debt;
- interest income on security deposits in 2008 of \$9 million (2007 - \$17 million) as a result of a decrease in United States short term interest rates;
- dividends on capital securities of \$8 million (2007 – nil); and
- interest incurred on debt related to real estate properties under development of \$20 million (2007 – \$22 million) was capitalized to fixed assets.

#### **Income Taxes**

The Company's 2008 effective income tax rate decreased to 29.1% from 31.0% in 2007. The decrease was primarily due to a change in the proportions of taxable income earned across different tax jurisdictions, lower Canadian federal and certain provincial statutory income tax rates relative to 2007 which was partially offset by an increase in income tax accruals relating to certain income tax matters and a 2007 cumulative adjustment of future taxes pursuant to a reduction in the Canadian federal and certain provincial statutory income tax rates.

#### **Net Earnings**

In 2008, net earnings increased \$215 million to \$545 million from \$330 million in 2007 and basic net earnings per common share increased \$0.79 to \$1.99 from \$1.20 in 2007. Basic net earnings per common share for 2008 were affected by the following:

- income of nil (2007 – charge of \$0.53) per common share related to lower than anticipated restructuring costs;
- charge of \$0.04 (2007 – \$0.30) per common share for stock-based compensation net of the equity forwards; and
- gain of \$0.06 per common share for the sale of the Company's food service business.

(1) See Non-GAAP Financial Measures on page 33.

## Management's Discussion and Analysis

### 5.2 Financial Condition

#### Financial Ratios

The net debt<sup>(1)</sup> to equity ratio continued to be within the Company's internal guideline of less than 1:1. The net debt<sup>(1)</sup> to equity ratio was 0.54:1 at the end of 2008 compared 0.67:1 at the end of 2007. Equity for the purpose of calculating the net debt<sup>(1)</sup> to equity ratio is defined by the Company as capital securities and shareholders' equity. The decrease in the net debt<sup>(1)</sup> to equity ratio at the end of 2008 when compared to 2007 was due to a decrease in short and long term debt, an increase in cash and cash equivalents, short term investments, security deposits, the issuance of capital securities, and 2008 net earnings.

Cash flows from operating activities cover a large portion of the Company's funding requirements and in 2008 exceeded the capital investment program. In 2008, funding requirements resulted primarily from working capital, the capital investment program and dividends paid on the Company's common shares.

In 2008, shareholders' equity increased \$285 million, or 5.1%, to \$5.8 billion. The increase in operating income resulted in an interest coverage ratio of 3.7 times in 2008 compared to 2.7 times in 2007.

The 2008 return on average total assets<sup>(1)</sup> was 8.2% compared to 5.8% in 2007. The 2008 return on average shareholders' equity was 9.4% compared to the 2007 return of 6.0%. The five year average return on shareholders' equity was 8.6% (2007 – 10.2%).

#### Capital Securities

12.0 million non-voting Second Preferred Shares, Series A, are authorized, 9.0 million of which were outstanding at year end. These preferred shares are presented on the consolidated balance sheet as other financial liabilities.

#### First Preferred Shares

1.0 million non-voting First Preferred Shares are authorized, of which none were outstanding at year end.

#### Common Share Capital

An unlimited number of common shares is authorized and 274,173,564 common shares were outstanding at year end. Further information on the Company's outstanding share capital is provided in note 20 to the consolidated financial statements.

At year end, a total of 7,892,660 stock options were outstanding, representing 2.9% of the Company's issued and outstanding common shares, which was within the Company's guideline of 5%. Further information on the Company's stock option plans is provided in note 22 to the consolidated financial statements.

#### Dividends

The declaration and payment of common share dividends and the amount thereof are at the discretion of the Board of Directors which takes into account the Company's financial results, capital requirements, available cash flow and other factors the Board considers relevant from time to time. Over the long term, the Company's objective is for its common share dividend payment ratio to be in the range of 20% to 25% of the prior year's basic net earnings per common share adjusted as appropriate for items which are not regarded to be reflective of ongoing operations giving consideration to the year end cash position, future cash flow requirements and investment opportunities. Dividends on the Preferred Shares rank in priority ahead of the common shares. During 2008, the Board declared dividends of \$0.84 (2007 - \$0.84) per common share. During 2008, the Board of Directors declared dividends of \$0.91 per second preferred share. For financial statement presentation purposes, preferred share dividends of \$8 million are included as a component of interest expense and other financing charges in the Consolidated Statement of Earnings (see note 5). Subsequent to year end, the Board declared a quarterly dividend of \$0.21 per common share payable April 1, 2009 and a quarterly dividend of \$0.37 per second preferred share payable April 30, 2009.

(1) See Non-GAAP Financial Measures on page 33.

## 6. Liquidity and Capital Resources

### 6.1 Cash Flows

#### Major Cash Flow Components

(\$ millions)	2008 (53 weeks)	2007 (52 weeks)	Change
Cash flows from (used in):			
Operating activities	\$ 989	\$ 1,245	\$ (256)
Investing activities	\$ (607)	\$ (851)	\$ 244
Financing activities	\$ (371)	\$ (472)	\$ 101

#### Cash Flows from Operating Activities

Cash flows from operating activities for 2008 were \$989 million compared to \$1,245 million in 2007. The decrease is attributable to the change in non-cash working capital as the increase in 2008 net earnings was offset by a reduction in restructuring charges in 2008 relative to 2007. The Company's 2008 on-shelf availability project is the primary reason for the increase in inventory relative to 2007, and the primary driver of the change in non-cash working capital. Also impacting operating cash flow was a \$63 million voluntary contribution to the Company's registered funded defined benefit pension plans, and consideration received of \$65 million from a related party in exchange for entering into a long-term supply agreement.

#### Cash Flows used in Investing Activities

Cash used in investing activities was \$607 million compared to \$851 million in 2007. The change was primarily due to the change in credit card receivables, after securitization, and movement in short-term investments, partially offset by increased capital spending and less proceeds from asset sales.

Capital investment amounted to \$750 million (2007 – \$613 million) for the year as the Company increased capital spending. Approximately 18% (2007 – 31%) of the capital investment was for new store development, expansions and land, approximately 36% (2007 – 43%) for store conversions and remodels, and approximately 46% (2007 – 26%) for infrastructure investment. The continued capital investment activity benefited all regions to varying degrees and strengthened the existing store base.

The Company is investing in its information technology and supply chain infrastructure and in renovations to its existing store base, with a focus on improving same-store sales. Loblaw expects to invest in 2009 approximately \$750 million in capital expenditures. Approximately 50% of these funds are expected to be used in upgrading information technology and supply chain infrastructure and the remainder on retail operations.

The 2008 corporate and franchised store capital investment program, which includes the impact of store openings and closures, resulted in an increase in net retail square footage of 0.5% compared to 2007. During 2008, 37 (2007 – 34) new corporate and franchised stores were opened and 115 (2007 – 73) underwent renovation. The 37 new stores, net of 37 (2007 – 79) store closures and stores which underwent conversions and major expansion, increased net retail square footage 0.2 million square feet (2007 – decrease of 0.1 million square feet). The 2008 average corporate store size increased 2.0% to 61,900 square feet (2007 – 60,800) and the average franchised store size remained relatively flat in 2008 at 28,400 square feet (2007 – 28,000).

At year end 2008, the Company had committed approximately \$46 million (2007 – \$113 million) with respect to capital investment projects such as the construction, expansion and renovation of buildings and the purchase of real property.

During 2008, the Company also generated \$125 million (2007 – \$223 million) from fixed asset sales.

## Management's Discussion and Analysis

### Capital Investment and Store Activity

	<b>2008</b> <b>(53 weeks)</b>	2007 (52 weeks)	Change
Capital investment (\$ millions)	<b>\$ 750</b>	\$ 613	\$ 137
Corporate square footage (in millions)	<b>37.7</b>	38.2	(1.3%)
Franchise square footage (in millions)	<b>12.1</b>	11.4	6.1%
Retail square footage (in millions)	<b>49.8</b>	49.6	0.4%
Number of corporate stores	<b>609</b>	628	(3.0%)
Number of franchised stores	<b>427</b>	408	4.7%
Percentage of corporate real estate owned	<b>74%</b>	73%	
Percentage of franchise real estate owned	<b>48%</b>	46%	
Average store size (sq. ft.)			
Corporate	<b>61,900</b>	60,800	1.8%
Franchised	<b>28,400</b>	28,000	1.4%

### Cash Flows used in Financing Activities

In 2008, cash flows used in financing activities were \$371 million compared to \$472 million in the prior year. In 2008, the Company received proceeds of \$218 million and \$296 million from issuances of capital securities and unsecured notes, respectively, which were used to reduce short term borrowings and retire 2008 debt maturities. Dividends paid in 2008 increased by \$58 million, which can be attributed to the timing of the payment of common share dividends. Subsequent to year end, the Company repaid its \$125 million 5.75% medium term note which matured.

Loblaw renewed its Normal Course Issuer Bid during the second quarter of 2008 to purchase on the Toronto Stock Exchange ("TSX"), or enter into equity derivatives to purchase, up to 13,708,678 of the Company's common shares, representing 5% of the common shares outstanding. In accordance with the requirements of the TSX, Loblaw may purchase its shares at the then market prices of such shares. The Company did not purchase any shares under its Normal Course Issuer Bids during 2008 and 2007.

### Net Debt<sup>(1)</sup>

Net debt<sup>(1)</sup> as at January 3, 2009 was \$3,287 million, a decrease of \$441 million from the prior year. During 2008, the Company refinanced a portion of its debt maturities with the capital securities, which were issued for proceeds of \$218 million. The balance is primarily related to the foreign exchange on foreign denominated cash and cash equivalents, short term investments and security deposits included in other assets.

### 6.2 Sources of Liquidity

Cash and cash equivalents, short term investments, future operating cash flow and the amounts available to be drawn against its credit facility are expected to enable the Company to finance its capital investment program and fund its ongoing business requirements including working capital and pension plan funding. The Company believes it has sufficient funding available to meet these requirements over the next twelve months. Given reasonable access to capital markets, the Company does not foresee any difficulty in securing financing to satisfy its long term obligations.

In the first quarter of 2008, the Company entered into an \$800 million, 5-year committed credit facility, provided by a syndicate of banks, which contains certain financial covenants. This facility is the primary source of the Company's short term funding requirements and permits borrowings having up to a 180-day term that accrue interest based on short term floating interest rates. This facility replaced a \$500 million, 364-day committed credit facility. As at January 3, 2009, \$190 million was drawn on the 5-year committed credit facility.

(1) See Non-GAAP Financial Measures on page 33.

During the second quarter of 2008, the Company issued USD \$300 million of fixed-rate unsecured notes in a private placement debt financing which contains certain financial covenants. The notes were issued in two equal tranches of USD \$150 million with 5 and 7 year maturities at interest rates of 6.48% and 6.86%, respectively. The Company entered into fixed cross currency swaps to manage the foreign exchange and US interest rate risk. A portion of these cross currency swaps were designated as cash flow hedges (see note 24 to the consolidated financial statements). The net proceeds from the issue of the notes were used to repay maturing debt obligations, including a portion of the \$390 million of 6.00% Medium Term Notes (“MTN”) which matured in June 2008.

During the third quarter, the Company closed its Canadian public offering of 9 million cumulative redeemable convertible Second Preferred Shares, Series A, at a price of \$25.00 per share, to yield 5.95% per annum, for an aggregate gross amount of \$225 million and the net proceeds of \$218 million were added to the general funds of the Company. The preferred shares have been listed and posted to trade on the TSX under the symbol “L.PR.A”. Dominion Bond Rating Service (“DBRS”) assigned a rating of Pfd-3 with a Negative trend and Standard & Poor’s (“S&P”) assigned a rating of P-3 (high) to the Company’s preferred shares.

Securitization of credit card receivables provides PC Bank, a wholly owned subsidiary of the Company, with an additional source of funds for the operation of its business. In 2008, PC Bank securitized an aggregate \$300 million (2007 – \$225 million) of credit card receivables. Under these securitization programs, a portion of the total interest in the credit card receivables is sold to independent trusts one of which has a term of 364 days, subject to annual renewal. If the term of this facility is not renewed, collections will be accumulated prior to the expiry and the amount of that portion of the securitized receivables will be repaid to that trust. In the absence of securitization, the Company would be required to raise alternative financing by issuing additional debt or equity instruments. Subsequent to year end, Eagle Credit Card Trust (“Eagle”) filed a base shelf prospectus which permits it to issue up to \$1.5 billion of notes over a 25 month period, subject to the availability of credit markets. Further information about PC Bank’s credit card receivables and securitization is provided in notes 1 and 9 to the consolidated financial statements and in the Off-Balance Sheet Arrangements section of this MD&A.

The Company has traditionally obtained its long term financing primarily through a MTN program. The Company may also refinance maturing long term debt with MTN if market conditions are appropriate or it may consider other alternatives.

The Company has equity forward contracts to buy its common shares at a cumulative average forward price which provide for settlement net of amounts owing in cash. At year end the cumulative interest net of dividends and unrealized market loss of \$92 million (2007 – \$91 million) is included in accounts payable and accrued liabilities. The Company is in discussions with a counterparty which may lead to the extinguishment of all or a portion of the liability.

In the normal course of business, the Company enters into certain arrangements, such as providing comfort letters to third-party lenders in connection with financing activities of certain franchisees, with no recourse liability to the Company. In addition, the Company establishes standby letters of credit used in connection with certain obligations related to the financing program for its independent franchisees, securitization of PC Bank’s credit card receivables, real estate transactions and benefit programs. At year end, the aggregate gross potential liability related to the Company’s standby letters of credit was approximately \$398 million (2007 – \$354 million), against which the Company had \$441 million (2007 – \$444 million) in credit facilities available to draw on.

During 2008, the Company’s MTN, other notes and debentures ratings and commercial paper ratings were downgraded twice by DBRS and once by S&P. On March 11, 2009, DBRS revised the trend on the Company’s commercial paper rating to stable from negative. The following table sets out the current credit ratings of the Company.

Credit Ratings (Canadian Standards)	Dominion Bond Rating Service		Standard & Poor’s	
	Credit Rating	Trend	Credit Rating	Outlook
Commercial paper	R-2 (middle)	Stable	A-2	Negative
Medium term notes	BBB	Negative	BBB	Negative
Preferred shares	Pfd-3	Negative	P-3 (high)	
Other notes and debentures	BBB	Negative	BBB	Negative

## Management's Discussion and Analysis

The rating organizations listed above base their credit ratings on quantitative and qualitative considerations. These credit ratings are forward-looking and intended to give an indication of the risk that the Company will not fulfill its obligations in a timely manner. As a result of the DBRS downgrade of the short term credit rating, the Company has limited access to commercial paper.

The Company's ability to obtain funding from external sources may be restricted by further downgrades in the Company's credit ratings and should the Company's financial performance and condition deteriorate. In addition, credit and capital markets are subject to inherent global risks that may negatively affect the Company's access and ability to fund its short term and long term debt requirements. The Company mitigates these risks by maintaining appropriate levels of cash and cash equivalents and short term investments, actively monitoring market conditions and diversifying its sources of funding and maturity profile. The Company also employs risk management strategies including forward-looking liquidity contingency plans.

### **Independent Funding Trust**

Certain independent franchisees of the Company obtain financing through a structure involving independent trusts, which were created to provide loans to the independent franchisees to facilitate their purchase of inventory and fixed assets, consisting mainly of fixtures and equipment. These trusts are administered by a major Canadian chartered bank.

During the first quarter of 2008, the Company was notified that an Event of Termination of the independent funding trust agreement for the Company's franchises had occurred as a result of the long term credit rating downgrade by DBRS. As a result of the Event of Termination, during the second quarter of 2008, the Company finalized an alternative financing arrangement for the independent funding trust in the form of a \$475 million, 364-day revolving committed credit facility provided by a syndicate of banks.

The gross principal amount of loans issued to the Company's independent franchisees outstanding at the end 2008 was \$388 million (2007 – \$418 million) including \$152 million (2007 – \$153 million) of loans payable by VIEs consolidated by the Company. Based on a formula, the Company has agreed to provide credit enhancement in the form of a standby letter of credit for the benefit of the independent funding trust equal to approximately 15% (2007 – 10%) of the principal amount of the loans outstanding at any point in time, \$66 million (2007 – \$44 million) as of the end of 2008. The standby letter of credit has never been drawn upon. This credit enhancement allows the independent funding trust to provide favorable financing terms to the Company's independent franchisees. As well, each independent franchisee provides security to the independent funding trust for its obligations by way of a general security agreement. In the event that an independent franchisee defaults on its loan and the Company has not, within a specified time period, assumed the loan, or the default is not otherwise remedied, the independent funding trust would assign the loan to the Company and draw upon this standby letter of credit. The Company has agreed to reimburse the issuing bank for any amount drawn on the standby letter of credit. This alternative financing arrangement will result in a higher relative financing cost to the franchisees, which in turn could adversely affect operating results. The alternative financing arrangement has been reviewed and the Company determined there were no material implications with respect to the consolidation of VIEs.

The Company is currently in the process of renewing the \$475 million, 364-day revolving committed credit facility, which is expected to be completed during the second quarter of 2009. If this facility is not renewed, the franchisees who are currently obtaining financing from the independent funding trust will have 12 months to arrange for alternative financing. Upon renewal, this financing could result in higher financing costs to the franchisees, which in turn could adversely affect operating results. Although the Company anticipates that appropriate financing for the franchisees will continue to be secured in the future, any failure to do so could adversely affect the Company's franchise programs and may impact its operating results. In addition, any new financing structure which might be implemented would need to be reviewed to determine if there are any implications with respect to the consolidation of VIEs.

### 6.3 Contractual Obligations

The following illustrates certain of the Company's significant contractual obligations and discusses other obligations as at January 3, 2009:

#### Summary of Contractual Obligations

(\$ millions)	Payments due by year						Total
	2009	2010	2011	2012	2013	Thereafter	
Long term debt (including capital lease obligations)	\$ 165	\$ 333	\$ 381	\$ 25	\$ 409	\$ 2,922	\$ 4,235
Operating leases <sup>(1)</sup>	207	189	166	143	125	793	1,623
Contracts for purchases of Real property and capital Investment projects <sup>(2)</sup>	45	1	-	-	-	-	46
Purchase obligations <sup>(3)</sup>	652	576	573	423	3	-	2,227
<b>Total contractual obligations</b>	<b>\$ 1,069</b>	<b>\$ 1,099</b>	<b>\$ 1,120</b>	<b>\$ 591</b>	<b>\$ 537</b>	<b>\$ 3,715</b>	<b>8,131</b>

At year end, the Company had other long term liabilities which included accrued benefit plan liability, future income taxes liability, stock-based compensation liability and an accrued insurance liability. These long term liabilities have not been included in the table for the following reasons:

- future payments of accrued benefit plan liability, principally post-retirement benefits, depend on when and if retirees submit claims;
- future payments of income taxes depend on the levels of taxable earnings and income tax rates;
- future payments of the share appreciation value on employee stock options depend on whether employees exercise their stock options, the market price of the Company's common shares on the exercise date and the manner in which colleagues exercise those stock options;
- future payments of restricted share units depend on the market price of the Company's common shares;
- future payments related to equity forwards depend on the market price of the Company's common shares; and
- future payments of insurance claims can extend over several years and depend on the timing of anticipated settlements and results of litigation.

### 6.4 Off-Balance Sheet Arrangements

In the normal course of business, the Company enters into the following off-balance sheet arrangements:

- standby letters of credit used in connection with certain obligations mainly related to real estate transactions and benefit programs, the aggregate gross potential liability of which is approximately \$216 million (2007 – \$221 million);
- guarantees; and
- the securitization of a portion of PC Bank's credit card receivables through independent trusts.

#### Guarantees

The Company has entered into various guarantee agreements including standby letters of credit in relation to the securitization of PC Bank's credit card receivables, third-party financing made available to the Company's independent franchisees, and obligations to indemnify third parties in connection with leases, business dispositions and other transactions in the normal course of the Company's business. For a detailed description of the Company's guarantees, see note 27 to the consolidated financial statements.

(1) Represents the minimum or base rents payable. Amounts are not offset by any expected sub-lease income.

(2) These obligations include agreements for the purchase of real property and capital commitments for construction, expansion and renovation of buildings. These agreements may contain conditions that may or may not be satisfied. If the conditions are not satisfied, it is possible the Company will no longer have the obligation to proceed with the transaction.

(3) These include contractual obligations of a material amount to purchase goods or services where the contract prescribes fixed or minimum volumes to be purchased or payments to be made within a fixed period of time for a set or variable price. These are only estimates of anticipated financial commitments under these arrangements and the amount of actual payments will vary. These purchase obligations do not include purchase orders issued or agreements made in the ordinary course of business which are solely for goods which are meant for resale, nor do they include any contracts which may be terminated on relatively short notice or with relatively insignificant cost or liability to the Company.

## Management's Discussion and Analysis

### Securitization of Credit Card Receivables

The Company, through *PC Bank*, securitizes credit card receivables through independent trusts administered by major Canadian chartered banks and through Eagle, also an independent trust. In these securitizations, *PC Bank* sells a portion of its credit card receivables to the trusts in exchange for cash. The trusts fund these purchases by issuing debt securities in the form of asset-backed commercial paper and asset-backed term notes respectively, to third-party investors. The securitizations are accounted for as asset sales only when *PC Bank* transfers control of the transferred assets and receives consideration other than beneficial interests in the transferred assets. All transactions between the trusts and *PC Bank* have been, and are expected to continue to be, accounted for as sales as contemplated by Canadian GAAP, specifically AcG 12, "*Transfers of Receivables*". As *PC Bank* does not control or exercise any measure of influence over the trusts, the financial results of the trusts have not been included in the Company's consolidated financial statements.

When *PC Bank* sells credit card receivables to the trusts, it no longer has access to the receivables but continues to maintain credit card customer account relationships, and certain servicing and administrative responsibilities. *PC Bank* does not receive a servicing fee from the trusts for its servicing responsibilities and accordingly, a servicing obligation is recorded. When a sale occurs, *PC Bank* retains rights to future cash flows after obligations to the investors in the trusts have been met, which is considered to be a retained interest. The issuing trusts' recourse to *PC Bank*'s assets is limited to *PC Bank*'s retained interests and is further supported through standby letters of credit provided by major Canadian chartered banks for 9% (2007 – 9%) on a portion of the securitized amount. These standby letters of credit could be drawn upon in the event of a major decline in the income flow from, or in the value of, the securitized credit card receivables. The Company has agreed to reimburse the issuing banks for any amounts drawn on the standby letters of credit. The subordinated notes issued by Eagle provide credit support to those notes which are more senior. The retained interests are recorded at fair value.

As at year end 2008, the total amount of securitized credit card receivables outstanding which *PC Bank* continues to service was \$1.8 billion (2008 – \$1.5 billion) and the associated retained interests amounted to \$14 million (2007 – \$8 million). The standby letter of credit supporting a portion of these securitized receivables amounted to approximately \$116 million (2007 – \$89 million). During 2008, *PC Bank* received income of \$176 million (2007 – \$141 million) in securitization revenue from the independent trusts relating to the securitized credit card receivables. In the absence of securitization, the Company would be required to raise alternative financing by issuing debt or equity instruments. Further disclosure regarding this arrangement is provided in notes 1 and 9 to the consolidated financial statements.

### Independent Funding Trust

Certain independent franchisees of the Company obtain financing through a structure involving independent trusts, which were created to provide loans to the independent franchisees to facilitate their purchase of inventory and fixed assets, consisting mainly of fixtures and equipment. Further disclosure regarding this arrangement is provided in Section 6.2, "Independent Funding Trusts" and in note 27 to the consolidated financial statements.

## 7. Quarterly Results of Operations

### 7.1 Results by Quarter

The 52-week reporting cycle followed by the Company is divided into four quarters of 12 weeks each except for the third quarter, which is 16 weeks in duration. When a fiscal year such as 2008 contains 53 weeks, the fourth quarter is 13 weeks in duration. The following is a summary of selected consolidated financial information derived from the Company's unaudited interim consolidated financial statements for each of the eight most recently completed quarters. This information was prepared in accordance with Canadian GAAP.



Summary of Quarterly Results  
(unaudited)

(\$ millions except where otherwise indicated)	First	Second	Third	Fourth	2008	First	Second	Third	Fourth	2007
	Quarter	Quarter	Quarter	Quarter	Total	Quarter	Quarter	Quarter	Quarter	Total
	(12 weeks)	(12 weeks)	(16 weeks)	(13 weeks)	(53 weeks)	(12 weeks)	(12 weeks)	(16 weeks)	(12 weeks)	(52 weeks)
Sales	\$6,527	\$7,037	\$9,493	\$7,745	\$30,802	\$6,347	\$6,933	\$9,137	\$6,967	\$29,384
Net earnings	62	140	155	188	545	54	119	117	40	330
Net earnings per common share Basic and diluted (\$)	\$ 0.23	\$ 0.51	\$ 0.56	\$ 0.69	\$ 1.99	\$ 0.20	\$ 0.43	\$ 0.43	\$ 0.14	\$ 1.20

Sales growth in 2008 was impacted by various factors. Sales and same-store sales growth were positive in all four quarters of 2008 compared to 2007. Quarterly same-store sales growth for the four quarters of 2008 were 2.8%, 0.7%, 3.0%, and 10.6%, respectively. The extra selling week in the fourth quarter of 2008 positively impacted sales by 7.9%.

Internal retail food price inflation increased as the year progressed but was lower than national food price inflation as measured by CPI. In the fourth quarter of 2008, national food price inflation had increased to 8.4% from 0.1% in the first quarter. This measure of inflation does not necessarily reflect the effect of inflation on the specific mix of goods sold in Loblaw stores.

Net retail square footage increased in 2008 by 0.2 million square feet, to 49.8 million square feet, with no significant changes in any quarters during the year.

Fluctuations in quarterly net earnings during 2008 reflect the impact of a number of specific charges including restructuring and other charges, the net effect of stock-based compensation net of the equity forwards. Earnings in the third and fourth quarters of 2008 benefited from the Company's cost reduction initiatives, whereas earnings in the first and second quarters of 2008 and the fourth quarter of 2007 were pressured from investments in lower retail pricing. Quarterly net earnings are also impacted by seasonality and the timing of holidays. The impact of seasonality is greatest in the fourth quarter and least in the first quarter.

Interest expense and other financing charges were reasonably consistent during each quarter of 2008 and were \$263 million in 2008 compared to \$252 million in 2007.

The change in the effective income tax rates for 2008 over 2007 was primarily due to a change in the proportions of taxable income earned across different tax jurisdictions, lower Canadian federal and certain provincial statutory income tax rates relative to 2007 which was partially offset by an increase in income tax accruals relating to certain income tax matters and a 2007 cumulative adjustment of future taxes pursuant to a reduction in the Canadian federal and certain provincial statutory income tax rates.

## 7.2 Fourth Quarter Results

The following is a summary of selected consolidated unaudited financial information for the fourth quarter of 2008. This information was prepared in accordance with Canadian GAAP and is reported in Canadian dollars. The analysis of the data contained in the table focuses on the results of operations and changes in the financial condition and cash flows in the fourth quarter.

## Management's Discussion and Analysis

### Selected Consolidated Information for the Fourth Quarter (unaudited)

(\$ millions except where otherwise indicated)	<b>2008 (13 weeks)</b>	2007 (12 weeks)
Sales	<b>\$ 7,745</b>	\$ 6,967
Operating expense	<b>7,428</b>	6,833
Operating income	<b>317</b>	134
Interest expense and other financing charges	<b>65</b>	59
Income taxes	<b>61</b>	27
Net earnings	<b>188</b>	40
Net earnings per common share (\$)		
Basic and diluted	<b>0.69</b>	0.14
Cash flows from (used in):		
Operating activities	<b>627</b>	508
Investing activities	<b>(427)</b>	(306)
Financing activities	<b>(161)</b>	(166)
Dividends declared per common share (\$)	<b>.21</b>	.21
Dividends declared on second preferred share Series A (\$)	<b>.371875</b>	-

### Total Sales, Sales Growth and Same-Store Sales Growth

(\$ millions)	<b>2008 (13 weeks)</b>	2007 (12 weeks)
Total sales	<b>\$ 7,745</b>	\$ 6,967
Total sales growth	<b>11.2 %</b>	2.7%
Same-store sales growth	<b>10.6 %</b>	2.6%

Sales in the 13-week fourth quarter increased by 11.2% to \$7,745 million compared to \$6,967 million in the 12-week fourth quarter of 2007. The following factors explain the major components in the change in sales for the fourth quarter of 2008 compared to the fourth quarter of 2007:

- same-store sales growth of 10.6% including an increase in sales and same-store sales growth of 7.9% due to the extra selling week in the fourth quarter of 2008;
- a shift of the Thanksgiving holiday to the fourth quarter of 2008 resulted in higher sales and same-store sales growth of approximately 0.8% during the fourth quarter of 2008;
- sales and same-store sales growth were negatively impacted by 1.0% due to a strike in certain Maxi stores in Quebec;
- on an equivalent 12 week basis, total sales growth in both food and drugstore was strong;
- on an equivalent 12 week basis, apparel sales growth was strong in the fourth quarter but this did not offset the decline in core general merchandise sales growth, which primarily declined due to reductions in assortment and square footage;
- on an equivalent 12 week basis, item count growth declined marginally, while customer count growth remained flat versus the fourth quarter of 2007;
- on an equivalent 12 week basis gas bar sales growth was negative as a result of lower fuel prices;
- the Company's analysis indicated that internal retail food price inflation was higher than the year-to-date trend, but lower than the national food price inflation of 8.4% as measured by CPI. In the fourth quarter of 2007, the Company experienced internal retail food price deflation; and
- during the fourth quarter of 2008, 16 new corporate and franchised stores were opened and 10 were closed, resulting in a net increase of 0.2 million square feet or 0.5%.

Operating income of \$317 million for the fourth quarter of 2008 increased by \$183 million, or 136.6%, compared to an operating income of \$134 million in 2007. Operating margin was 4.1% compared to 1.9% in the fourth quarter of 2007. The increase in operating income was mainly due to lower restructuring and lower net stock-based compensation costs, higher sales, and cost reduction initiatives.

The following items influenced operating income in the fourth quarter of 2008 compared to the fourth quarter of 2007:

- income of \$8 million (2007 – charge of \$36 million) due to lower than anticipated restructuring costs;
- income of \$17 million (2007 – charge of \$52 million) related to stock-based compensation net of the equity forwards. A non-cash gain on equity forwards resulted from an increase in the Company's share price during the fourth quarter of 2008; and
- gain of \$22 million on the sale of the Company's food service business in the fourth quarter of 2008.

Included in 2008 fourth quarter operating income is a fixed asset impairment charge of \$29 million (2007 - \$33 million). In the fourth quarter of 2007, an \$11 million gain was realized related to the sale of an office building in Calgary, Alberta. On an equivalent 12 week basis and excluding the above items, operating income in the fourth quarter of 2008 improved compared to the fourth quarter of 2007.

EBITDA<sup>(1)</sup> increased by \$173 million, or 64.6%, to \$441 million in the fourth quarter of 2008 compared to \$268 million in the fourth quarter of 2007. EBITDA margin<sup>(1)</sup> increased in the fourth quarter of 2008 to 5.7% compared to 3.8% in 2007. The increases in EBITDA<sup>(1)</sup> and EBITDA margin<sup>(1)</sup> were due to lower restructuring charges, lower net stock-based compensation costs, higher sales and cost reduction initiatives.

The Company experienced higher store labour costs in the fourth quarter of 2008 as a result of higher sales. Labour productivity decreased slightly in the fourth quarter of 2008 compared to the same period in 2007 as a result of investments in training and the Company's commitment to improve customer service during the holiday season. Labour productivity has improved on a year over year basis.

Total interest expense and other financing charges for the fourth quarter of 2008 were \$65 million compared to \$59 million in 2007.

The effective income tax rate in the fourth quarter of 2008 was 24.2% (2007 – 36.0%). The quarter over quarter reduction in the effective income tax rate is primarily due to a change in the proportions of taxable income earned across different tax jurisdictions, lower Canadian federal and certain provincial statutory income tax rates relative to the fourth quarter of 2007 and a decrease in income tax accruals relating to certain income tax matters which was partially offset by a 2007 cumulative adjustment of future taxes pursuant to a reduction in Canadian federal and certain provincial statutory income tax rates.

Net earnings for the fourth quarter increased by \$148 million, or 370.0%, to \$188 million from \$40 million in the fourth quarter of 2007. Basic net earnings per common share for the fourth quarter increased by \$0.55, or 392.9%, to \$0.69 from \$0.14 in the fourth quarter of 2007.

Fourth quarter cash flows from operating activities were \$627 million in 2008 compared to \$508 million in 2007. The increase was mainly due to the increase in net earnings before minority interest and restructuring charges. Also impacting operating cash flow in the fourth quarter was a \$63 million contribution to the Company's registered funded defined benefit pension plans, and consideration received of \$65 million in exchange for entering into a long-term supply agreement with a related party. Fourth quarter cash flows used in investing activities were \$427 million in 2008 compared to \$306 million in 2007. The increase was primarily due to increased capital spending associated with the Company's investment in its infrastructure and less proceeds from asset sales, partially offset by a decrease in the change in cash flows from credit card receivables. Capital investment for the fourth quarter amounted to \$353 million (2007 – \$173 million). Fourth quarter cash flows used in financing activities were \$161 million in 2008 compared to \$166 million in 2007. The change is a result of less short-term borrowing requirements in the fourth quarter, which were partially offset by the timing of the payment of common share dividends of \$58 million in 2008.

(1) See Non-GAAP Financial Measures on page 33.

## Management's Discussion and Analysis

### 8. Controls and Procedures

#### Disclosure Controls and Procedures

Management is responsible for establishing and maintaining a system of disclosure controls and procedures to provide reasonable assurance that all material information relating to the Company and its subsidiaries is gathered and reported to senior management on a timely basis so that appropriate decisions can be made regarding public disclosure.

As required by National Instrument 52-109 (Certification of Disclosure in Issuers' Annual and Interim Filings), the Executive Chairman, as Chief Executive Officer, and the Chief Financial Officer have caused to be evaluated under their supervision the effectiveness of such disclosure controls and procedures. Based on that evaluation, they have concluded that the design and operation of the system of disclosure controls and procedures were effective as at January 3, 2009.

### 9. Internal Control over Financial Reporting

Management is also responsible for establishing and maintaining adequate internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP.

As required by National Instrument 52-109 (Certification of Disclosure in Issuers' Annual and Interim Filings), the Executive Chairman, as Chief Executive Officer, and the Chief Financial Officer have caused to be evaluated under their supervision the effectiveness of such internal controls over financial reporting using the framework established in 'Internal Control – Integrated Framework (COSO Framework) published by The Committee of Sponsoring Organizations of the Treadway Commission (COSO)'. Based on that evaluation, they have concluded that the design and operation of the Company's internal controls over financial reporting were effective as at January 3, 2009.

In designing and evaluating such controls, it should be recognized that due to inherent limitations, any controls, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives and may not prevent or detect misstatements. Projections of any evaluations of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Additionally, management is necessarily required to use judgment in evaluating controls and procedures.

#### Changes in Internal Control over Financial Reporting

Management has also evaluated whether there were changes in the Company's internal controls over financial reporting that occurred during the period beginning on October 11, 2008 and ended on January 3, 2009 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. Management has determined that no material changes occurred during this period.

### 10. Risks and Risk Management

In 2008, the Company assessed key operating and financial risks by conducting risk assessments with members of the senior management team and Board of Directors. Risks identified through these assessments were analyzed and discussed as part of the Company's annual business planning process and were also factored into the development of a risk-based internal audit plan.

Descriptions of the risks and risk management strategies identified through risk assessments and the business planning process are included in the operating and financial risks discussed below, any of which has the potential to negatively affect the financial performance of the Company. The Company has operating and risk management strategies, including insurance programs, which help to mitigate the potential financial impact of these operating risks. While the Company employs strategies to minimize these risks, these strategies do not guarantee that events or circumstances will not occur which could negatively affect the Company's financial condition and performance.

## **10.1 Operating Risks and Risk Management**

### **Competitive Environment**

The retail industry in Canada is highly competitive. If the Company is ineffective in responding to consumer trends or ineffective in executing its strategies, its financial performance could be negatively impacted.

The Company's competitors include traditional supermarket operators, as well as mass merchandisers, warehouse clubs, drugstores, limited assortment stores, discount stores, convenience stores and specialty stores. Many of these competitors now offer a selection of food, drugstore and general merchandise. Others remain focused on supermarket-type merchandise. The Company is also subject to competitive pressures from new entrants into the marketplace and from the expansion of existing competitors, particularly those expanding into the grocery market. These competitors may have extensive resources which will allow them to compete effectively with the Company in the long term. Increased competition could adversely affect the Company's ability to achieve its objectives. The Company's inability to compete effectively with its current or any future competitors could result in, among other things, reduced market share and lower pricing in response to its competitors' pricing activities. Accordingly, the Company's competitive position and financial performance could be negatively impacted.

The Company monitors its market share and the markets in which it operates and will adjust its operating strategies, which include, but are not limited to, closing underperforming stores, relocating stores or reformatting them under a different banner, reviewing pricing and adjusting product offerings and marketing programs. The Company's control label program represents a competitive advantage because it enhances customer loyalty by offering superior value and provides some protection against national brand pricing strategies.

### **Economic Environment**

In the last six months of 2008 and continuing into 2009, economic conditions in Canada and the United States deteriorated, which may impact the Company's operations negatively in the future as increased unemployment levels, changes in interest rates, reduced access to credit or changes in inflation could severely impact consumer spending and ultimately negatively impact sales and margins. Management regularly monitors economic conditions and their impact on the Company's operations, and actively considers these factors in making short term operating and longer term strategic decisions.

### **Change Management and Execution**

Significant initiatives in support of the Company's multi-year turnaround plan are underway or planned. These initiatives include the restructuring of the Company's supply chain and execution of the information technology strategic plan. While these changes are expected to bring benefits to the Company in the form of a more agile and consumer-focused business, success is dependent on management effectively realizing the intended benefits. Ineffective change management may result in disruptions to the operations of the business or affect the ability of the Company to implement and achieve its strategic objectives due to a lack of clear accountabilities or lack of requisite knowledge, which may cause employees to act in a manner which is inconsistent with Company objectives. Any of these events could negatively impact the Company's performance. The Company may not always achieve the expected cost savings and other benefits of its initiatives.

### **Distribution and Supply Chain**

The need to invest in and improve the Company's supply chain may adversely affect the Company's capacity to effectively and efficiently access current and potential customers. A significant restructuring of the Company's supply chain will continue for the next several years. Although this initiative is expected to result in improved service levels for the Company's stores, the scale of the change and the implementation of new processes could cause disruption in the flow of goods to stores, which would negatively affect sales.

### **Information Technology**

To support the current and future requirements of the business in an efficient, cost-effective and well-controlled manner, the Company is reliant on information technology (IT) systems. These systems are essential in providing management with the appropriate information for decision making, including its key performance indicators. Any significant failure or disruption of these systems could negatively affect the Company's reputation, revenues and financial performance.

## Management's Discussion and Analysis

The Company has under invested in its IT infrastructure in the past and its systems were in need of being upgraded. These systems may not properly support the required business processes of the Company. An IT strategic plan was developed to guide the new systems environment that Loblaw requires. Implementation of this plan was initiated in 2008 and will continue throughout 2009, 2010 and 2011. Change management risk and other associated risks will arise from the various projects which will be undertaken to upgrade existing systems and introduce new systems to effectively manage the business going forward. Failure by the Company to appropriately invest in information technology or failure to implement information technology infrastructure in a timely or effective manner may negatively impact the Company's financial performance.

Failure or disruption in the Company's IT systems may result in a lack of relevant and reliable information that enables management to effectively prioritize its products or balance its businesses in a strategic context which may preclude the Company from optimizing its overall performance.

Any failures in the Company's information security systems or non-compliance with information security standards, including those in relation to personal information belonging to the Company's customers, could result in harm to the reputation or competitive position of the Company and could negatively affect financial performance.

### **Colleague Development and Retention**

The degree to which the Company is not effective in developing its employees and establishing appropriate succession planning processes and retention strategies could lead to a lack of requisite knowledge, skills and experience which could, in turn, affect Loblaw's ability to execute its strategies, efficiently run its operations and meet its goals for financial performance. The Company continues to focus on the development of colleagues at all levels and across all regions. Effective colleague development and succession planning are essential to sustaining the growth and success of the Company. Although progress was made in 2008, these areas are not yet fully developed and efforts are ongoing.

### **Food Safety and Public Health**

The Company is subject to risks associated with product defects, food safety and product handling. Such liabilities may arise in relation to the storage, distribution and display of products and, with respect to the Company's control label products, in relation to the production, packaging and design of products. Any event related to these matters has the potential to adversely affect the Company's reputation and its financial performance.

A majority of the Company's sales are generated from food products and the Company could be vulnerable in the event of a significant outbreak of food-borne illness or increased public health concerns in connection with certain food products. Such an event could negatively affect the Company's financial performance. Procedures are in place to manage such events, should they occur. These procedures identify risks, provide clear communication to employees and consumers and are aimed at ensuring that potentially harmful products are expeditiously removed from inventory. The Company has food safety procedures and programs which address safe food handling and preparation standards. The Company endeavors to employ best practices for the storage and distribution of food products and also actively supports consumer awareness of safe food handling and consumption. The ability of these procedures to address such events is dependent on their successful execution. The existence of these procedures does not mean that the Company will in all circumstances be able to mitigate these risks.

The Company strives to ensure its control label products meet all applicable regulatory requirements including having nutritional labelling so that today's health conscious consumer can make informed choices.

### **Environmental, Health and Safety**

Adverse environmental, health and safety events could negatively affect the Company's reputation and financial performance. The Company has environmental, health and workplace safety programs and has established policies and procedures aimed at ensuring compliance with applicable environmental legislative requirements. To this end, the Company employs environmental risk assessments and audits using internal and external resources together with employee awareness programs throughout its operating locations. The Company endeavours to be socially and environmentally responsible, and recognizes that the competitive pressures for economic growth and cost efficiency must be integrated with sound environmental stewardship and ecological considerations. The Company participates in industry and government-led environmental initiatives aimed at reducing the environmental impact of its operations.

The Company maintains a large portfolio of real estate and is subject to environmental risks associated with the contamination of such properties, whether by previous owners or occupants, neighbouring properties or from its own operations. The Company could be subject to increased or unexpected costs associated with the related remediation activities.

In recent years, provincial and municipal governments have introduced legislation that imposes liabilities on retailers for costs associated with recycling and disposal of consumer goods packaging. This is a growing trend and the Company expects to be subject to increased costs associated with these laws.

The Environmental, Health and Safety Committee of the Board of Directors receives regular reporting from management addressing current and potential future issues, identifying new regulatory concerns and related communication efforts. The Company's dedicated Environmental Affairs staff work closely with the operations to help ensure corporate requirements are met.

### **Labour Relations**

A majority of the Company's store level and distribution centre workforce is unionized. Renegotiating collective agreements may result in work stoppages or slowdowns, which could negatively affect the Company's financial performance, depending on their nature and duration.

The Company is willing to accept the short term costs of labour disruption in order to negotiate competitive labour costs and operating conditions for the longer term. In 2008, 75 collective agreements affecting approximately 14,000 employees expired, with the single largest agreement covering approximately 3,100 employees. The Company also negotiated 75 collective agreements in 2008 which represented a combination of agreements expired in 2008, carried over from prior years and those negotiated early.

Several of the Company's competitors operate in a non-union environment. These competitors may benefit from lower labour costs and more favourable operating efficiencies, making it more difficult for the Company to compete.

### **Trademark or Brand Erosion**

Erosion of a trademark or brand over time may threaten the demand for the Company's products or services and impair its ability to grow future revenue streams. The Company offers a strong control label program, including the *President's Choice, no name* and *Joe Fresh Style* brands. The Company endeavors to have the appropriate contractual protections in its arrangements with control label vendors.

### **Legal, Taxation and Accounting**

Changes to any of the laws, rules, regulations or policies related to the Company's business including the production, processing, preparation, distribution, packaging and labelling of its products could have an adverse impact on Loblaw's financial and operational performance. In the course of complying with such changes, the Company may incur significant costs. Failure by the Company to fully comply with applicable laws, rules, regulation and policies may subject it to civil or regulatory actions or proceedings, including fines, assessment, injunctions, recalls or seizures, which may have an adverse effect on the Company's financial results.

## Management's Discussion and Analysis

The Company is subject to various laws regarding the protection of personal information and has adopted a Privacy Code setting out guidelines for the handling of personal information. Any failure of the Company to comply with these laws may result in damage to its reputation and negatively affect financial performance.

There can be no assurance that the tax laws and regulations in the jurisdiction affecting the Company will not be changed in a manner which could adversely affect the Company. New accounting pronouncements introduced by appropriate authoritative bodies may also impact the Company's financial results.

### **Merchandising and Excess Inventory**

The Company's merchandising processes may create inventory that; customers don't want or need, are not reflective of current trends in consumer tastes or habits, are priced at a level customers are not willing to pay, or meet a need, but is late in reaching the market that a competitor reached first. This may result from pervasive changes to customers' needs and wants without the Company's awareness or without adequately adapting (e.g. increased demand for faster delivery or turnaround on products). Recent consumer trends that dominate the retail industry include customer's concerns for their own and their family's health, lack of time, increasing demand for value and premium products in one location, a willingness to buy certain general merchandise on food-focused shopping trips and an increasing demand that retailers source ethically and in a way that demonstrates care for the environment and the community.

It is also possible that a number of the Company's general merchandising programs will result in excess inventory that cannot be sold profitably through the Company's stores. Excess inventory may result in mark downs, shrink or the need to liquidate the inventory, all of which may negatively impact the Company's financial performance. In addition, the Company's current inventory management infrastructure, including its information technology systems, is not efficient in its tracking of inventory through all stages of the supply chain, although, the Company has implemented procedures and information technology workarounds which provide management with the ability to adequately detect and quantify excess and obsolete inventory.

### **Business Continuity**

The Company's ability to continue critical operations and processes could be negatively impacted by a weather disaster, prolonged IT failure, food pandemic or other national/international catastrophe.

### **Vendor Management**

Inefficient, ineffective or incomplete vendor management strategies, policies and/or procedures may impact the Company's ability to optimize financial performance, meet customer needs and/or control costs and quality. The Company has recently implemented practices and performance expectations with the vendor base, where vendors have been asked to support sales plans, cost reduction initiatives and to align with major program changes. Delays with the implementation of this program will have an impact on the Company's ability to realize the expected benefits.

### **Franchise Independence**

A substantial portion of the Company's revenues and earnings come from amounts paid by franchisees. Franchisees are independent businesses and, as a result, their operations may be negatively affected by factors beyond the Company's control which in turn may damage the Company's reputation and potentially affect revenues and earnings. Revenues and earnings would also be negatively affected and the Company's reputation could be harmed, if a significant number of franchisees were to experience operational failures, including health and safety exposures; experience financial difficulty; be unwilling or unable to pay the Company for products rent or other fees; or fail to enter into renewals of franchise agreements. The Company's franchise system is also subject to franchise laws and regulations enacted by a number of provinces. Any new legislation or failure to comply with existing legislation may negatively affect operations, and could add administrative costs and burdens associated with these regulations, all of which could affect the Company's relationship with its franchisees.



### **Employee Future Benefit Contributions**

The Company manages the assets in its defined benefit pensions plans by engaging professional investment managers who operate under prescribed investment policies and procedures in respect of permitted investments and asset allocations. The performance of the Company's pension plans will be negatively impacted where the plan assets underperform. If capital market returns continue to be negative, the Company will be required to make contributions to its registered funded defined benefit pension plans in excess of those currently contemplated, which in turn may have a negative effect on the Company's financial performance and cash flow.

During 2008, the Company contributed \$138 million (2007 – \$74 million) to its registered funded defined benefit pension plans, including an additional voluntary contribution of \$63 million in the fourth quarter of 2008 which partially offset the impact of the negative returns experienced by the plans during the year. During 2009, the Company expects to contribute approximately \$100 million to these plans. This estimate may vary subject to actuarial valuations being completed, market performance and regulatory requirements. The Company regularly monitors and assesses plan experience and the impact of changes in participant demographics, capital markets and other economic factors on its funding requirements, employee future benefit costs and actuarial assumptions. The Company also expects to make contributions in 2009 to defined contribution pension plans and multi-employer pension plans, as well as benefit payments to the beneficiaries of the unfunded defined benefit pension and other benefit plans.

### **Multi-Employer Pension Plans**

In addition to the Company-sponsored pension plans, the Company participates in various multi-employer pension plans, providing pension benefits in which approximately 40% (2007 – 41%) of employees of the Company and of its independent franchisees participate. The administration of these plans and the investment of their assets are legally controlled by a board of independent trustees generally consisting of an equal number of union and employer representatives. In some circumstances, Loblaw may have a representative on the board of trustees of these multi-employer pension plans. The Company's responsibility to make contributions to these plans is limited by the amounts established pursuant to its collective agreements; however, poor performance of these plans could have an adverse impact on the Company's employees and former employees who are members of these plans. Pension cost for these plans is recognized as contributions are due.

The trustees of a multi-employer pension plan in which the Company's employees and those of its independent franchisees participate are involved in proceedings brought by the Financial Services Commission of Ontario whereby it has been alleged that the trustees violated certain provisions of the Pension Benefits Act (*Ontario*) in its management of the plan's funds. One of the trustees, an officer of Loblaw, is entitled to indemnification from the Company.

### **Third-Party Suppliers**

Certain aspects of the Company's business are significantly affected by third parties who provide Loblaw with goods and services. Although appropriate contractual arrangements are put in place with these third parties, the Company has no direct influence over how such third parties are managed. It is possible that negative events affecting these third parties could in turn negatively impact the Company's operations and its financial performance.

A large portion of the Company's case-ready meat products are produced by a third party which operates facilities currently dedicated to Loblaw. The Company's control label products, which are among the most recognized brands in Canada, are manufactured under contract by third-party vendors. In order to preserve the brands' equity, these vendors are held to high standards of quality. The Company also uses third-party logistic services including those in connection with a dedicated warehouse and distribution centre in Pickering, Ontario, a warehouse and distribution centre in Ajax, Ontario, and third-party common carriers. Any disruption in these services could interrupt the delivery of merchandise to the stores and therefore could negatively impact sales.

*President's Choice Financial* banking services are provided by a major Canadian chartered bank. *PC Bank* uses third-party service providers to process credit card transactions, operate call centres and monitor a portion of credit and fraud for the *President's Choice Financial MasterCard*. To minimize operating risk, *PC Bank* and the Company actively manage and monitor their relationships with all third-party service providers. *PC Bank* has developed a vendor management policy, approved by its Board of Directors, and has established a vendor management team that provides its Board with regular reports on vendor management and risk assessment. *PC Financial* ceased soliciting for new home and automobile insurance business effective February 21, 2009; however, it will continue to provide customer service (including claims service) and renewal policies to existing customers.

## Management's Discussion and Analysis

The Company relies on third parties for investment management, custody and other services for its cash equivalents, short term investments, security deposits and pension assets. Any disruption in the services provided by these suppliers could affect the return on these assets or liquidity of the Company.

### **Real Estate and Store Renovations**

Real estate development plans may be contingent on successful negotiation of labour agreements with respect to same-site expansion or redevelopment. The Company maintains a significant portfolio of owned retail real estate and, whenever practical, pursues a strategy of purchasing sites for future store locations. This enhances the Company's operating flexibility by enabling the Company to introduce new departments and services that could be precluded under third party operating leases. At year end 2008, the Company owned 74% (2007 – 73%) of its corporate store square footage and owned 48% (2007 – 46%) of its franchise square footage. As part of ongoing review of performance of, and customer satisfaction with, the Company's stores, the Company from time to time undertakes store renovations and remodeling. In doing so, the Company could be negatively impacted if such renovations and remodeling are carried out in a manner that is disruptive to the ongoing store operations or results in a poor customer experience.

### **Seasonality**

The Company's operations as they relate to food, specifically inventory levels, sales volume and product mix, are impacted to some degree by certain holiday periods in the year. Certain general merchandise items are subject to more seasonal fluctuations.

### **Utility and Fuel Prices**

The Company is a significant consumer of electricity, other utilities and fuel. The Company has entered into contracts to fix the price of a portion of its future variable costs associated with electricity, natural gas and fuel. Despite these arrangements, cost increases in these items could still negatively affect the Company's financial performance.

### **Ethical Business Conduct**

The Company has adopted a Code of Business Conduct which employees and directors of the Company are required to acknowledge and agree to on a regular basis. The Company has in place an Ethics and Business Conduct Committee which monitors compliance with the Code of Business Conduct and determines how the Company can best ensure it is conducting its business in an ethical manner. The Company has also adopted a Vendor Code of Conduct which outlines its ethical expectations to its vendor community in a number of areas, including social responsibility. Any failure of the Company or its vendors to adhere to these policies, the law or ethical business practices could significantly affect Loblaw's reputation and brands and could, therefore, negatively impact the Company's financial performance.

### **Insurance**

The Company attempts to limit its exposure to certain risks through a combination of appropriate levels of self-insurance and the purchase of various insurance coverages, including an integrated insurance program. The Company's insurance program is based on various lines and limits of coverage. Insurance is arranged on a multi-year basis with reliable, financially stable insurance companies as rated by A.M. Best Company, Inc. The Company combines comprehensive risk management programs and the active management of claims handling and litigation processes by using internal professionals and external technical expertise. These programs do not guarantee that any given risk will be mitigated in all circumstances.

### **Holding Company Structure**

Loblaw Companies Limited is a holding company. As such, it does not carry on business directly but does so through its subsidiaries. It has no major source of income or assets of its own, other than the interests it has in its subsidiaries, which are all separate legal entities. Loblaw Companies Limited is therefore financially dependent on dividends and other distributions it receives from its subsidiaries.

## 10.2 Financial Risks and Risk Management

### Liquidity

Liquidity risk is the risk that the Company cannot meet a demand for cash or fund its obligations as they come due. Liquidity risk also includes the risk of not being able to liquidate assets in a timely manner at a reasonable price.

Should the Company's financial performance and condition deteriorate or downgrades in the Company's credit ratings occur, the Company's ability to obtain funding from external sources may be restricted. In addition, credit and capital markets are subject to inherent global risks that may negatively affect the Company's access and ability to fund its short term and long term debt maturities. The Company mitigates these risks by maintaining appropriate levels of cash and cash equivalents and short term investments, by actively monitoring market conditions and diversifying its sources of funding and maturity profile. The Company also employs risk management strategies including forward-looking liquidity contingency plans.

### Credit

The Company is exposed to credit risk resulting from the possibility that counterparties may default on their financial obligations. Exposure to credit risk relates to derivative instruments, cash equivalents, short term investments, security deposits included in other assets, pension assets held in the Company's defined benefit plans, *PC Bank's* credit card receivables and other receivables from independent franchisees, associated stores and independent accounts.

The Company may be exposed to losses if a counterparty to the Company's financial or non-financial derivative agreements fails to fulfill its obligations.

The Company has sought to minimize potential counterparty risk and losses by conducting transactions for its derivative agreements with counterparties that have at minimum a long term "A" credit rating from a recognized credit rating agency and by placing risk adjusted limits on its exposure to any single counterparty for its financial derivative agreements. The Company has internal policies, controls and reporting processes, which require ongoing assessment and corrective action, if necessary, with respect to its derivative transactions. In addition, net obligations and asset amounts on cross currency swaps and equity forwards are each netted by agreement with counterparties.

Credit risk associated with the Company's cash equivalents, short term investments and security deposits included in other assets results from the possibility that a counterparty may default on the repayment of a security. The Company attempts to mitigate this risk through policies and guidelines that require issuers of permissible investments to have at minimum a long term "A" credit rating from a recognized credit rating agency and that specify minimum and maximum exposures to specific industries, issuers and types of investment instruments. The Company purchases and holds these investments directly in custody accounts, and has limited exposure to any third party money market portfolios and funds.

Credit risk from *PC Bank's* credit card receivables and receivables from independent franchisees, associated stores and independent accounts results from the possibility that customers may default on their payment obligation. *PC Bank* manages the credit card receivable risk by employing stringent credit scoring techniques, actively monitoring the credit card portfolio, and reviewing techniques and technology that can improve the effectiveness of the collection process. In addition, these receivables are dispersed among a large, diversified group of credit card customers.

Accounts receivable from independent franchisees, associated stores and independent accounts are actively monitored on an ongoing basis and settled on a frequent basis in accordance with the terms specified in the applicable agreements.

## Management's Discussion and Analysis

### Commodity Price

The Company uses financial and non-financial derivative instruments in the form of future contracts, option contracts and forward contracts to manage its current and anticipated exposure to fluctuations in commodity prices. The Company is exposed to increases in the prices of commodities in operating its stores and distribution centres, as well as the indirect link of commodities to its consumer products. To manage this exposure, the Company uses purchase commitments for a portion of its needs for certain consumer products that may be commodities based and the Company expects to take delivery of these consumer products in the normal course of business. A non-financial derivative contract is used to hedge electricity price risk for a portion of the Company's expected electricity consumption in Alberta. The Company also enters into exchange traded futures and option contracts to minimize cost volatility and fuel prices.

### Interest Rate

The Company is exposed to interest rate risk which it manages through the use of interest rate swaps. Interest rate swaps are transactions in which the Company exchanges interest flows with a counter party on a specified notional amount for a pre-determined period based on agreed-upon fixed and floating interest rates. Notional amounts are not exchanged. The Company's interest rate risk arises from the issuance of short term debt and equity forwards, net of its cash and cash equivalents, short term investments and security deposits included in other assets. The Company manages fluctuations in its interest expense through its exposure to a mix of fixed and floating interest rates, by managing the duration of its financial instruments and by entering into interest rate swaps.

### Common Share Market Price

The Company enters into equity forwards to manage its exposure to fluctuations in its stock-based compensation cost as a result of changes in the market price of its common shares. The equity forwards allow for settlement in cash, common shares or net settlement. These forwards change in value as the market price of the Company's common shares changes and provide a partial offset to fluctuations in Loblaw's stock-based compensation cost, including RSU plan expense. The partial offset between the Company's stock-based compensation costs, including RSU plan expense, and the equity forwards is effective when the market price of the Company's common shares exceeds the exercise price of the related employee stock options. When the market price of the common shares is lower than the exercise price of the related employee stock options, only RSUs will provide a partial offset to these equity forwards. The amount of net stock-based compensation cost recorded in operating income is mainly dependent upon the number of unexercised stock options and RSUs, their vesting schedules relative to the number of underlying common shares on the equity forwards, and the level of fluctuations in the market price of the underlying common shares. As at the 2008 year end, 4,690,732 stock options had exercise prices which were greater than the market price of the Company's common shares at year end.

### Foreign Currency Exchange Rate

The Company enters into cross currency swaps to manage its current and anticipated exposure to fluctuations in foreign currency exchange rates. Cross currency swaps are transactions in which interest payments and principal amounts in United States dollars are exchanged against the receipt of interest payments and principal amounts in Canadian dollars. The Company is exposed to foreign currency exchange rate variability, primarily on its United States dollar denominated cash and cash equivalents, short term investments, security deposits included in other assets, foreign denominated purchases in accounts payable and accrued liabilities, and USD private placement notes included in long term debt.

### Derivative Instruments

As discussed above, the Company uses over-the counter derivative instruments to manage certain risks and costs. The fair value of derivative instruments is subject to changing market conditions which could negatively impact earnings. The Company's policies and guidelines prohibit the use of any derivative instrument for trading or speculative purposes. See notes 1 and 24 to the consolidated financial statements for additional information about the Company's financial derivative instruments.

## 11. Related Party Transactions

The Company's majority shareholder, Weston and its affiliates other than Loblaw, are related parties. It is the Company's policy to conduct all transactions and settle all balances with related parties on market terms and conditions. Related party transactions include:

### Inventory Purchases

Purchases of inventory from related parties for resale in the distribution network represented approximately 3% (2007 – 3%) of the cost of sales, selling and administrative expenses.

### Cost Sharing Agreements

Weston has entered into certain contracts with third parties for administrative and corporate services, including telecommunication services and information technology related matters on behalf of the Company. Through cost sharing agreements that have been established between the Company and Weston concerning these costs, the Company has agreed to be responsible to Weston for its proportionate share of the costs incurred on its behalf. Payments by the Company pursuant to these cost sharing agreements in 2008 were approximately \$28 million (2007 – \$27 million).

### Real Estate Matters

The Company leases certain properties from an affiliate of Weston, namely office space for approximately \$2 million (2007 – \$2 million).

### Borrowings/Lendings

The Company, from time to time, may borrow funds from or may lend funds to Weston on a short term basis at short term market borrowing rates. There were no such amounts outstanding as at year end.

### Income Tax Matters

From time to time, the Company and Weston and its affiliates may make elections that are permitted or required under applicable income tax legislation with respect to affiliated corporations and, as a result, may enter into agreements in that regard. These elections and accompanying agreements did not have any material impact on the Company.

### Supply Agreement

The Company entered into a long term supply agreement with a subsidiary of Weston, and in exchange received cash proceeds of \$65 million which will be recognized into income over the term of the agreement, of which \$1 million was recognized in 2008. As at January 3, 2009, \$8 million was included in accounts payable and accrued liabilities and \$56 million in other liabilities. Certain assets and liabilities of a wholly-owned subsidiary were subsequently sold by Weston.

### Management Agreements

The Company has an agreement with Weston to provide certain administrative services by each company to the other. The services to be provided under this agreement include those related to commodity management, pension and benefits, tax, medical, travel, information system, risk management, treasury and legal. Payments are made quarterly based on the actual costs of providing these services. Where services are provided on a joint basis for the benefit of the Company and Weston together, each party pays the appropriate proportion of such costs. Net payments under this agreement in 2008 were \$13 million (2007 – \$9 million). Fees paid under this agreement are reviewed each year by the Audit Committee.

The Company, through Glenhuron Bank Limited ("Glenhuron"), a wholly-owned subsidiary of the Company, manages certain United States cash, cash equivalents and short term investments for wholly owned non-Canadian subsidiaries of Weston and management fees earned are based on market rates. As of year end, Glenhuron had an agreement with a subsidiary of Weston for the administration of a loan portfolio of third-party long term loans receivable. Subsequent to year end, the subsidiary of Weston sold the business which involved this loan portfolio and, as a result, the agreement is now between Glenhuron and a third party and will no longer be a related party transaction.

## Management's Discussion and Analysis

### 12. Critical Accounting Estimates

The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts and disclosures made in the consolidated financial statements and accompanying notes.

Management continually evaluates the estimates and assumptions it uses. These estimates and assumptions are based on management's historical experience, best knowledge of current events and conditions and activities that the Company may undertake in the future. Actual results could differ from these estimates.

The estimates and assumptions described in this section depend upon subjective or complex judgments about matters that may be uncertain and changes in these estimates and assumptions could materially impact the consolidated financial statements.

#### 12.1 Inventories

Certain retail store inventories are stated at the lower of cost and estimated net realizable value. Estimation or judgment is required in the determination of (i) discount factors used to convert inventory to cost after a physical count at retail has been completed and (ii) estimated inventory losses, or shrinkage, occurring between the last physical inventory count and the balance sheet date.

Inventories counted at retail are converted to cost by applying a discount factor to retail selling prices. This discount factor is determined at the category level, is calculated in relation to historical gross margins and is reviewed on a regular basis for reasonableness. Inventory shrinkage, which is calculated as a percentage of sales, is evaluated throughout the year and provides for estimated inventory shortages from the last physical count to the balance sheet date. To the extent that actual losses experienced vary from those estimated, both inventories and operating income will be impacted.

Changes or differences in these estimates may result in changes to inventories on the consolidated balance sheet and a charge or credit to operating income in the consolidated statement of earnings.

During the first quarter of 2008, the Company implemented Section 3031, "Inventories" ("Section 3031"), which replaced Section 3030 of the same title. Section 3031 provides guidance with respect to the determination of cost and requires inventories to be measured at the lower of cost and net realizable value.

Additional information on inventories is provided in note 11 to the consolidated financial statements.

#### 12.2 Employee Future Benefits

The cost and accrued benefit plan obligations of the Company's defined benefit pension plans and other benefit plans are accrued based on actuarial valuations which are dependent on assumptions determined by management. These assumptions include the discount rate, the expected long term rate of return on plan assets, the expected growth rate of health care costs, the rate of compensation increase, retirement ages and mortality rates. These assumptions are reviewed annually by management and the Company's actuaries.

The discount rate, the expected long term rate of return on plan assets and the expected growth rate in health care costs are the three most significant assumptions.

The discount rates are based on market interest rates as at the Company's measurement date of September 30 on a portfolio of Corporate AA bonds with terms to maturity that, on average, match the terms of the accrued benefit plan obligations. The discount rates used to determine the 2008 net cost for defined benefit pension and other benefit plans were 5.5% and 5.3%, respectively, on a weighted average basis, compared to 5.0% and 5.0%, respectively, in 2007. The discount rates used to determine the net 2009 defined benefit pension and other benefit plans costs increased to 6.0% and 5.7%, respectively.

The expected long term rate of return on plan assets is based on current market conditions, the asset mix, the active management of defined benefit pension plan assets and on historical returns. The Company reduced the expected long term rate of return on plan assets to 7.25% in calculating its defined benefit pension plans cost for 2009. The Company's defined benefit pension plan assets had a 10 year annualized return of 6.3% as at the 2008 measurement date. The actual annual returns within this 10 year period varied with market conditions.

The expected growth rate in health care costs for 2008 was based on external data and the Company's historical trends for health care costs. In 2009, the growth rate of health care costs is estimated at 9.5% and is assumed to gradually decrease to 5.0% by 2015, remaining at that level thereafter.

Since the three key assumptions discussed above are forward-looking and long term in nature, they are subject to uncertainty and actual results may differ. In accordance with Canadian GAAP, differences between actual experience and the assumptions, as well as the impact of changes in the assumptions, are accumulated as unamortized net actuarial gains or losses and amortized over future periods, affecting the recognized cost of defined benefit pension plans and other benefit plans and the accrued benefit plan obligation in future periods. While the Company believes that its assumptions are appropriate, significant differences in actual experience or significant changes in the Company's assumptions may materially affect its defined benefit pension plans and other benefit plans accrued benefit plan obligations and future cost.

Additional information regarding the Company's pension and other benefit plans, including a sensitivity analysis for changes in key assumptions, is provided in note 14 to the consolidated financial statements and in the Employee Future Benefit Contributions discussion in the Operating Risks and Risk Management section of this MD&A.

### **12.3 Goodwill**

Goodwill is not amortized and is assessed for impairment at the reporting unit level at least annually. Any potential goodwill impairment is identified by comparing the fair value of a reporting unit to its carrying value. If the fair value of the reporting unit exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value of the reporting unit exceeds its fair value, a more detailed goodwill impairment assessment must be undertaken. A goodwill impairment charge is recognized to the extent that, at the reporting unit level, the carrying value of goodwill exceeds the implied fair value.

The Company determines the fair value using a discounted cash flow model corroborated by other valuation techniques such as market multiples. The process of determining these fair values requires management to make estimates and assumptions including, but not limited to, projected future sales, earnings and capital investment, discount rates and terminal growth rates. Projected future sales, earnings and capital investment are consistent with strategic plans presented to the Company's Board. Discount rates are based on an industry weighted average cost of capital. These estimates and assumptions are subject to change in the future due to uncertain competitive and economic market conditions or changes in business strategies.

The Company performed the annual goodwill impairment test in 2008 and it was determined that the fair value of each of the reporting units exceeded its respective carrying value and therefore no goodwill impairment was identified.

## Management's Discussion and Analysis

### 12.4 Income Taxes

Future income tax assets and liabilities are recognized for the future income tax consequences attributable to temporary differences between the financial statement carrying values of assets and liabilities and their respective income tax bases. Future income tax assets or liabilities are measured using enacted or substantively enacted income tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The calculation of current and future income taxes requires management to make estimates and assumptions and to exercise judgment regarding the financial statement carrying values of assets and liabilities which are subject to accounting estimates inherent in those balances, the interpretation of income tax legislation across various jurisdictions, expectations about future operating results, the timing of reversal of temporary differences and possible audits of income tax filings by the tax authorities. Management believes it has adequately provided for income taxes based on currently available information. Changes or differences in underlying estimates or assumptions may result in changes to the current or future income tax balances on the consolidated balance sheet, a charge or credit to income tax expense in the consolidated statement of earnings and may result in cash payments or receipts.

### 12.5 Goods and Services Tax and Provincial Sales Taxes

During 2005, the Company recorded a charge relating to an audit and proposed assessment by the Canada Revenue Agency relating to GST on certain products sold on which GST was not appropriately charged and remitted. In light of this proposed assessment, the Company assessed and estimated the potential liabilities for GST and PST in other areas of its operations for various periods. The ultimate remaining amount paid will depend on the outcome of audits performed by or settlements reached with the various tax authorities, and therefore may differ from this estimate. Management will continue to assess the remaining accrual as progress towards resolution with the various tax authorities is made and will adjust the remaining accrual accordingly. Changes in this accrual may result in a charge or credit to operating income in the consolidated statement of earnings.

### 12.6 Fixed Assets

Fixed assets to be held and used are reviewed for impairment annually and when events or circumstances indicate that their carrying value exceeds the sum of the undiscounted cash flows expected from their use and eventual disposition. An impairment loss is measured as the amount by which the fixed assets carrying value exceeds the fair value. As discussed in note 12 to the consolidated financial statements, the Company recorded fixed asset impairment charge of \$29 million (2007 – \$33 million) and an accelerated depreciation charge of \$11 million (2007 – charge of \$3 million).

The factor that most significantly influences the impairment assessments and calculations is estimates of future cash flows. The Company uses its internal plans in estimating future cash flows. These plans reflect the Company's current best estimate of future cash flows but may change due to uncertain competitive and economic market conditions or changes in business strategies. Changes or differences in these estimates may result in changes to fixed assets on the consolidated balance sheet and a charge to operating income on the consolidated statement of earnings.



## **13. Accounting Standards**

### **13.1 Accounting Standards Implemented in 2008**

#### **Capital Disclosures and Financial Instruments – Disclosure and Presentation**

In December 2006, the Canadian Institute of Chartered Accountants (“CICA”) issued three new accounting standards: Section 1535, “Capital Disclosures” (“Section 1535”), Section 3862, “Financial Instruments – Disclosures” (“Section 3862”) and Section 3863, “Financial Instruments – Presentation” (“Section 3863”).

Section 1535 establishes guidelines for the disclosure of information regarding a company’s capital and how it is managed. Enhanced disclosures with respect to the entity’s objectives, policies and processes for managing capital and quantitative disclosure about what the entity regards as capital are required. For new disclosures refer to note 21 to the consolidated financial statements. The adoption of Section 1535 did not have an impact on the Company’s results of operations or financial condition.

Section 3862 and Section 3863 replaced Section 3861, “Financial Instruments – Disclosure and Presentation”. Section 3862 requires increased disclosures regarding the risks associated with financial instruments and how these risks are managed. Section 3863 carries forward standards for presentation of financial instruments and non-financial derivative instruments and provides additional guidance for the classification of financial instruments, from the perspective of the issuer, between liabilities and equity. For new disclosures refer to notes 25 and 26 to the consolidated financial statements. Comparative information about the nature and extent of risks arising from financial instruments is not required in the year Section 3862 is adopted. The adoption of Section 3862 and Section 3863 did not have an impact on the Company’s results of operations or financial condition.

#### **Inventories**

During the first quarter of 2008, the Company also implemented Section 3031, “Inventories”, which replaced Section 3030 of the same title. Section 3031 provides guidance with respect to the determination of cost and requires inventories to be measured at the lower of cost and net realizable value. Costs such as storage costs and administrative overhead that do not contribute to bringing inventories to their present location and condition are specifically excluded from the cost of inventories and expensed in the period incurred. Reversal of previous write-downs to net realizable value when there is a subsequent increase in the value of inventories is now required. The cost of the inventories should be based on a first-in, first-out or a weighted average cost formula. Techniques used for the measurement of cost of inventories, such as the retail method may be used if the results approximate cost. The new standard also requires additional disclosures including the accounting policies used in measuring inventories, the carrying amount of the inventories, amounts recognized as an expense during the period, write-downs below cost to net realizable value for inventories recorded at period end and the amount of any reversal of any write-downs recognized as a reduction in expenses.

Upon implementation of Section 3031, a decrease in opening inventories of \$65 million, an increase in current income taxes receivable of \$24 million and a decrease of \$41 million to opening retained earnings were recorded on the consolidated balance sheet resulting from the application of a consistent cost formula for all inventories having a similar nature and use to the Company. For further details of the specific accounting changes and related impacts, see notes 2 and 10 to the consolidated financial statements.

### **13.2 Future Accounting Standards**

The Company closely monitors new accounting standards to assess the impact, if any, on its consolidated financial statements. In 2009, the Company will be reviewing the implications of the following standards and implementing the recommendations as required:

## Management's Discussion and Analysis

### **Goodwill and Intangible Assets**

In November 2007, the CICA issued amendments to Section 1000 "Financial Statement Concepts", and AcG 11 "Enterprises in the Development Stage", issued a new Handbook Section 3064 "Goodwill and Intangible Assets" ("Section 3064"), to replace Section 3062 "Goodwill and Other Intangible Assets", withdrew Section 3450 "Research and Development Costs" and amended EIC 27 "Revenues and Expenditures During the Pre-operating Period" to not apply to entities that have adopted Section 3064. These amendments provide guidance for the recognition of internally developed intangible assets, including assets developed from research and development activities, ensuring consistent treatment of all intangible assets, whether separately acquired or internally developed. The amendments are effective for annual and interim financial statements relating to fiscal years beginning on or after October 1, 2008 and therefore the Company will implement them in the first quarter of 2009, retroactively with restatement of the comparative periods for the current and prior year. The impact of implementing these amendments on the Company's financial statements is currently being assessed.

### **Credit Risk and the Fair Value of Financial Risks and Financial Liabilities**

On January 20, 2009 the Emerging Issues Committee issued EIC 173 "Credit Risk and the Fair Value of Financial Risks and Financial Liabilities". The committee reached a consensus that a company's credit risk and the credit risk of its counterparties should be considered when determining the fair value of its financial assets and financial liabilities, including derivative instruments, for presentation and disclosure purposes. The accounting treatment for this Abstract should be applied retrospectively without restatement of prior periods to all financial assets and financial liabilities measured at fair value in interim and annual financial statements ending on or after January 20, 2009. The Company is assessing the impact of this Abstract on the financial statements and will implement this Abstract in the first quarter of 2009.

### **International Financial Reporting Standards ("IFRS")**

The Canadian Accounting Standards Board will require all public companies to adopt IFRS for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. Companies will be required to provide IFRS comparative information for the previous fiscal year. The transition from Canadian GAAP to IFRS will be applicable for the Company for the first quarter of 2011 when the Company will prepare both the current and comparative financial information using IFRS.

The Company has completed a diagnostic impact assessment, has completed planning activities, including the establishment of a steering committee comprised of senior management, and is currently progressing through the detailed assessment and design of the overall implementation strategy.

The Company expects the transition to IFRS to impact accounting, financial reporting, internal control over financial reporting, information systems and business processes. The Company will continue to review all proposed and continuing projects of the International Accounting Standards Board to determine their impact on the Company, and will continue to invest in training and resources throughout the transition period to facilitate a timely conversion.

## **14. Outlook<sup>(1)</sup>**

The Company remains confident in its approach and will continue to focus on making measured progress on its key transformation priorities, including food renewal, store enhancements, product innovation, infrastructure, and customer value. During 2009 the Company will step up investments in information technology and supply chain which will increase the associated expense by approximately \$100 million. This investment, coupled with the continuing economic challenges and competitive pressures are expected to challenge results in 2009.

(1) To be read in conjunction with "Forward Looking Statements" on page 2 of this Annual Report – Financial Review.

## 15. Non-GAAP Financial Measures

The Company reports its financial results in accordance with Canadian GAAP. It has historically also included in its Quarterly and Annual Reports certain non-GAAP financial measures and ratios. Over the past year, the Company has reviewed its practices with respect to the disclosure of non-GAAP financial measures. The Company considered the separate presentation of non-GAAP financial measures taking into account the discussion in the MD&A of the results of operations and the impact of specific events on these results of operations, the disclosure practices of its industry peers and best practices.

Based on this review, the Company decided that effective the first quarter of 2008 it would discontinue its use of the following non-GAAP financial measures: sales and sales growth excluding the impact of tobacco sales and VIEs, adjusted operating income and adjusted operating margin, adjusted EBITDA and adjusted EBITDA margin and adjusted basic net earnings per common share. The Company will continue to discuss the impact of individual specific items that are important in understanding the ongoing operations including those that relate to sales, operating income and basic earnings per common share.

The Company will continue to use the following non-GAAP financial measures: EBITDA and EBITDA margin, net debt, return on average total assets and free cash flow. The Company believes these non-GAAP financial measures provide useful information to both management and investors in measuring the financial performance and financial condition of the Company for the reasons outlined below. These measures do not have a standardized meaning prescribed by Canadian GAAP and, therefore, may not be comparable to similarly titled measures presented by other publicly traded companies, nor should they be construed as an alternative to other financial measures determined in accordance with Canadian GAAP.

## Management's Discussion and Analysis

### EBITDA and EBITDA Margin

The following table reconciles earnings before minority interest, income taxes, interest expense, depreciation and amortization ("EBITDA") to operating income which is reconciled to Canadian GAAP net earnings measures reported in the consolidated statements of earnings, for the years ended January 3, 2009 and December 29, 2007. EBITDA is useful to management in assessing the Company's performance of its ongoing operations and its ability to generate cash flows to fund its cash requirements, including the Company's capital investment program.

EBITDA margin is calculated as EBITDA divided by sales.

(\$ millions)	2008 (53 weeks)	2007 (52 weeks)	2006 (52 weeks)	2005 (52 weeks)	2004 (52 weeks)
Net earnings (loss) <sup>(1)</sup>	\$ 545	\$ 330	\$ (219)	\$ 746	\$ 968
Add impact of the following:					
Minority interest	10	4	1	3	-
Income taxes	228	150	248	400	445
Interest expense and other financing charges	263	252	259	252	239
Operating income <sup>(1)</sup>	1,046	736	289	1,401	1,652
Add impact of the following:					
Depreciation and amortization	585	588	590	558	473
EBITDA	\$ 1,631	\$ 1,324	\$ 879	\$ 1,959	\$ 2,125

### Net Debt

The following table reconciles net debt used in the net debt to equity ratio to Canadian GAAP measures reported in the audited consolidated balance sheets as at the years ended. The Company calculates net debt as the sum of long term debt and short term debt less cash, cash equivalents, short term investments and security deposits included in other assets. The net debt to equity ratio is useful in assessing the amount of leverage employed.

(\$ millions)	2008	2007	2006	2005	2004
Bank indebtedness	\$ 52	\$ 3	\$ 1	\$ 30	\$ 28
Short term debt	190	418	647	436	473
Long term debt due within one year	165	432	27	161	216
Long term debt	4,070	3,852	4,212	4,194	3,935
Less: Cash and cash equivalents <sup>(2)</sup>	528	430	568	587	472
Short term investments <sup>(2)</sup>	225	225	104	4	3
Security deposits included in other assets <sup>(2)</sup>	437	322	324	329	349
Net debt	\$ 3,287	\$ 3,728	\$ 3,891	\$ 3,901	\$ 3,828

(1) In 2008, the Company adopted Canadian Institute of Chartered Accountants ("CICA") Section 3031 "Inventories" without restatement of prior periods. In 2007, the Company implemented CICA Section 3855 "Financial Instruments – Recognition and Measurement", CICA Section 3865 "Hedges", CICA Section "1530 – Comprehensive Income", and CICA Section 3251 "Equity" without restatement of prior periods. In 2005, the Company adopted Accounting Guideline 15 "Consolidation of Variable Interest Entities", without restatement of prior periods.

(2) Certain prior year information has been reclassified to conform with current year presentation.

### Free Cash Flow

The following table reconciles free cash flow to Canadian GAAP measures reported in the consolidated cash flow statements as at the years ended. The Company calculates free cash flow as cash flows from operating activities less fixed asset purchases and dividends. The Company believes free cash flow is a useful measure of the Company's cash available for additional funding and investing activities.

(\$ millions)	2008	2007	2006	2005	2004
Cash flows from operating activities	\$ 989	\$ 1,245	\$ 1,180	\$ 1,489	\$ 1,443
Less: Fixed asset purchases	750	613	937	1,156	1,258
Dividends	288	230	173	230	209
Free cash flow	\$ (49)	\$ 402	\$ 70	\$ 103	\$ (24)

### Total Assets

The following table reconciles total assets used in the return on average total assets to Canadian GAAP measures reported in the audited consolidated balance sheets as at the years ended. The Company believes the return on average total assets ratio is useful in assessing the performance of its operating assets and therefore excludes cash, cash equivalents, short term investments and security deposits included in other assets from the total assets used in the ratio.

(\$ millions)	2008	2007	2006	2005	2004
Total assets	\$ 13,985	\$ 13,674	\$ 13,486	\$ 13,761	\$ 12,949
Less: Cash and cash equivalents <sup>(1)</sup>	528	430	568	587	472
Short term investments <sup>(1)</sup>	225	225	104	4	3
Security deposits included in other assets <sup>(1)</sup>	437	322	324	329	349
Total assets	\$ 12,795	\$ 12,697	\$ 12,490	\$ 12,841	\$ 12,125

### 16. Additional Information

Additional information about the Company, including its Annual Information Form and other disclosure documents, has been filed electronically with various securities regulators in Canada through the System for Electronic Document Analysis and Retrieval (SEDAR) and is available online at [www.sedar.com](http://www.sedar.com) and with the Office of the Superintendent of Financial Institutions (OSFI) as the primary regulator for the Company's subsidiary, PC Bank.

March 12, 2009  
Toronto, Canada

(1) Certain prior year information has been reclassified to conform with current year presentation.

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## Management's Statement of Responsibility for Financial Reporting

The management of Loblaw Companies Limited is responsible for the preparation, presentation and integrity of the accompanying consolidated financial statements, Management's Discussion and Analysis and all other information in the Annual Report. This responsibility includes the selection and consistent application of appropriate accounting principles and methods in addition to making the judgments and estimates necessary to prepare the consolidated financial statements in accordance with Canadian generally accepted accounting principles. It also includes ensuring that the financial information presented elsewhere in the Annual Report is consistent with that in the consolidated financial statements.

To provide reasonable assurance that assets are safeguarded and that relevant and reliable financial information is produced, management is required to design a system of internal controls and certify as to the design and operating effectiveness of internal controls over financial reporting. A dedicated control compliance team reviews and evaluates internal controls, the results of which are shared with management on a quarterly basis. KPMG LLP, whose report follows, were appointed as independent auditors by a vote of the Company's shareholders to audit the consolidated financial statements.

The Board of Directors, acting through an Audit Committee comprised solely of directors who are independent, is responsible for determining that management fulfills its responsibilities in the preparation of the consolidated financial statements and the financial control of operations. The Audit Committee recommends the independent auditors for appointment by the shareholders. The Audit Committee meets regularly with senior and financial management, internal auditors and the independent auditors to discuss internal controls, auditing activities and financial reporting matters. The independent auditors and internal auditors have unrestricted access to the Audit Committee. These consolidated financial statements and Management's Discussion and Analysis have been approved by the Board of Directors for inclusion in the Annual Report based on the review and recommendation of the Audit Committee.

Toronto, Canada  
March 12, 2009

**[signed]**  
**Galen G. Weston**  
Executive Chairman

**[signed]**  
**Allan L. Leighton**  
Deputy Chairman and President

**[signed]**  
**Robert G. Vaux**  
Chief Financial Officer

## Independent Auditors' Report

To the Shareholders of Loblaw Companies Limited:

We have audited the consolidated balance sheets of Loblaw Companies Limited as at January 3, 2009 and December 29, 2007, the consolidated statements of earnings, changes in shareholders' equity, comprehensive income and the consolidated cash flow statements for the 53 week and 52 week years then ended January 3, 2009 and December 29, 2007. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at January 3, 2009 and December 29, 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

  
Toronto, Canada  
March 12, 2009

  
Chartered Accountants, Licensed Public Accountants

## Consolidated Statements of Earnings

For the years ended January 3, 2009 and December 29, 2007

(\$ millions except where otherwise indicated)

	2008 (53 weeks)	2007 (52 weeks)
<b>Sales</b>	<b>\$ 30,802</b>	<b>\$ 29,384</b>
<b>Operating Expenses</b>		
Cost of sales, selling and administrative expenses (notes 2 and 11)	29,172	27,838
Depreciation and amortization	585	588
Restructuring (note 4)	(1)	222
	<b>29,756</b>	<b>28,648</b>
<b>Operating Income</b>	<b>1,046</b>	<b>736</b>
Interest expense and other financing charges (note 5)	263	252
<b>Earnings Before Income Taxes and Minority Interest</b>	<b>783</b>	<b>484</b>
Income Taxes (note 6)	228	150
<b>Net Earnings Before Minority Interest</b>	<b>555</b>	<b>334</b>
Minority Interest	10	4
<b>Net Earnings</b>	<b>\$ 545</b>	<b>\$ 330</b>
<b>Net Earnings Per Common Share</b> (\$) (note 7)		
Basic and diluted	<b>\$ 1.99</b>	<b>\$ 1.20</b>

See accompanying notes to the consolidated financial statements.



## Consolidated Statements of Changes in Shareholders' Equity

For the years ended January 3, 2009 and December 29, 2007 (\$ millions except where otherwise indicated)	2008 (53 weeks)	2007 (52 weeks)
<b>Common Share Capital, Beginning and End of Year</b> (note 20)	<b>\$ 1,196</b>	\$ 1,196
<b>Retained Earnings, Beginning of Year</b>	<b>\$ 4,330</b>	\$ 4,245
Cumulative impact of implementing new accounting standards (note 2)	(41)	(15)
Net earnings	545	330
Dividends declared per common share – 84¢ (2007 – 84¢)	(230)	(230)
<b>Retained Earnings, End of Year</b>	<b>\$ 4,604</b>	\$ 4,330
<b>Accumulated Other Comprehensive Income, Beginning of Year</b>	<b>\$ 19</b>	\$ –
Cumulative impact of implementing new accounting standards (note 2)	–	16
Other comprehensive income	11	3
<b>Accumulated Other Comprehensive Income, End of Year</b> (note 23)	<b>\$ 30</b>	\$ 19
<b>Total Shareholders' Equity</b>	<b>\$ 5,830</b>	\$ 5,545

See accompanying notes to the consolidated financial statements.

## Consolidated Statements of Comprehensive Income

For the years ended January 3, 2009 and December 29, 2007 (\$ millions)	2008 (53 weeks)	2007 (52 weeks)
<b>Net earnings</b>	<b>\$ 545</b>	\$ 330
<b>Other comprehensive income</b>		
Net unrealized gain (loss) on available-for-sale financial assets	40	(56)
Reclassification of (gain) loss on available-for-sale financial assets to net earnings	(21)	33
	19	(23)
Net gain on derivative instruments designated as cash flow hedges	21	57
Reclassification of gain on derivative instruments designated as cash flow hedges to net earnings	(29)	(31)
	(8)	26
Other comprehensive income	11	3
<b>Total Comprehensive Income</b>	<b>\$ 556</b>	\$ 333

See accompanying notes to the consolidated financial statements.

## Consolidated Balance Sheets

As at January 3, 2009 and December 29, 2007

(\$ millions)

	2008	2007
<b>Assets</b>		
Current Assets		
Cash and cash equivalents (note 8)	\$ 528	\$ 430
Short term investments	225	225
Accounts receivable (note 9)	867	885
Inventories (note 11)	2,188	2,032
Income taxes (note 6)	40	111
Future income taxes (note 6)	41	56
Prepaid expenses and other assets	71	32
<b>Total Current Assets</b>	<b>3,960</b>	<b>3,771</b>
Fixed Assets (note 12)	8,045	7,953
Goodwill (note 3)	807	806
Other Assets (note 13)	1,173	1,144
<b>Total Assets</b>	<b>\$ 13,985</b>	<b>\$ 13,674</b>
<b>Liabilities</b>		
Current Liabilities		
Bank indebtedness	\$ 52	\$ 3
Short term debt (note 15)	190	418
Accounts payable and accrued liabilities	2,823	2,860
Long term debt due within one year (note 16)	165	432
<b>Total Current Liabilities</b>	<b>3,230</b>	<b>3,713</b>
Long Term Debt (note 16)	4,070	3,852
Future Income Taxes (note 6)	171	180
Other Liabilities (note 17)	445	368
Capital Securities (note 19)	219	-
Minority Interest	20	16
<b>Total Liabilities</b>	<b>8,155</b>	<b>8,129</b>
<b>Shareholders' Equity</b>		
Common Share Capital (note 20)	1,196	1,196
Retained Earnings	4,604	4,330
Accumulated Other Comprehensive Income (notes 2 and 23)	30	19
<b>Total Shareholders' Equity</b>	<b>5,830</b>	<b>5,545</b>
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$ 13,985</b>	<b>\$ 13,674</b>

Contingencies, commitments and guarantees (note 27). Leases (note 18).

See accompanying notes to the consolidated financial statements.

Approved on Behalf of the Board

**[signed]**  
**Galen G. Weston**  
 Director

**[signed]**  
**Thomas C. O'Neill**  
 Director

## Consolidated Cash Flow Statements

For the years ended January 3, 2009 and December 29, 2007  
(\$ millions)

	<b>2008</b> <b>(53 weeks)</b>	2007 <b>(52 weeks)</b>
<b>Operating Activities</b>		
Net earnings before minority interest	\$ 555	\$ 334
Depreciation and amortization	585	588
Restructuring (note 4)	(1)	222
Future income taxes	27	(17)
Change in non-cash working capital	(284)	35
Other	107	83
<b>Cash Flows from Operating Activities</b>	<b>989</b>	<b>1,245</b>
<b>Investing Activities</b>		
Fixed asset purchases	(750)	(613)
Short term investments	45	(154)
Proceeds from fixed asset sales	125	223
Credit card receivables, after securitization (note 9)	82	(238)
Franchise investments and other receivables	(37)	19
Other	(72)	(88)
<b>Cash Flows used in Investing Activities</b>	<b>(607)</b>	<b>(851)</b>
<b>Financing Activities</b>		
Bank indebtedness	50	2
Short term debt	(228)	(229)
Long term debt (note 16)		
Issued	301	25
Retired	(424)	(39)
Capital securities issued (note 19)	218	-
Dividends	(288)	(230)
Other	-	(1)
<b>Cash Flows used in Financing Activities</b>	<b>(371)</b>	<b>(472)</b>
Effect of foreign currency exchange rate changes on cash and cash equivalents (note 8)	87	(60)
Change in Cash and Cash Equivalents	98	(138)
Cash and Cash Equivalents, Beginning of Year	430	568
<b>Cash and Cash Equivalents, End of Year</b>	<b>\$ 528</b>	<b>\$ 430</b>

See accompanying notes to the consolidated financial statements.

## Notes to the Consolidated Financial Statements

For the years ended January 3, 2009 and December 29, 2007  
(\$ millions except where otherwise indicated)

### Note 1. Summary of Significant Accounting Policies

The consolidated financial statements were prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and are reported in Canadian dollars.

**Basis of Consolidation** The consolidated financial statements include the accounts of Loblaw Companies Limited and its subsidiaries, collectively referred to as the "Company" or "Loblaw". The Company's interest in the voting share capital of its subsidiaries is 100%.

The Company also consolidates variable interest entities ("VIEs") pursuant to Canadian Institute of Chartered Accountants ("CICA") Accounting Guideline ("AcG") 15, "Consolidation of Variable Interest Entities" ("AcG 15"), that are subject to control by Loblaw on a basis other than through ownership of a majority of voting interest. AcG 15 defines a variable interest entity as an entity that either does not have sufficient equity at risk to finance its activities without subordinated financial support or where the holders of the equity at risk lack the characteristics of a controlling financial interest. AcG 15 requires the primary beneficiary to consolidate VIEs and considers an entity to be the primary beneficiary of a VIE if it holds variable interests that expose it to a majority of the VIEs' expected losses or that entitle it to receive a majority of the VIEs' expected residual returns or both.

**Fiscal Year** The fiscal year of the Company ends on the Saturday closest to December 31. As a result, the Company's fiscal year is usually 52 weeks in duration but includes a 53rd week every 5 to 6 years. The years ended January 3, 2009 and December 29, 2007 contained 53 weeks and 52 weeks, respectively.

**Revenue Recognition** Sales include revenues, net of estimated returns, from customers through corporate stores operated by the Company and independent franchisee stores that are consolidated by the Company pursuant to AcG 15. In addition, sales include sales to and service fees from associated stores and independent account customers and franchised stores excluding VIE stores net of sales incentives offered by Loblaw. The Company recognizes revenue at the time the sale is made to its customers.

**Earnings per Share ("EPS")** Basic EPS is calculated by dividing the net earnings available to common shareholders by the weighted average number of common shares outstanding during the year. Diluted EPS is calculated using the treasury stock method and the if converted method. The treasury stock method assumes that all outstanding stock options with an exercise price below the average market price during the year are exercised and the assumed proceeds are used to purchase the Company's common shares at the average market price during the year. Under the if converted method, diluted EPS also takes into consideration the dilutive effect of the conversion options on the capital securities which are assumed to be converted using the market share price at the end of the year.

**Cash, Cash Equivalents and Bank Indebtedness** Cash equivalents consist primarily of highly liquid marketable investments with a maturity of 90 days or less. Cash equivalents are either designated as held-for-trading financial assets or classified as available-for-sale financial assets and are carried at quoted market value. See note 8 for more information.

**Short Term Investments** Short term investments consist primarily of government treasury bills, government-sponsored debt securities, corporate commercial paper and bank term deposits. Short term investments are either designated as held-for-trading financial assets or classified as available-for-sale financial assets and are carried at quoted market value.

**Security Deposits** Security deposits consist primarily of government treasury bills and government-sponsored debt securities and are included in other assets for balance sheet presentation purposes. Security deposits are either designated as held-for-trading financial assets or classified as available-for-sale financial assets and are carried at quoted market value.

**Credit Card Receivables** The Company, through *President's Choice Bank* ("PC Bank"), a wholly owned subsidiary of the Company, has credit card receivables that are stated net of an allowance for credit losses. Any credit card receivable with a payment that is contractually 180 days in arrears, or where the likelihood of collection is considered remote, is written off. Interest income on credit card receivables is recorded on an accrual basis and is recognized in operating income.

**Allowance for Credit Losses** PC Bank maintains an allowance for probable credit losses on aggregate exposures for which losses cannot be determined on an item-by-item basis. The allowance is based upon a statistical analysis of past and current performance, the level of allowance already in place and management's judgment. The allowance for credit losses is deducted from the credit card receivables balance. The net credit loss experience for the year is recognized in operating income.

**Securitization** PC Bank securitizes credit card receivables through the sale of a portion of the total interest in certain receivables to independent trusts and does not exercise any control over the trusts' management or assets. PC Bank does retain certain servicing and administrative responsibilities. The credit card receivables are removed from the consolidated balance sheet when PC Bank has surrendered control and are considered sold for accounting purposes pursuant to AcG 12, "Transfers of Receivables". When PC Bank sells credit card receivables in a securitization transaction, it has a retained interest in the securitized receivables represented by the rights to future cash flows after obligations to investors have been met. Although PC Bank remains responsible for servicing all credit card receivables, it does not receive additional compensation for servicing those credit card receivables sold to the independent trusts and accordingly a service liability is recorded. The service liability is recorded at fair value upon initial recognition. In the absence of quoted market rates for servicing securitized assets, fees payable to a replacement servicer, in the event that a replacement servicer was to be appointed, formed the basis of determination of fair value of the servicing liability. Gains or losses on the sale of these receivables depends, in part, on the previous carrying amount of receivables involved in the securitization, allocated between the receivables sold and the retained interest, based on their relative fair values at the date of securitization. The fair value of the retained interests is determined as the best estimate of the net present value of expected future cash flows using management's best estimates of key assumptions such as monthly payment rates, weighted average life, expected annual credit losses and discount rates. Any gain or loss on a sale is recognized in operating income at the time of the securitization. Retained interests are designated as held-for-trading financial assets and are recorded at fair value on the consolidated balance sheet.

**Vendor Allowances** The Company receives allowances from certain of its vendors whose products it purchases for resale. These allowances are received for a variety of buying and/or merchandising activities, including vendor programs such as volume purchase allowances, purchase discounts, listing fees and exclusivity allowances. Consideration received from a vendor is a reduction in the cost of the vendor's products or services and is recognized as a reduction in the cost of sales, selling and administrative expenses and the related inventory when recognized in the consolidated statement of earnings and the consolidated balance sheet. Certain exceptions apply if the consideration is a payment for assets or services delivered to the vendor or for reimbursement of selling costs incurred to promote the vendor's products, provided that these costs are separate, incremental and identifiable.

**Inventories** In 2008, as a result of the implementation of CICA Section 3031 "Inventories" ("Section 3031"), the Company values merchandise inventories at the lower of cost and net realizable value. Costs include the costs of purchase net of vendor allowances plus other costs, such as transportation, that are directly incurred to bring inventories to their present location and condition. Seasonal general merchandise and inventories at the distribution centres are measured at weighted average cost. The Company uses the retail method to measure the cost of certain retail store inventories. The Company estimates net realizable value as the amount that inventories are expected to be sold taking into consideration fluctuations in retail prices due to seasonality less estimated costs necessary to make the sale. Inventories are written down to net realizable value when the cost of inventories is estimated to be unrecoverable due to obsolescence, damage or declining selling prices. When circumstances that previously caused inventories to be written down below cost no longer exist or when there is clear evidence of an increase in retail selling prices, the amount of the write-down previously recorded is reversed. Storage costs, indirect administrative overhead and certain selling costs related to inventories are expensed in the period that these costs are incurred. See note 2 for more information.

In 2007, the Company utilized the retail method for retail store inventories, which were stated at the lower of cost and estimated net realizable value less normal gross profit margin. Distribution centre inventories and seasonal general merchandise inventories were stated at the lower of cost and estimated net realizable value.

## Notes to the Consolidated Financial Statements

**Fixed Assets** Fixed assets are recorded at cost including capitalized interest. Depreciation commences when the assets are put into use and is recognized on a straight-line basis to depreciate the cost of these assets over their estimated useful lives. Estimated useful lives range from 20 to 40 years for buildings, up to 10 years for building improvements and from 3 to 10 years for equipment and fixtures. Leasehold improvements are depreciated over the lesser of the lease term and their estimated useful lives and may include renewal options when an improvement is made after inception of the lease to a maximum of 25 years, which approximates economic life. Equipment under capital leases is depreciated over the term of the lease.

Fixed assets are reviewed for impairment when events or changes in circumstances indicate that the carrying value exceeds the sum of the undiscounted future cash flows expected from use and eventual disposal. These events or changes in circumstances include a commitment to close a store or distribution centre or to relocate or convert a store. Fixed assets are also reviewed for impairment annually. For purposes of annually reviewing store assets for impairment, asset groups are reviewed at their lowest level for which identifiable cash flows are largely independent of cash flows of other assets and liabilities. Therefore, store net cash flows are grouped together by primary market areas, where cash flows are largely dependent on each other. Primary markets are regional areas where a number of store formats operate within close proximity to one another. If an indicator of impairment exists, such as sustained negative operating cash flows of the respective asset group, then an estimate of undiscounted future cash flows of each such store within this group is prepared and compared to its carrying value. For purposes of annually reviewing distribution centre assets for impairment, distribution centre net cash flows are grouped with the respective net cash flows of the stores they service. An impairment in the store network serviced by the distribution centre may indicate an impairment in the distribution centre assets as well. If these assets are determined to be impaired, the impairment loss is measured as the excess of the carrying value over fair value. In addition, the carrying value of fixed assets is evaluated whenever events or changes in circumstances indicate that the carrying value of fixed assets may not be recoverable. These events or changes in circumstances include a commitment to close a store or distribution centre or to relocate or convert a store where the carrying value of its assets is greater than the expected undiscounted future cash flows.

**Deferred Charges** Deferred charges are amortized over the related assets' estimated useful lives.

**Goodwill** Goodwill represents the excess of the purchase price of a business acquired over the fair value of the underlying net assets acquired at the date of acquisition. Goodwill is not amortized and is assessed for impairment at a minimum on an annual basis, at the reporting unit level. Any potential goodwill impairment is identified by comparing the fair value of a reporting unit to its carrying value. If the fair value of the reporting unit exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value of the reporting unit exceeds its fair value, a more detailed goodwill impairment assessment must be undertaken. A goodwill impairment charge is recognized to the extent that, at the reporting unit level, the carrying value of goodwill exceeds the implied fair value and is recorded in operating income.

The Company determines the fair value using a discounted cash flow model corroborated by other valuation techniques such as market multiples. The process of determining these fair values requires management to make estimates and assumptions including, but not limited to, projected future sales, earnings and capital investment, discount rates and terminal growth rates. Projected future sales, earnings and capital investment are consistent with strategic plans presented to the Company's Board of Directors. Discount rates are based on an industry weighted average cost of capital. These estimates and assumptions are subject to change in the future due to uncertain competitive and economic market conditions or changes in business strategies. See note 3 for more information.

**Financial Instruments** CICA Section 3855 "Financial Instruments – Recognition and Measurement" ("Section 3855") establishes guidance for recognizing and measuring financial assets, financial liabilities and non-financial derivative instruments. All financial instruments must be classified into a defined category, namely, held-for-trading financial assets or financial liabilities, held-to-maturity investments, loans and receivables, available-for-sale financial assets, or other financial liabilities. The standard requires that financial instruments be included on the Company's balance sheet and measured at fair value, except for loans and receivables, held-to-maturity financial assets and other financial liabilities which are measured at cost or amortized cost. Gains and losses on held-for-trading financial assets and financial liabilities are recognized in net earnings in the period in which they arise. Unrealized gains and losses, including changes in foreign exchange rates on available-for-sale financial assets are recognized in other comprehensive income until the financial asset is derecognized or impaired, at which time any unrealized gains or losses are recorded in net earnings. Transaction costs other than those related to financial instruments classified as held-for-trading, which are expensed as incurred, are amortized using the effective interest method.

As a result of Section 3855, the following classifications were assumed:

- Cash and cash equivalents and short term investments are designated as held-for-trading with the exception of certain United States dollar denominated cash equivalents and short term investments designated in a cash flow hedging relationship, which are classified as available-for-sale financial assets.
- Accounts receivable are classified as loans and receivables.
- Investments in equity instruments are classified as available-for-sale.
- Bank indebtedness, accounts payable and certain accrued liabilities, short term debt, long term debt, capital lease obligations and capital securities have been classified as other financial liabilities.
- Certain accrued liabilities are classified as held-for-trading.

The Company has not classified any financial assets as held-to-maturity.

**Derivative Instruments** The Company uses financial derivative instruments in the form of cross currency swaps, interest rate swaps and equity forwards to manage its current and anticipated exposure to fluctuations in foreign currency exchange rates, interest rates and the market price of the Company's common shares. The Company uses financial and non-financial derivative instruments in the form of futures contracts, option contracts and forward contracts to manage its current and anticipated exposure to fluctuations in commodity prices. The Company does not enter into derivative agreements for trading or speculative purposes.

All financial derivative instruments are recorded at fair value on the consolidated balance sheet in accordance with CICA Section 3855. Non-financial derivative instruments, such as certain contracts that are linked to commodity prices, are recorded at fair value on the consolidated balance sheet unless they are exempt from this treatment based upon expected purchase, sale or usage requirements. Embedded derivative instruments are separated from their host contract and recorded on the consolidated balance sheet at fair value. Fair values are based on quoted market prices where available from active markets, otherwise fair values are estimated using valuation methodologies, primarily discounted cash flow analysis. Derivative instruments are recorded in current or non-current assets and liabilities based on their remaining terms to maturity. All changes in fair value of the derivative instruments are recorded in net earnings unless cash flow hedge accounting is applied.

The Company formally identifies, designates and documents the relationship between hedging instruments and hedged items including cross currency swaps and interest rate swaps as cash flow hedges against its exposure to fluctuations in the foreign currency exchange rate and variable interest rates on a portion of its United States dollar cash and cash equivalents, short term investments and security deposits included in other assets. The Company also designates cross currency swaps as cash flow hedges against its exposure to fluctuations in the foreign currency exchange rate on its United States dollar private placement note. The Company assesses whether these derivative instruments continue to be highly effective in offsetting the change in the cash flows of hedged items. If and when a derivative instrument is no longer expected to be highly effective, hedge accounting is discontinued. Hedge ineffectiveness, if any, is included in current period net earnings.

**Foreign Currency Translation** Assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the foreign currency exchange rate in effect at the balance sheet date. Exchange gains or losses arising from the translation of these balances denominated in foreign currencies are recognized in operating income except for cross currency swaps and available-for-sale cash and cash equivalents, short term investments and security deposits included in other assets denominated in United States dollars which are designated in a cash flow hedge and are deferred in accumulated other comprehensive income and reclassified to net earnings when realized. Revenues and expenses denominated in foreign currencies are translated into Canadian dollars at the average foreign currency exchange rate for the year.

## Notes to the Consolidated Financial Statements

**Income Taxes** The asset and liability method of accounting is used for income taxes. Under the asset and liability method, future income tax assets and liabilities are recognized for the future income tax consequences attributable to temporary differences between the financial statement carrying values of existing assets and liabilities and their respective income tax bases. Future income tax assets and liabilities are measured using enacted or substantively enacted income tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in income tax rates is recognized in income tax expense when enacted or substantively enacted. Future income tax assets are evaluated and a valuation allowance, if required, is recorded against any future income tax asset if it is more likely than not that the asset will not be realized.

**Employee Future Benefits** The Company sponsors a number of pension plans including registered funded defined benefit pension plans, defined contribution pension plans and supplemental unfunded arrangements providing pension benefits in excess of statutory limits. The Company also offers certain employee post-retirement and post-employment benefit plans and a long term disability benefit plan. Post-retirement and post-employment benefit plans are generally not funded, are mainly non-contributory and include health care, life insurance and dental benefits. The Company also contributes to various multi-employer pension plans which provide pension benefits.

*Defined Benefit Plans* The cost and accrued benefit plan obligations of the Company's defined benefit pension plans and other benefit plans, including post-retirement, post-employment and long term disability benefits, are accrued based on actuarial valuations. The actuarial valuations for the defined benefit plans are determined using the projected benefit method prorated on service and management's best estimate of the discount rate, the expected long term rate of return on plan assets, the rate of compensation increase, retirement ages, termination rates, mortality rates and expected growth rate of health care costs. Actuarial valuations are performed using a September 30 measurement date for accounting purposes. Market values used to value benefit plan assets are as at the measurement date. The discount rate used to value the accrued benefit plan obligation is based on market interest rates as at the measurement date, assuming a portfolio of Corporate AA bonds with terms to maturity that, on average, match the terms of the accrued benefit plan obligations.

Past service costs arising from plan amendments are amortized over the expected average remaining service period of the active employees. The unamortized net actuarial gain or loss that exceeds 10% of the greater of the accrued benefit plan obligation or the fair value of the benefit plan assets at the beginning of the year is amortized over the expected average remaining service period of the active employees for defined benefit pension and post-retirement benefit plans. The unamortized net actuarial gain or loss for post-employment and long term disability benefits is amortized over periods not exceeding three years. The expected average remaining service period of the active employees covered by the defined benefit pension plans ranges from 9 to 18 years, with a weighted average of 12 years. The expected average remaining service period of the employees covered by the post-retirement benefit plans ranges from 7 to 20 years, with a weighted average of 15 years.

The net accrued benefit plan asset or liability represents the cumulative difference between the cost and the funding contributions and is recorded in other assets and other liabilities.

*Defined Contribution and Multi-Employer Pension Plans* The costs of pension benefits for defined contribution pension plans and multi-employer pension plans are expensed as contributions are due.

**Stock Option Plan** The Company recognizes a compensation cost in operating income and a liability related to employee stock option grants that allow for settlement in shares or in the share appreciation value in cash at the option of the employee, using the intrinsic value method. Under the intrinsic value method, the stock-based compensation liability is the amount by which the market price of the common shares at the balance sheet date exceeds the exercise price of the stock options. A year-over-year change in the stock-based compensation liability is recognized in operating income on a prescribed vesting basis.



**Restricted Share Unit (“RSU”) Plan** The Company recognizes a compensation cost in operating income on a prescribed vesting basis for each RSU granted equal to the market value of a Loblaw common share at the date on which RSUs are awarded to each participant prorated over the performance period and adjusts for changes in the market value until the end of the performance date. The cumulative effect of the change in market value is recognized in operating income in the period of change.

**Employee Share Ownership Plan** The Company maintains an Employee Share Ownership Plan which allows employees to acquire the Company’s common shares through regular payroll deductions of up to 5% of their gross regular earnings. The Company contributes an additional 25% of each employee’s contribution to the plan, which is recognized in operating income as a compensation cost when the contribution is made.

**Deferred Share Units (“DSU”)** Members of the Company’s Board of Directors, who are not management of the Company, may elect annually to receive all or a portion of their annual retainer(s) and fees in the form of DSUs. The DSU compensation liability is accounted for based on the number of units outstanding and the market value of Loblaw common shares at the balance sheet date. The year-over-year change in the deferred share unit compensation liability is recognized in operating income.

**Executive Deferred Share Units (“EDSU”)** In 2008, the Company approved the introduction of an EDSU Plan. Under this plan, executives may elect to defer up to 100% of the Short Term Incentive Plan (“STIP”) earned by the executive in any year into the EDSU Plan, subject to an overall cap of three times the executive’s base salary. All EDSUs held by an executive will be paid out in cash by December 15 of the year following the year in which the executive’s employment ceases for any reason. An election to participate in the plan in any year must be made before the beginning of the year and is irrevocable. The number of EDSUs granted in respect of any year will be determined by dividing the STIP bonus that is subject to the EDSU plan election by the value of the Company’s common shares on the date the STIP bonus would otherwise be payable. For this purpose, and for purposes of determining the value of a EDSU upon conversion of the EDSUs into cash, the value of the EDSUs will be calculated by using the weighted average of the trading prices of the Company’s common shares on the Toronto Stock Exchange for the five trading days prior to the valuation date.

**Use of Estimates and Assumptions** The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts and disclosures made in the consolidated financial statements and accompanying notes. These estimates and assumptions are based on management’s historical experience, best knowledge of current events and conditions and activities that may be undertaken in the future. Actual results could differ from these estimates.

Certain estimates, such as those related to valuation of inventories, goodwill, income taxes, Goods and Services Tax, provincial sales taxes, fixed asset impairment and employee future benefits depend upon subjective or complex judgments about matters that may be uncertain, and changes in those estimates could materially impact the consolidated financial statements. Illiquid credit markets, volatile equity, foreign currency, and energy markets and declines in consumer spending have combined to increase the uncertainty inherent in such estimates and assumptions. As future events and their effects cannot be determined with precision, actual results could differ significantly from these estimates. Changes in those estimates resulting from continuing changes in the economic environment will be reflected in the financial statements in future periods.

**Presentation** Certain prior year information has been reclassified to conform with current year presentation. Security deposits, which were previously presented as cash and cash equivalents and short term investments on the consolidated balance sheets, are now included in other assets on the consolidated balance sheets and totaled \$437 as at January 3, 2009 (2007 – \$322). The Company’s unrealized equity forwards liability, which were previously presented as other long term liabilities on the consolidated balance sheets, are now included in accounts payable in accrued liabilities and totaled \$92 as at January 3, 2009 (2007 – \$91).

## Notes to the Consolidated Financial Statements

### Future Accounting Standards

**Goodwill and Intangible Assets** In November 2007, the CICA issued amendments to Section 1000 “Financial Statement Concepts”, and AcG 11 “Enterprises in the Development Stage”, issued a new Handbook Section 3064 “Goodwill and Intangible Assets” (“Section 3064”) to replace Section 3062 “Goodwill and Other Intangible Assets”, withdrew Section 3450 “Research and Development Costs” and amended Emerging Issues Committee (“EIC”) Abstract 27 “Revenues and Expenditures During the Pre-operating Period” to not apply to entities that have adopted Section 3064. These amendments provide guidance for the recognition of internally developed intangible assets, including assets developed from research and development activities, ensuring consistent treatment of all intangible assets, whether separately acquired or internally developed. The amendments are effective for annual and interim financial statements relating to fiscal years beginning on or after October 1, 2008 and therefore the Company will implement them in the first quarter of 2009, retroactively with restatement of the comparative periods for the current and prior year. The impact of implementing these amendments on the Company’s financial statements is currently being assessed.

**Credit Risk and the Fair Value of Financial Risks and Financial Liabilities** On January 20, 2009 the EIC issued EIC 173 “Credit Risk and the Fair Value of Financial Risks and Financial Liabilities”. The committee reached a consensus that a company’s credit risk and the credit risk of its counterparties should be considered when determining the fair value of its financial assets and financial liabilities, including derivative instruments, for presentation and disclosure purposes. The accounting treatment for this Abstract should be applied retrospectively without restatement of prior periods to all financial assets and financial liabilities measured at fair value in interim and annual financial statements ending on or after January 20, 2009. Retrospective application with restatement of prior periods is permitted but not required. The Company is assessing the impact of this Abstract on the financial statements and will implement this Abstract in the first quarter of 2009.

### Note 2. Implementation of New Accounting Standards

#### Accounting Standards Implemented in 2008

**Capital Disclosures and Financial Instruments – Disclosure and Presentation** In December 2006, the CICA issued three new accounting standards: Section 1535 “Capital Disclosures” (“Section 1535”), Section 3862 “Financial Instruments – Disclosures” (“Section 3862”) and Section 3863 “Financial Instruments – Presentation” (“Section 3863”).

Section 1535 establishes guidelines for the disclosure of information regarding a company’s capital and how it is managed. The standard requires enhanced disclosures with respect to (i) an entity’s objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; and (iii) whether the entity has complied with any external capital requirements, and if it has not complied, the consequences of such non-compliance. For new disclosures refer to note 21. The adoption of Section 1535 did not have an impact on the Company’s financial results or position.

Section 3862 and Section 3863 replaced Section 3861, “Financial Instruments – Disclosure and Presentation”. Section 3862 requires increased disclosures regarding the risks associated with financial instruments such as credit risks, liquidity risks and market risks and the techniques used to identify, monitor and manage these risks. Section 3863 carries forward standards for presentation of financial instruments and non-financial derivatives and provides additional guidance for the classification of financial instruments, from the perspective of the issuer, between liabilities and equity. For new disclosures refer to notes 25 and 26. Comparative information about the nature and extent of risks arising from financial instruments is not required in the year Section 3862 is adopted. The adoption of Section 3862 and Section 3863 did not have an impact on the Company’s financial results or position.

**Inventories** Effective January 1, 2008, the Company implemented Section 3031 issued by the CICA in June 2007, which replaces Section 3030 of the same title. Section 3031 requires inventories to be measured at the lower of cost and net realizable value. Costs such as storage costs and administrative overhead that do not contribute to bringing inventories to their present location and condition are specifically excluded from the cost of inventories and expensed in the period incurred. Reversal of previous write-downs to net realizable value when there is a subsequent increase in the value of inventories is now required. The cost of inventories should be based on a first-in, first-out or weighted average cost formula. Techniques used for the measurement of cost of inventories, such as the retail method, may be used if the results approximate cost. The new standard also requires additional disclosures including the accounting policies used in measuring inventories, the carrying amounts of the inventories, amounts recognized as an expense during the period, write-downs and the amount of any reversal of any write-downs recognized as a reduction in expenses.

The Company values merchandise inventories at the lower of cost and net realizable value. Costs include the costs of purchase net of vendor allowances plus other costs, such as transportation, that are directly incurred to bring inventories to their present location and condition. Seasonal general merchandise and inventories at the distribution centres are measured at weighted average cost. The Company uses the retail method to measure the cost of certain retail store inventories. The Company estimates net realizable value as the amount that inventories are expected to be sold taking into consideration fluctuations in retail prices due to seasonality less estimated costs necessary to make the sale. Inventories are written down to net realizable value when the cost of inventories is estimated to be unrecoverable due to obsolescence, damage or declining selling prices. When circumstances that previously caused inventories to be written down below cost no longer exist or when there is clear evidence of an increase in retail selling prices, the amount of the write-down previously recorded is reversed. Storage costs, indirect administrative overhead and certain selling costs related to inventories are expensed in the period that these costs are incurred.

The transitional adjustments resulting from the implementation of Section 3031 are recognized in the 2008 opening balance of retained earnings. Prior period balances have not been restated. Upon implementation of these requirements, a decrease in opening inventories of \$65, an increase in current income taxes receivable of \$24 and a decrease of \$41 to opening retained earnings were recorded on the consolidated balance sheet resulting from the application of a consistent cost formula for all inventories having a similar nature and use to the Company.

In addition to the disclosure of accounting policies used in measuring inventories, Section 3031 also requires additional disclosures. See note 11 for the amount of merchandise inventories recognized as an expense in the period, the amount of inventories written down below cost to net realizable value for inventories recorded at period end and the amount of any reversal of any previously recognized write-downs.

### **Accounting Standards Implemented in 2007**

On December 31, 2006, the Company implemented the CICA Handbook Section 3855, "Financial Instruments – Recognition and Measurement", Section 3865, "Hedges", Section 1530, "Comprehensive Income", Section 3251, "Equity" and Section 3861, "Financial Instruments – Disclosure and Presentation". These standards were applied without restatement of prior periods. All transitional adjustments resulting from these standards resulted in a decrease in retained earnings, net of income taxes and minority interest of \$15 million and an increase in accumulated other comprehensive loss, net of income taxes and minority interest of \$16 million in 2007.

### **Note 3. Goodwill**

In 2008 and 2007, the Company performed its annual goodwill impairment test and determined that there was no impairment to the carrying value of goodwill.

In the normal course of business, the Company may acquire from time to time franchisee stores and convert them to corporate stores. In 2008, the Company acquired 1 franchisee business (2007 – 4 franchisee businesses). The acquisitions were accounted for using the purchase method of accounting with the results of the business acquired included in the consolidated financial statements from the date of acquisition. The fair value of the net assets acquired consisted of fixed assets of nil (2007 – \$3), other assets principally inventory of nil (2007 – \$1) and goodwill of \$1 (2007 – \$8) for cash consideration of \$1 (2007 – \$9), net of accounts receivable due from the franchisees of nil (2007 – \$3).

## Notes to the Consolidated Financial Statements

The following table discloses the changes in goodwill over 2008 and 2007.

	2008	2007
Balance, beginning of year	\$ 806	\$ 794
Goodwill acquired	1	8
Other	-	4
Balance, end of year	\$ 807	\$ 806

### Note 4. Restructuring and Other Charges

**Project Simplify** During 2007, the Company approved and announced the restructuring of its merchandising and store operations into more streamlined functions as part of Project Simplify. The year-to-date charge of \$3 (2007 – \$197) is comprised of \$2 (2007 – \$139) for employee termination costs including severance, additional pension costs resulting from the termination of employees and retention costs; and \$1 (2007 – \$58) of other costs, primarily consulting directly associated with the restructuring. Cash payments in 2008 were \$36 (2007 – \$149). As at the end of 2008, a remaining liability of \$1 (2007 – \$33) was recorded on the consolidated balance sheets in respect of this initiative.

**Store Operations** During 2007, the Company completed the previously announced restructuring of its store operations. In 2008, the Company recognized income of \$3 (2007 – charge of \$16) related to this plan. Cash payments in 2008 were \$1 (2007 – \$22). As at the end of 2008, a remaining liability of nil (2007 – \$3) was recorded on the consolidated balance sheets in respect of this initiative.

**Supply Chain Network** During 2005, the Company approved a comprehensive plan to restructure its supply chain operations nationally. Year-to-date income of \$1 (2007 – charge of \$9) is composed of income of \$3 (2007 – charge of \$7) for employee termination costs resulting from planned involuntary terminations and a charge of \$2 (2007 – \$2) for site closing and other costs. Cash payments in 2008 were \$25 (2007 – \$5). As at the end of 2008, a remaining liability of \$7 (2007 – \$33) was recorded on the consolidated balance sheets in respect of this initiative.

The following table provides a summary of the costs recognized and cash payments made, as well as the corresponding net liability as at January 3, 2009 and December 29, 2007:

	Employee Termination Costs	Site Closing Costs and Other	2008 Total	2007 Total
Net liability, beginning of year	\$ 59	\$ 12	\$ 71	\$ 40
Costs recognized:				
Project Simplify	\$ 2	\$ 1	\$ 3	\$ 197
Store operations	-	(3)	(3)	16
Supply chain network	(3)	2	(1)	9
	\$ (1)	\$ -	\$ (1)	\$ 222
Cash payments:				
Project Simplify	\$ 26	\$ 10	\$ 36	\$ 149
Store operations	1	-	1	22
Supply chain network	23	2	25	5
	\$ 50	\$ 12	\$ 62	\$ 176
Charges against other assets <sup>(1)</sup>	-	-	-	15
Net liability, end of year	\$ 8	\$ -	\$ 8	\$ 71
Recorded in the consolidated balance sheet as follows:				
Accounts payable and accrued liabilities	8	-	8	50
Other liabilities (note 17)	-	-	-	21
Net liability, end of year	\$ 8	\$ -	\$ 8	\$ 71

#### Note 5. Interest Expense and Other Financing Charges

	2008	2007
Interest on long term debt	\$ 286	\$ 285
Interest (income) expense on financial derivative instruments	(4)	12
Net short term interest expense (income)	2	(6)
Interest income on security deposits	(9)	(17)
Dividends on capital securities	8	-
Capitalized to fixed assets	(20)	(22)
Interest expense	\$ 263	\$ 252

(1) Represents defined benefit pension plan cost applied to other assets. Charges against other assets relate to the contractual termination benefits cost recognized which reduced the accrued benefit plan asset (see note 14).

## Notes to the Consolidated Financial Statements

During 2008, net interest expense of \$283 (2007 – \$261) was recorded related to the financial assets and financial liabilities not classified as held-for-trading. In addition, \$12 (2007 – \$24) of income from cash and cash equivalents and short term investments, held by Glenhuron Bank Limited (“Glenhuron”), a wholly owned subsidiary of the Company located in Barbados, were recognized in net short term interest income. Interest income on security deposits were also earned by Glenhuron.

Interest and dividends on capital securities paid in 2008 were \$402 (2007 – \$397), and interest received in 2008 was \$132 (2007 – \$128).

### Note 6. Income Taxes

The effective income tax rate in the consolidated statements of earnings is reported at a rate different than the weighted average basic Canadian federal and provincial statutory income tax rate for the following reasons:

	2008	2007
Weighted average basic Canadian federal and provincial statutory income tax rate	<b>30.8%</b>	33.2%
Net increase (decrease) resulting from:		
Earnings in jurisdictions taxed at rates different from the Canadian statutory income tax rates	<b>(3.2)</b>	1.4
Non-taxable amounts	<b>(0.3)</b>	(1.5)
Impact of statutory income tax rate changes on future income tax balances	–	(2.3)
Other	<b>1.8</b>	0.2
Effective income tax rate	<b>29.1%</b>	31.0%

Net income taxes paid in 2008 were \$122 (2007 – \$220).

The cumulative effects of changes in Canadian federal and certain provincial statutory income tax rates on future income tax assets and liabilities are included in the consolidated financial statements at the time of substantive enactment. Accordingly, in 2007 an \$11 net reduction to the future income tax expense was recognized as a result of the change in the Canadian federal and certain provincial statutory income tax rates.

The income tax effects of temporary differences that gave rise to significant portions of the future income tax assets (liabilities) were as follows:

	2008	2007
Accounts payable and accrued liabilities	\$ 32	\$ 47
Other liabilities	146	120
Fixed assets	(294)	(259)
Other assets	(101)	(89)
Losses carried forward (expiring 2015 to 2028)	78	41
Other	9	16
<b>Net future income tax liabilities</b>	<b>\$ (130)</b>	<b>\$ (124)</b>
	2008	2007
Recorded in the consolidated balance sheets as follows:		
Current future income tax assets	\$ 41	\$ 56
Non-current future income tax liabilities	(171)	(180)
<b>Net future income tax liabilities</b>	<b>\$ (130)</b>	<b>\$ (124)</b>

**Note 7. Basic and Diluted Net Earnings per Common Share** (\$, except where otherwise indicated)

	2008	2007
Net earnings for basic earnings per share (\$ millions)	\$ 545	\$ 330
Dividends on capital securities (\$ millions) (note 21)	8	-
Net earnings for diluted earnings per share (\$ millions)	553	330
Weighted average common shares outstanding (in millions) (note 20)	274.2	274.2
Dilutive effect of stock-based compensation (in millions)	0.1	-
Dilutive effect of capital securities (in millions) (note 19)	3.6	-
Diluted weighted average common shares outstanding (in millions)	277.9	274.2
<b>Basic and diluted net earnings per common share (\$)</b>	<b>\$ 1.99</b>	<b>\$ 1.20</b>

Stock options outstanding with an exercise price greater than the market price of the Company's common shares at January 3, 2009 were not recognized in the computation of diluted net earnings per common share. Accordingly, 4,690,732 (2007 – 6,390,459) stock options, with a weighted average exercise price of \$52.98 (2007 – \$52.67) per common share, were excluded from the computation of diluted net earnings per common share.

## Notes to the Consolidated Financial Statements

### Note 8. Cash and Cash Equivalents

The components of cash and cash equivalents as at January 3, 2009 and December 29, 2007 were as follows:

	2008	2007
Cash	\$ 42	\$ 61
Cash equivalents – short term investments with a maturity of 90 days or less:		
Bank term deposits	–	77
Government treasury bills	219	109
Government-sponsored debt securities	58	59
Corporate commercial paper	209	124
Cash and cash equivalents	\$ 528	\$ 430

The Company recognized an unrealized foreign currency exchange gain of \$210 (2007 – loss of \$155) as a result of translating its United States dollar denominated cash and cash equivalents, short term investments and security deposits which are included in other assets, of which a gain of \$87 (2007 – loss of \$60) related to cash and cash equivalents. The resulting gain or loss on cash and cash equivalents, short term investments and security deposits which are included in other assets is partially offset in operating income and accumulated other comprehensive income by the unrealized foreign currency exchange loss or gain on the cross currency swaps as described in note 24.

### Note 9. Accounts Receivable

The components of accounts receivable as at January 3, 2009 and December 29, 2007 were as follows:

	2008	2007
Credit card receivables	\$ 2,206	\$ 2,023
Amount securitized	(1,775)	(1,475)
Net credit card receivables	431	548
Other receivables	436	337
Accounts receivable	\$ 867	\$ 885

**Credit Card Receivables** The Company, through *PC* Bank, securitizes certain credit card receivables by selling them to independent trusts that issue interest bearing securities. When *PC* Bank sells credit card receivables, it retains servicing responsibilities, certain administrative responsibilities and the rights to future cash flows after obligations to investors have been met. These retained interests have been designated as held-for-trading and are carried at their fair value in accounts receivable. The fair value of these retained interests was estimated using management's best estimate of the net present value of expected future cash flows using key assumptions. Although *PC* Bank remains responsible for servicing all credit card receivables, it does not receive additional compensation for servicing those credit card receivables sold to the independent trusts.



During 2008, \$300 (2007 – \$225) of credit card receivables were securitized through the sale of a portion of the total interest in these receivables to independent trusts. A portion of the securitized receivables are in an independent trust facility with a term of 364 days, subject to annual renewal. If the term of this facility is not renewed, collections will be accumulated prior to the expiry and the amount of that portion of the securitized receivables will be repaid to the independent trusts. The securitization yielded a \$1 gain (2007 – \$1) on the initial sale inclusive of \$1 (2007 – nil) servicing liability. During 2008, PC Bank received income of \$176 (2007 – \$141) in securitization revenue from the independent trusts relating to the securitized credit card receivables. An increase in servicing liability of \$1 (2007 – \$2) was recognized during the year on securitization and the fair value at year end of recognized servicing liabilities was \$11 (2007 – \$10). The trusts' recourse to PC Bank's assets is limited to PC Bank's retained interests and is further supported by the Company through standby letters of credit for \$116 (2007 – \$89) on a portion of the securitized amount (see note 27).

Net credit loss experience of \$35 (2007 – \$11) includes \$99 (2007 – \$57) of credit losses on the total portfolio of credit card receivables net of credit losses of \$64 (2007 – \$46) relating to securitized credit card receivables.

The following table displays the sensitivity of the current fair value of retained interests to an immediate 10% and 20% adverse change in the 2008 key economic assumptions. The sensitivity analysis provided in the table is hypothetical and should be used with caution. The sensitivities of each key assumption have been calculated independently of any changes in other key assumptions. Actual experience may result in changes in a number of key assumptions simultaneously. Changes in one factor may result in changes in another, which could amplify or reduce the impact of such assumptions.

	Change in Assumptions		
	2008	10%	20%
Carrying value of retained interests	\$ 14		
Payment rate (monthly)	41.56%	\$ (1)	\$ (2)
Weighted average life (years)	0.7		
Expected credit losses	5.35%	\$ (2)	\$ (4)
Annual discount rate applied to residual cash flows	7.65%		
Net Yield	13.00%	\$ (4)	\$ (9)
Cost of Funds	3.65%	\$ (1)	\$ (3)

The details on the cash flows from securitization are as follows:

	2008	2007
Proceeds from new securitizations	\$ 300	\$ 225
Net cash flows received on retained interests	\$ 177	\$ 143

Credit card receivables that are past due of \$7 as at January 3, 2009 are not classified as impaired as they are less than 90 days past due and most receivables are reasonably expected to remedy the past due status. Any credit card receivable balances with a payment that is contractually 180 days in arrears or where the likelihood of collection is considered remote are written-off. Concentration of credit risk with respect to receivables is limited due to the Company's customer base being diverse. Credit risk on the credit card receivables is managed as described in note 26.

**Other Receivables** Other receivables consist mainly of receivables from independent franchisees, associated stores and independent accounts. Other receivables that are past due but not impaired totaled \$79 as at January 3, 2009, of which a nominal amount were more than 60 days past due.

## Notes to the Consolidated Financial Statements

### Note 10. Allowances for Receivables

The allowance for credit card receivables recorded in the consolidated balance sheets is maintained at a level which is considered adequate to absorb credit related losses on credit card receivables. The allowance for credit card losses is recorded in accounts receivables in the consolidated balance sheets. The allowance for other receivables from associated stores and independent accounts is recorded in accounts receivable on the consolidated balance sheets. A continuity of the Company's allowances for losses is as follows:

#### Credit Card Receivables

	January 3, 2009	December 29, 2007
Allowance at beginning of year	\$ (13)	\$ (11)
Provision for losses	(35)	(11)
Recoveries	(14)	(7)
Write-offs	47	16
Allowance at end of year	\$ (15)	\$ (13)

#### Other Receivables

	January 3, 2009	December 29, 2007
Allowance at beginning of year	\$ (35)	\$ (37)
Provision for losses	(81)	(79)
Write-offs	92	81
Allowance at end of year	\$ (24)	\$ (35)

### Note 11. Inventories

The cost of merchandise inventories recognized as an expense during the year ended January 3, 2009 was \$23,891. The Company recorded \$16 as an expense for the write-down of inventories below cost to net realizable value for inventories recorded as at January 3, 2009. There was no reversal of inventories written down previously that are no longer estimated to sell below cost.

## Note 12. Fixed Assets

	2008			2007		
	Cost	Accumulated Depreciation	Net Book Value	Cost	Accumulated Depreciation	Net Book Value
Properties held for development	\$ 556	–	\$ 556	\$ 525	–	\$ 525
Properties under development	164	–	164	89	–	89
Land	1,753	–	1,753	1,709	–	1,709
Buildings	5,471	\$ 1,454	4,017	5,292	\$ 1,254	4,038
Equipment and fixtures	4,266	3,033	1,233	4,108	2,857	1,251
Building and leasehold improvements	517	255	262	518	238	280
	<b>12,727</b>	<b>4,742</b>	<b>7,985</b>	12,241	4,349	7,892
Capital leases – buildings and equipment	170	110	60	164	103	61
	<b>\$ 12,897</b>	<b>\$ 4,852</b>	<b>\$ 8,045</b>	\$ 12,405	\$ 4,452	\$ 7,953

The following items were recognized in operating income during 2008: fixed asset impairment charge of \$29 (2007 – \$33) and accelerated depreciation charge of \$11 (2007 – \$3).

## Note 13. Other Assets

	2008	2007
Security deposits	\$ 437	\$ 322
Accrued benefit plan asset (note 14)	273	181
Franchise investments and other receivables	203	217
Unrealized cross currency swaps receivable (note 24)	107	270
Deferred charges and other	153	154
	<b>\$ 1,173</b>	\$ 1,144

Included in deferred charges and other above are \$21 (2007 – \$9) of unrealized interest rate swap receivable and \$7 (2007 – \$5) related to an electricity forward contract (see note 24).

## Note 14. Employee Future Benefits

### Pension and Other Benefit Plans

The Company sponsors a number of pension plans, including registered funded defined benefit pension plans, defined contribution pension plans and supplemental unfunded arrangements providing pension benefits in excess of statutory limits. Certain obligations of the Company to these supplemental pension arrangements are secured by a standby letter of credit issued by a major Canadian chartered bank. The Company's defined benefit pension plans are predominantly non-contributory and these benefits are, in general, based on career average earnings.

## Notes to the Consolidated Financial Statements

A national defined contribution pension plan for salaried employees was introduced by the Company during 2006. All eligible salaried employees were given the option to join this new plan and convert their past accrued pension benefits or to remain in their existing defined benefit pension plans. All new salaried employees participate only in the national defined contribution pension plan.

The Company also offers certain employee post-retirement and post-employment benefit plans and a long term disability benefit plan. Post-retirement and post-employment benefit plans are generally not funded, are mainly non-contributory and include health care, life insurance and dental benefits. Employees eligible for post-retirement benefits are those who retire at certain retirement ages and employees eligible for post-employment benefits are those on long term disability leave. The majority of post-retirement health care plans for current and future retirees include a limit on the total benefits payable by the Company.

The Company also contributes to various multi-employer pension plans that provide pension benefits.

The accrued benefit plan obligations and the fair value of the benefit plan assets were determined using a September 30 measurement date for accounting purposes.

### **Funding of Pension and Other Benefit Plans**

The most recent actuarial valuations of the defined benefit pension plans for funding purposes ("funding valuations") were performed as at December 31, 2006 or December 31, 2007. The Company is required to file funding valuations at least every three years; the next funding valuations for two plans will be prepared as at December 31, 2008 and for the remainder no later than December 31, 2009 and 2010.

Total cash payments made by the Company during 2008, consisting of contributions to funded defined benefit pension plans, defined contribution pension plans, multi-employer pension plans, long term disability benefit plan and benefits paid directly to beneficiaries of the supplemental unfunded defined benefit pension plans and other benefit plans, were \$215 (2007 – \$183).

During 2009, the Company expects to contribute approximately \$100 to its registered funded defined benefit pension plans. This estimate may vary subject to the completion of actuarial valuations, market performance and regulatory requirements. The Company also expects to make contributions in 2009 to defined contribution pension plans and multi-employer pension plans as well as benefit payments to the beneficiaries of the supplemental unfunded defined benefit pension plans and other benefit plans.

## Pension and Other Benefit Plans Status

Information on the Company's defined benefit pension plans and other benefit plans, in aggregate, was as follows:

	2008			2007		
	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>	Total	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>	Total
<b>Benefit Plan Assets</b>						
Fair value, beginning of year	\$ 1,161	\$ 33	\$ 1,194	\$ 1,052	\$ 44	\$ 1,096
Actual (loss) return on plan assets	(145)	2	(143)	91	1	92
Employer contributions	142	11	153	77	10	87
Employee contributions	2	1	3	2	2	4
Benefits paid	(81)	(24)	(105)	(61)	(23)	(84)
Transfers to national defined contribution pension plan	(23)	-	(23)	-	-	-
Other	-	-	-	-	(1)	(1)
Fair value, end of year	\$ 1,056	\$ 23	\$ 1,079	\$ 1,161	\$ 33	\$ 1,194
<b>Accrued Benefit Plan Obligations</b>						
Balance, beginning of year	\$ 1,232	\$ 319	\$ 1,551	\$ 1,262	\$ 308	\$ 1,570
Current service cost	47	38	85	52	44	96
Interest cost	69	18	87	65	16	81
Benefits paid	(81)	(24)	(105)	(61)	(23)	(84)
Actuarial gain	(85)	(28)	(113)	(87)	(22)	(109)
Contractual termination costs <sup>(2)</sup>	-	-	-	7	-	7
Special termination costs <sup>(2)</sup>	-	-	-	6	-	6
Curtailment gains <sup>(3)</sup>	-	-	-	(11)	(2)	(13)
Transfers to national defined contribution pension plan	(23)	-	(23)	-	-	-
Other	2	-	2	(1)	(2)	(3)
Balance, end of year	\$ 1,161	\$ 323	\$ 1,484	\$ 1,232	\$ 319	\$ 1,551
<b>Deficit of Plan Assets Versus Plan Obligations</b>						
Unamortized past service costs	2	(5)	(3)	2	(6)	(4)
Unamortized net actuarial loss	334	97	431	193	137	330
Net accrued benefit plan asset (liability)	\$ 231	\$ (208)	\$ 23	\$ 124	\$ (155)	\$ (31)
Recorded in the consolidated balance sheets as follows:						
Other assets (note 13)	\$ 273	\$ -	\$ 273	\$ 170	\$ 11	\$ 181
Other liabilities (note 17)	(42)	(208)	(250)	(46)	(166)	(212)
Net accrued benefit plan asset (liability)	\$ 231	\$ (208)	\$ 23	\$ 124	\$ (155)	\$ (31)

(1) Other benefit plans include post-retirement, post-employment and long term disability benefit plans.

(2) Contractual and special termination costs resulted from the 2007 Project Simplify, which involves the restructuring and streamlining of the Company's merchandising and store operations, were recorded in restructuring and other charges in 2007 (see note 4).

(3) Certain defined benefit pension plans and other benefit plans affected by the 2007 Project Simplify to restructure and streamline the Company's merchandising and store operations were re-measured as at March 31, 2007 and costs subsequent to April 1, 2007 were determined using a discount rate of 5.0%. This resulted in a nominal impact to 2007 net earnings and curtailment gains which were offset against unamortized net actuarial losses for those plans.

## Notes to the Consolidated Financial Statements

### Funded Status of Plans in a Deficit

Included in the accrued benefit plan obligations and the fair value of benefit plan assets at year end are the following amounts in respect of plans with accrued benefit plan obligations in excess of benefit plan assets:

	2008		2007	
	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>
Fair Value of Benefit Plan Assets	\$ 977	\$ 23	\$ 326	\$ 33
Accrued Benefit Plan Obligations	1,083	323	424	319
Deficit of Plan Assets versus Plan Obligations	\$ (106)	\$ (300)	\$ (98)	\$ (286)

(1) Other benefit plans include post-retirement, post-employment and long term disability benefit plans.

### Asset Allocations

The benefit plan assets are held in trust and at September 30 consisted of the following asset categories:

Percentage of Plan Assets	2008		2007	
	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>
Asset Category				
Equity securities	62%	– %	63%	–%
Debt securities	37%	99%	35%	91%
Cash and cash equivalents	1%	1%	2%	9%
Total	100%	100%	100%	100%

(1) Other benefit plans include post-employment and long term disability benefit plans.

Pension benefit plan assets include securities issued by the Company's majority shareholder, George Weston Limited ("Weston") and by Loblaw having a fair value of nil and \$2 (2007 – \$5 and \$1), respectively, as at September 30, 2008. Other benefit plan assets do not include any Weston or Loblaw securities.

## Pension and Other Benefit Plans Cost

The total net cost for the Company's benefit plans and multi-employer pension plans was as follows:

	2008		2007	
	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>
Current service cost, net of employee contributions	\$ 45	\$ 37	\$ 50	\$ 42
Interest cost on plan obligations	69	18	65	16
Actual loss (return) on plan assets	145	(2)	(91)	(1)
Actuarial gain	(85)	(28)	(87)	(22)
Contractual termination costs <sup>(2)</sup>	-	-	7	-
Special termination costs <sup>(2)</sup>	-	-	6	-
Curtailment loss <sup>(2)</sup>	-	-	2	-
Defined benefit plan cost (income), before adjustments to recognize the long term nature of employee future benefit costs	174	25	(48)	35
(Shortfall) excess of actual return over expected return on plan assets	(230)	-	9	(1)
Excess of amortized net actuarial loss over actual actuarial gain on accrued benefit obligation	91	40	99	34
Shortfall of amortized past service costs over actual past service costs	-	(1)	-	(1)
Net defined benefit plan cost	35	64	60	67
Defined contribution plan cost	11	-	10	-
Multi-employer pension plan cost	51	-	50	-
Net benefit plan cost	\$ 97	\$ 64	\$ 120	\$ 67
Recognized in the consolidated statements of earnings as follows:				
Pension and other benefit plan costs	\$ 97	\$ 64	\$ 105	\$ 67
Restructuring and other charges <sup>(2)</sup>	-	-	15	-
Net benefit plan cost	\$ 97	\$ 64	\$ 120	\$ 67

(1) Other benefit plans include post-retirement, post-employment and long term disability benefit plans.

(2) Contractual and special termination costs and curtailment losses resulted from the 2007 Project Simplify, which involves the restructuring and streamlining of the Company's merchandising and store operations, were recorded in restructuring and other charges in 2007 (see note 4).

## Notes to the Consolidated Financial Statements

### Plan Assumptions

The significant annual weighted average actuarial assumptions used in calculating the Company's accrued benefit plan obligations as at the measurement date of September 30 and the net defined benefit plan cost for the year were as follows:

	2008		2007	
	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>
Accrued Benefit Plan Obligations				
Discount rate	6.0%	5.8%	5.5%	5.3%
Rate of compensation increase	3.5%		3.5%	
Net Defined Benefit Plan Cost				
Discount rate <sup>(2)</sup>	5.5%	5.3%	5.0%	5.0%
Expected long term rate of return on plan assets	7.5%	5.0%	7.75%	5.0%
Rate of compensation increase	3.5%		3.5%	

(1) Other benefit plans include post-retirement, post-employment and long term disability benefit plans.

(2) Certain defined benefit pension plans and other benefit plans affected by the 2007 Project Simplify to restructure and streamline the Company's merchandising and store operations were re-measured as at March 31, 2007 and costs subsequent to April 1, 2007 were determined using a discount rate of 5.0%. This resulted in a nominal impact to 2007 net earnings and curtailment gains which were offset against unamortized net actuarial losses for those plans.

The growth rate of health care costs, primarily drug and other medical costs for other benefit plans, was estimated at 10.0% (2007 – 10.0%) and is assumed to gradually decrease to 5.0% by 2015 (2007 – 5.0% by 2015), remaining at that level thereafter.

### Sensitivity of Key Assumptions

The following table outlines the key assumptions for 2008 and the sensitivity of a 1% change in each of these assumptions on the accrued benefit plan obligations and on the benefit plan cost for defined benefit pension plans and other benefit plans. The table reflects the impact on the current service and interest cost components for the discount rate and expected growth rate of health care costs assumptions.

The sensitivity analysis provided in the table is hypothetical and should be used with caution. The sensitivities of each key assumption have been calculated independently of any changes in other key assumptions. Actual experience may result in changes in a number of key assumptions simultaneously. Changes in one factor may result in changes in another, which could amplify or reduce the impact of such assumptions.

	Pension Benefit Plans		Other Benefit Plans <sup>(1)</sup>	
	Accrued Benefit Plan Obligations	Benefit Plan Cost <sup>(2)</sup>	Accrued Benefit Plan Obligations	Benefit Plan Cost <sup>(2)</sup>
Expected long term rate of return on plan assets		7.5%		5.0%
Impact of: 1% increase	n/a	\$ (11)	n/a	\$ -
1% decrease	n/a	\$ 11	n/a	\$ -
Discount rate	6.0%	5.5%	5.8%	5.3%
Impact of: 1% increase	\$ (160)	\$ (8)	\$ (36)	\$ (3)
1% decrease	\$ 186	\$ 9	\$ 42	\$ 3
Expected growth rate of health care costs <sup>(3)</sup>			9.5%	10.0%
Impact of: 1% increase	n/a	n/a	\$ 31	\$ 5
1% decrease	n/a	n/a	\$ (27)	\$ (4)

n/a – not applicable

(1) Other benefit plans include post-retirement, post-employment and long term disability benefit plans.

(2) Discount rate and expected growth rate of health care costs sensitivity is for current service and interest costs only.

(3) Gradually decreasing to 5.0% by 2015 (2007 – 5.0% by 2015) for the accrued benefit plan obligation and the benefit plan cost, and remaining at that level thereafter.



## Note 15. Short Term Debt

In 2008, the Company entered into an \$800 5-year committed credit facility provided by a syndicate of banks which contains certain financial covenants (see note 21). This facility is the primary source of the Company's short term funding requirements and permits borrowings having up to a 180-day term. Interest is based on a floating rate, primarily the bankers' acceptance rate and an applicable margin based on the Company's credit rating. This facility replaced a \$500, 364-day committed credit facility. As at January 3, 2009, \$190 was drawn on the new 5-year committed credit facility. In 2008, short term debt included nil (2007 – \$418) of commercial paper.

## Note 16. Long Term Debt

	2008	2007
<b>Loblaw Companies Limited Notes</b>		
6.00%, due 2008	\$ –	\$ 390
5.75%, due 2009	125	125
7.10%, due 2010	300	300
6.50%, due 2011	350	350
5.40%, due 2013	200	200
6.00%, due 2014	100	100
7.10%, due 2016	300	300
6.65%, due 2027	100	100
6.45%, due 2028	200	200
6.50%, due 2029	175	175
11.40%, due 2031		
– principal	151	151
– effect of coupon repurchase	(55)	(44)
6.85%, due 2032	200	200
6.54%, due 2033	200	200
8.75%, due 2033	200	200
6.05%, due 2034	200	200
6.15%, due 2035	200	200
5.90%, due 2036	300	300
6.45%, due 2039	200	200
7.00%, due 2040	150	150
5.86%, due 2043	55	55
<b>Private Placement Notes</b>		
6.48%, due 2013 (US \$150 million)	180	–
6.86%, due 2015 (US \$150 million)	181	–
Other at a weighted average interest rate of 11.50%, due 2009 to 2043	9	17
VIE loans payable (i) (see note 27)	152	153
Capital lease obligations (i) (see note 18)	62	62
<b>Total long term debt</b>	<b>4,235</b>	<b>4,284</b>
<b>Less amount due within one year</b>	<b>165</b>	<b>432</b>
	<b>\$ 4,070</b>	<b>\$ 3,852</b>

(i) Pursuant to the requirements of AcG 15, the consolidated balance sheet as at January 3, 2009 includes \$179 (2007 – \$183) of loans payable and capital lease obligations of VIEs consolidated by the Company, \$35 (2007 – \$32) of which is due within one year.

## Notes to the Consolidated Financial Statements

During 2008, the Company issued United States Dollar ("USD") \$300 of fixed rate notes in a private placement debt financing which contains certain financial covenants (see note 21). The notes were issued in two equal tranches of USD \$150 with 5 and 7 year maturities at interest rates of 6.48% and 6.86%, respectively. The Company entered into fixed cross currency swaps, a portion of which are designated as cash flow hedges to manage the foreign exchange risk. As at January 3, 2009, \$361 was recorded in long term debt on the consolidated balance sheet. For further information on the Company's policies with respect to cash flow hedges, refer to note 1.

The schedule of repayment of long term debt, inclusive of VIE and other debt, based on maturity is as follows: 2009 – \$165; 2010 – \$333; 2011 – \$381; 2012 – \$25; 2013 – \$409; thereafter – \$2,922.

During 2008, the \$390 6.00% medium term note due June 2, 2008 matured and was repaid. Subsequent to year end, the Company repaid its \$125 5.75% medium term note that matured.

See note 25 for the fair value of long term debt.

### Note 17. Other Liabilities

	2008	2007
Accrued benefit plan liability (note 14)	\$ 250	\$ 212
Deferred vendor allowances (note 29)	56	–
Unrealized interest rate swap liability (note 24)	43	28
Goods and services tax and provincial sales tax	27	23
Stock-based compensation (note 22)	12	10
Restructuring and other charges (note 4)	–	21
Other	57	74
	<b>\$ 445</b>	<b>\$ 368</b>

Included in other above is a guarantee of \$7 (2007 – \$7) which is a financial liability related to the standby letter of credit issued by a major Canadian chartered bank for the benefit of an independent funding trust.

### Note 18. Leases

#### As Lessee

Future minimum lease payments relating to the Company's operating leases are as follows:

	Payments due by year						2008 Total	2007 Total
	2009	2010	2011	2012	2013	Thereafter to 2046		
Operating lease payments	\$ 207	\$ 189	\$ 166	\$ 143	\$ 125	\$ 793	<b>\$ 1,623</b>	\$ 1,423
Expected sub-lease income	(33)	(29)	(23)	(18)	(16)	(64)	<b>(183)</b>	(172)
Net operating lease payments	<b>\$ 174</b>	<b>\$ 160</b>	<b>\$ 143</b>	<b>\$ 125</b>	<b>\$ 109</b>	<b>\$ 729</b>	<b>\$ 1,440</b>	<b>\$ 1,251</b>

### **As Lessor**

Fixed assets on the consolidated balance sheets include cost of properties held for leasing purposes of \$603 (2007 – \$571) and related accumulated depreciation of \$173 (2007 – \$163). Rental income for the year ended January 3, 2009 from these operating leases totaled \$45 (2007 – \$49).

### **Capital Leases**

Capital lease obligations of \$62 (2007 – \$62) are included in the consolidated balance sheet as at year end (see note 16). The capital lease obligations are related primarily to equipment of the third-party VIE that provides distribution and warehousing services. The amount due within one year is \$8 (2007 – \$9).

### **Sale-Leaseback**

In 2007, the Company completed a sale-leaseback transaction of property and a partially constructed building (“Property”) for a total purchase price of \$109, subject to a vendor take back mortgage of \$35 (2007 – \$27) which bears interest at 6% due in 2009. There was no gain or loss recorded on the sale of the Property. The Company has leased back the Property for a term of 20 years, with options to renew for an additional 20 years, and in turn subleased the Property to a third-party logistics provider. In 2008, the leaseback was accounted for as an operating lease. The Company also entered into a warehousing and distribution agreement with the third-party logistics provider, which will use this Property to provide services to Loblaw.

### **Note 19. Capital Securities** (\$, except where otherwise indicated)

**Second Preferred Shares, Series A (authorized – 12.0 million shares)** During the third quarter of 2008, the Company issued 9.0 million 5.95% non-voting Second Preferred Shares, Series A, with a face value of \$225 million for net proceeds of \$218 million, which entitle the holder to a fixed cumulative preferred cash dividend of \$1.4875 per share per annum which will, if declared, be payable quarterly. On and after July 31, 2013, the Company may, at its option, redeem for cash, in whole or in part, these outstanding preferred shares as follows:

On or after July 31, 2013 at \$25.75 per share, together with all accrued and unpaid dividends to but not including the redemption date;  
On or after July 31, 2014 at \$25.50 per share, together with all accrued and unpaid dividends to but not including the redemption date; and  
On or after July 31, 2015 at \$25.00 per share, together with all accrued and unpaid dividends to but not including the redemption date.

On and after July 31, 2013, the Company may, at its option, convert these preferred shares into that number of common shares of the Company determined by dividing the then applicable redemption price, together with all accrued and unpaid dividends to but excluding the date of conversion, by the greater of \$2.00 and 95% of the then current market price of the common shares. On and after July 31, 2015, these outstanding preferred shares are convertible, at the option of the holder, into that number of common shares of the Company determined by dividing \$25.00, together with accrued and unpaid dividends to but excluding the date of conversion, by the greater of \$2.00 and 95% of the then current market price of the common shares. This option is subject to the Company’s right to redeem the preferred shares for cash or arrange for their sale to substitute purchasers. These preferred shares which are presented as Capital Securities on the Consolidated Balance Sheet are classified as other financial liabilities, and measured using the effective interest method.

## Notes to the Consolidated Financial Statements

### Note 20. Common Share Capital (authorized – unlimited)

The changes in the common shares issued and outstanding during the year were as follows:

	2008		2007	
	Number of Common Shares	Common Share Capital	Number of Common Shares	Common Share Capital
Issued and outstanding, beginning and end of year	274,173,564	\$ 1,196	274,173,564	\$ 1,196
Weighted average outstanding	274,173,564		274,173,564	

Approximately 62% of the common shares are owned by George Weston Limited; the remaining shares are widely held.

**Normal Course Issuer Bids** In the second quarter of 2008, Loblaw renewed its Normal Course Issuer Bid (“NCIB”) to purchase on the Toronto Stock Exchange, or enter into equity derivatives to purchase, up to 13,708,678 of Company’s common shares, representing approximately 5% of the common shares outstanding. In accordance with the rules and by-laws of the Toronto Stock Exchange, Loblaw may purchase its shares at the then market price of such shares. The Company did not purchase any shares under its NCIB during fiscal 2008 or 2007.

### Note 21. Capital Management

The Company defines capital as net debt, capital securities and shareholders’ equity. Equity for the purpose of calculating the net debt to equity ratio is defined by the Company as capital securities and shareholders’ equity. The Company’s objectives when managing capital are to:

- ensure sufficient liquidity to support its financial obligations and execute its operating and strategic plans;
- maintain financial capacity and access to capital to support future development of the business;
- minimize the cost of its capital while taking into consideration current and future industry, market and economic risks and conditions;
- utilize short term funding sources to manage its working capital requirements and long term funding sources to match the long term nature of the fixed assets of the business.

The following ratios are used by the Company to monitor its capital:

	As at January 3, 2009	As at December 29, 2007
Interest coverage <sup>(1)</sup>	3.7:1	2.7:1
Net debt to equity <sup>(1)</sup>	.54:1	.67:1

Interest coverage is calculated as operating income divided by interest expense and other financing charges adding back interest capitalized to fixed assets. The interest coverage ratio is calculated for the 53 week period ended January 3, 2009 and for the 52 week period ended December 29, 2007. The Company manages debt on a net basis as outlined below. The net debt to equity ratio continued to be within the Company’s internal guideline of less than 1:1. This ratio is useful in assessing the amount of leverage employed. These ratios are also calculated from time-to-time on an alternative basis by management to approximate the methodology of debt rating agencies and other market participants.

(1) See Non-GAAP Financial Measures on page 33.

## Debt

The following table details the net debt calculation used in the net debt to equity ratio as at the periods ended as indicated:

(\$ millions)	As at January 3, 2009	As at December 29, 2007
Bank indebtedness	\$ 52	\$ 3
Short term debt	190	418
Long term debt due within one year	165	432
Long term debt	4,070	3,852
Less: Cash and cash equivalents	528	430
Short term investments	225	225
Security deposits included in other assets	437	322
Net debt <sup>(1)</sup>	\$ 3,287	\$ 3,728

Capital securities are excluded from the calculation of net debt because the Company at its option can convert the Second Preferred Shares into common shares.

Security deposits consist primarily of Government treasury bills and Government-sponsored debt securities which Glenhuron is required to place with counterparties as collateral to enter into and maintain outstanding derivatives and equity forwards. The amount of the required security deposits will fluctuate primarily as a result of the change in market value of the derivatives.

The Company monitors its credit ratings as part of its goal to maintain access to capital markets for its liquidity requirements. The Company's ability to obtain funding from external sources may be restricted by downgrades in the Company's credit rating and should the Company's financial performance and condition deteriorate. In addition, credit and capital markets are subject to inherent global risks that may negatively affect the Company's access and ability to fund its short term and long term debt requirements. The Company mitigates these risks by maintaining appropriate levels of cash and cash equivalents and short term investments, actively monitoring market conditions and diversifying its capital sources and maturity profile. The Company also employs risk management strategies including forward-looking liquidity contingency plans.

During the second quarter of 2008, the Company filed a Short Form Base Shelf Prospectus ("Prospectus") allowing for the potential issue of up to \$1 billion of unsecured debentures and/or preferred shares subject to the availability of funding by capital markets. During the third quarter of 2008, the Company issued preferred shares under the Prospectus (see note 19).

## Dividends (\$)

The declaration and payment of dividends and the amount thereof are at the discretion of the Board of Directors of the Company ("Board") which takes into account the Company's financial results, capital requirements, available cash flow and other factors the Board considers relevant from time to time. Over the long term, the Company's objective is for its dividend payment ratio to be in the range of 20% to 25% of the prior year's basic net earnings per common share adjusted as appropriate for items which are not regarded to be reflective of ongoing operations giving consideration to the year end cash position, future cash flow requirements and investment opportunities. During 2008, the Board declared common share dividends of \$0.84 (2007– \$0.84) per common share. During 2008, the Board of Directors declared dividends of \$0.911275 per second preferred share. For financial statement presentation purposes, preferred share dividends of \$8 million are included as a component of interest expense and other financing charges on the Consolidated Statement of Earnings for the year ended January 3, 2009 (see note 5).

(1) See Non-GAAP Financial Measures on page 33.

## Notes to the Consolidated Financial Statements

The Series A Second Preferred Shares rank after the First Preferred Shares to the extent that there is a conflict between the preferences, priorities and rights attaching to the two classes of preferred shares, and shall be entitled to preferences over the common shares with respect to the priority in the payment of dividends and with respect to the priority in the distribution of assets of the Company in the event of the liquidation, dissolution or winding up of the Company. The Company has 1.0 million non-voting First Preferred Shares which are authorized of which none were outstanding at year end.

### Covenants and Regulatory Requirements

The committed credit facility which the Company entered into during the first quarter of 2008 (see note 15) and the USD \$300 fixed-rate private placement notes which the Company issued during the second quarter of 2008 (see note 16) both contain certain financial covenants. The covenants under both agreements include maintaining an interest coverage ratio as well as a leverage ratio, which the Company measures on a quarterly basis. These ratios are defined in the respective agreements. As at January 3, 2009, the Company was in compliance with these covenants.

The Company is also subject to externally imposed capital requirements from the Office of the Superintendent of Financial Institutions ("OSFI"), as the primary regulator of PC Bank, and the Central Bank of Barbados, as the primary regulator of Glenhuron, both wholly-owned subsidiaries of the Company. PC Bank's capital management objectives are to maintain a consistently strong capital position while considering the Bank's economic risks and to meet all regulatory capital requirements as defined by OSFI. A new regulatory capital management framework, Basel II, has been implemented in Canada that establishes regulatory capital requirements that are more sensitive to a bank's risk profile. PC Bank met all applicable capital targets as at the end of 2008. Glenhuron is currently regulated under Basel I. Under Basel I, Glenhuron's assets are risk weighted and the minimum ratio of capital to risk weighted assets is 8.0%. Glenhuron's ratio of capital to risk weighted assets met the minimum requirements under Basel I as at January 3, 2009.

### Note 22. Stock-Based Compensation (\$, except where otherwise indicated)

The Company maintains various types of stock-based compensation plans, which are described below.

The Company's net stock-based compensation cost recognized in operating income related to its stock option plan, the associated equity forwards and the restricted share unit plan was as follows:

(\$ millions)	2008	2007
Stock option plan expense	\$ 8	\$ -
Equity forwards (gain) loss (note 24)	(10)	67
Restricted share unit plan expense	9	5
Net stock-based compensation cost	\$ 7	\$ 72

**Stock Option Plan** The Company maintains a stock option plan for certain employees. Under this plan, the Company may grant options for up to 13.7 million common shares which is the Company's guideline on the number of stock option grants up to a maximum of 5% of outstanding common shares at any time. Stock options have up to a seven-year term, vest 20%-33% cumulatively on each anniversary date of the grant and are exercisable at the designated common share price, which is 100% of the market price of the Company's common shares on the last trading day prior to the effective date of the grant. Each stock option is exercisable into one common share of the Company at the price specified in the terms of the option, or option holders may elect to receive in cash the share appreciation value equal to the excess of the market price at the date of exercise over the specified option price.

During 2008, the Company granted 3,431,432 (2007 – 4,368,980) stock options with a weighted average exercise price of \$28.99 (2007 – \$47.28) per common share under its existing stock option plan which allows for settlement in shares or in the share appreciation value in cash at the option of the employee.

In 2008, the share appreciation value of nil (2007 – a nominal amount) was paid on the exercise of nil (2007 – 108,000) stock options. In 2008 and 2007, the Company did not issue common shares or receive cash consideration on the exercise of stock options.

In addition, 2,071,528 (2007 – 1,812,870) stock options were forfeited or cancelled.

At year end, a total of 7,892,660 (2007 – 6,532,756) stock options were outstanding, and represented approximately 2.9% (2007 – 2.4%) of the Company's issued and outstanding common shares, which was within the Company's guideline of 5%. Of the outstanding options, 7,892,660 (2007 – 6,491,516) relate to stock option grants that allow for settlement in shares or in the share appreciation value in cash at the option of the employee and nil (2007 – 41,240) relate to stock option grants, issued prior to December 30, 2001 that will be settled by issuing common shares.

A summary of the status of the Company's stock option plan and activity was as follows:

	2008		2007	
	Options (number of shares)	Weighted Average Exercise Price/Share	Options (number of shares)	Weighted Average Exercise Price/Share
Outstanding options, beginning of year	6,532,756	\$ 52.34	4,084,646	\$ 61.36
Granted	3,431,432	\$ 28.99	4,368,980	\$ 47.28
Exercised	–	\$ –	(108,000)	\$ 48.75
Forfeited/cancelled	(2,071,528)	\$ 48.13	(1,812,870)	\$ 60.69
Outstanding options, end of year	7,892,660	\$ 43.29	6,532,756	\$ 52.34
Options exercisable, end of year	1,971,244	\$ 56.05	1,314,278	\$ 59.00

Range of Exercise Prices	2008 Outstanding Options			2008 Exercisable Options	
	Number of Options Outstanding	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price/Share	Number of Exercisable Options	Weighted Average Exercise Price/Share
\$ 28.95 – \$ 33.10	3,201,928	6	\$ 29.10	17,668	\$ 33.03
\$ 46.01 – \$ 50.80	2,914,694	5	\$ 47.63	582,939	\$ 47.63
\$ 53.60 – \$ 69.75	1,776,038	2	\$ 61.75	1,370,637	\$ 59.92

**Restricted Share Unit Plan** The Company maintains a RSU plan for certain senior employees. The RSUs entitle employees to a cash payment after the end of each performance period, of up to 3 years, following the date of award. The RSU payment will be an amount equal to the weighted average price of a Loblaw common share on the last three trading days preceding the end of the performance period for the RSUs multiplied by the number of RSUs held by the employee.

During 2008, the Company granted 416,294 (2007 – 335,056) RSUs to 346 (2007 – 349) employees, 103,103 (2007 – 161,621) RSUs were cancelled and 252,479 (2007 – 154,700) were paid out in the amount of \$9 million (2007 – \$8 million). At year end, a total of 829,399 (2007 – 768,687) RSUs were outstanding.

## Notes to the Consolidated Financial Statements

**Employee Share Ownership Plan (“ESOP”)** The Company maintains an ESOP which allows employees to acquire the Company’s common shares through regular payroll deductions of up to 5% of their gross regular earnings. The Company contributes an additional 25% (2007 – 25%) of each employee’s contribution to the plan. The ESOP is administered through a trust which purchases the Company’s common shares on the open market on behalf of employees. A compensation cost of \$6 million (2007 – \$6 million) related to this plan was recognized in operating income.

**Deferred Share Unit Plan** Members of the Company’s Board of Directors, who are not management of the Company, may elect annually to receive all or a portion of their annual retainer(s) and fees in the form of DSUs, the value of which is determined by the market price of the Company’s common shares at the time the director’s annual retainer(s) or fees are earned. Upon termination of Board service, the common shares due to the director, as represented by the DSUs, will be purchased on the open market on the director’s behalf. At year end, 79,939 (2007 – 56,082) DSUs were outstanding. The year-over-year change in the deferred share unit compensation liability was \$1 million (2007 – a nominal amount) and was recognized in operating income.

**Executive Deferred Share Units** In 2008, the Company approved the introduction of an EDSU Plan. Under this plan, executives may elect to defer up to 100% of the STIP earned by the executive in any year into the EDSU Plan, subject to an overall cap of three times the executive’s base salary. All EDSUs held by an executive will be paid out in cash by December 15 of the year following the year in which the executive’s employment ceases for any reason. An election to participate in the plan in any year must be made before the beginning of the year and is irrevocable. The number of EDSUs granted in respect of any year will be determined by dividing the STIP bonus that is subject to the EDSU plan election by the value of the Company’s common shares on the date the STIP bonus would otherwise be payable. For this purpose, and for purposes of determining the value of a EDSU upon conversion of the EDSUs into cash, the value of the EDSUs will be calculated by using the weighted average of the trading prices of the Company’s common shares on the Toronto Stock Exchange for the five trading days prior to the valuation date.

### Note 23. Accumulated Other Comprehensive Income

The following table provides further detail regarding the composition of accumulated other comprehensive income for the years ended January 3, 2009 and December 29, 2007:

	2008			2007		
	Cash Flow Hedges	Available-for-sale Assets	Total	Cash Flow Hedges	Available-for-sale Assets	Total
Balance, beginning of year	\$ 22	\$ (3)	\$ 19	\$ –	\$ –	\$ –
Cumulative impact of implementing new accounting standards [net of income taxes of nil (2007 – \$1)] (note 2)	–	–	–	(4)	20	16
Net unrealized gain (loss) on available-for-sale financial assets [net of income taxes of \$1 (2007 – \$5)]	–	40	40	–	(56)	(56)
Reclassification of gain (loss) on available-for-sale financial assets [net of income taxes recovered of \$5 (2007 – nil)]	–	(21)	(21)	–	33	33
Net gain on derivatives designated as cash flow hedges [net of income taxes of \$22 (2007 – \$2)]	21	–	21	57	–	57
Reclassification of gain on derivatives designated as cash flow hedges [net of income taxes of \$21 (2007 – \$1)]	(29)	–	(29)	(31)	–	(31)
Balance, end of year	\$ 14	\$ 16	\$ 30	\$ 22	\$ (3)	\$ 19



An estimated net gain of \$2 (2007 – \$18) recorded in accumulated other comprehensive income related to the cash flow hedges as at January 3, 2009, is expected to be reclassified to net earnings during the next 12 months. This will be offset by the estimated loss on available-for-sale financial assets that are hedged. Remaining amounts will be reclassified to net earnings over periods up to 5 years.

## Note 24. Financial Instruments

A summary of the Company's outstanding financial derivative instruments is as follows:

	Notional Amounts Maturing						2008	2007
	2009	2010	2011	2012	2013	Thereafter	Total	Total
Cross currency swap receivable	\$ 31	\$ 199	\$ 56	\$ 166	\$ 75	\$ 654	\$ 1,181	\$ 1,100
Cross currency swap payable	\$ -	\$ -	\$ -	\$ -	\$ (148)	\$ (148)	\$ (296)	\$ -
Interest rate swaps receivable	\$ 140	\$ 50	\$ 200	\$ -	\$ -	\$ -	\$ 390	\$ 630
Interest rate swaps payable	\$ -	\$ -	\$ -	\$ -	\$ (150)	\$ -	\$ (150)	\$ (150)
Equity forwards	\$ (261)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ (261)	\$ (254)
Electricity forward contract	\$ (8)	\$ (9)	\$ (8)	\$ -	\$ -	\$ -	\$ (25)	\$ (33)

Notional amounts do not represent assets or liabilities and are therefore not recorded on the consolidated balance sheet. The notional amounts are used in order to calculate the payments to be exchanged under the contracts.

**Cross Currency Swaps** The Company entered into cross currency swaps (see note 26) to exchange United States dollars for \$1,181 (2007 – \$1,100) Canadian dollars, which mature by 2017. Cross currency swaps totalling \$320 (2007 – \$560) are designated in a cash flow hedge and the remaining undesignated \$861 (2007 – \$540) are classified as held-for-trading financial assets. Currency adjustments receivable or payable arising from these swaps are settled in cash on maturity. A cumulative unrealized foreign currency exchange rate receivable of \$36 (2007 – \$270) was recorded in other assets.

In 2008, the Company entered into fixed cross currency swaps to exchange \$296 Canadian dollars for \$300 USD, which mature by 2015. A portion of these cross currency swaps are designated in a cash flow hedge to manage the foreign exchange related to a part of the Company's fixed rate USD private placement notes (see note 16).

**Interest Rate Swaps** The Company's interest rate swaps (see note 26) convert a notional \$390 (2007 – \$630) of its floating rate available-for-sale cash and cash equivalents, short term investments and security deposits included in other assets to average fixed rate investments at 5.39% (2007 – 5.60%), which mature by 2011. At year end, the fair value of these interest rate swaps of \$21 (2007 – \$9) was recorded in other assets and the unrealized fair value gain of \$21 (2007 – \$9) is deferred, net of tax, in accumulated other comprehensive income. When realized, these unrealized gains are reclassified to net earnings.

During 2007, the Company terminated hedge accounting for its interest rate swaps previously designated as a cash flow hedge of the variable interest rate exposure on commercial paper. These interest rate swaps converted a notional \$150 of floating rate commercial paper debt to an average fixed rate debt of 8.37% which matures by 2013. As a result of this termination in 2007, the cumulative loss of \$2, net of income taxes, in accumulated other comprehensive income was reclassified to net earnings. At January 3, 2009, the fair value of these interest rate swaps of \$43 (2007 – \$28) was recorded in other liabilities.

## Notes to the Consolidated Financial Statements

**Equity Forwards (\$, except where otherwise indicated)** At year end 2008, the Company had cumulative equity forwards (see note 22) to buy 4.8 million (2007 – 4.8 million) of its common shares at a cumulative average forward price of \$54.46 (2007 – \$53.14) including \$9.59 (2007 – \$8.27) per common share of interest expense, net of dividends, that has been recognized in net earnings and will be paid at termination. The equity forwards provide for settlement of net amounts owing between the Company and its counterparty in cash or common shares. They change in value as the market price of the Company's common shares changes and provide a partial offset to fluctuations in Loblaw's stock-based compensation cost, including RSU plan expense. The partial offset between the Company's stock-based compensation costs, including RSU plan expense, and the equity forwards is effective when the market price of the Company's common shares exceed the exercise price of the related employee stock options. When the market price of the common shares is lower than the exercise price of the related employee stock options, only RSUs will provide a partial offset to these equity forwards. The amount of net stock-based compensation cost recorded in operating income is mainly dependent upon the number of unexercised stock options and RSUs, their vesting schedules relative to the number of underlying common shares on the equity forwards, the market price and fluctuations in the market price of the underlying common shares. Cumulative interest net of dividends and unrealized market loss of \$92 million (2007 – \$91 million) is included in accounts payable and accrued liabilities relating to these equity forwards. The Company is in discussions with the counterparty which may lead to the extinguishment of all or a portion of the liability.

**Electricity Forward Contract** The Company entered into an electricity forward contract to minimize price volatility and to maintain a portion of the Company's electricity costs in Alberta, Canada at approximately 2006 rates. This electricity forward contract has an initial term of five years and expires in December 2011. Loblaw is required to measure its electricity forward contract at fair value in accordance with Section 3855. At year end, the fair value of this forward contract of \$7 (2007 – \$5) was recorded in other assets. During 2008, a gain in value of \$2 (2007 – loss of \$2) was recorded in operating income.

**Fuel Exchange Traded Futures and Options** The Company entered into exchange traded futures contracts and options contracts to minimize cost volatility on fuel prices. Futures contracts establish a fixed cost on a portion of the Company's fuel exposure and option contracts typically provide protection against a range of cost outcomes. As at January 3, 2009, the Company had \$4 (2007 - nil) recorded in accounts payable and accrued liabilities related to the above contracts.

### Note 25. Fair Values of Financial Instruments

The fair value of derivative instruments is the estimated amount that the Company would receive or pay to terminate the instrument at the reporting date. The fair values have been determined by reference to prices available from the markets on which the instruments trade and prices provided by counterparties. The fair values of all derivative instruments approximated their carrying value and are recorded in other assets or other liabilities on the consolidated balance sheets.

The following tables provide a comparison of carrying and fair values for each classification of financial instruments as at January 3, 2009 and December 29, 2007:

**As at January 3, 2009**

	Financial derivatives designated in a cash flow hedge	Financial instruments required to be classified as held-for-trading	Financial instruments designated as held-for-trading	Available-for-sale instruments measured at fair value	Loans and receivables	Other financial liabilities	Total carrying amount	Total fair value
<b>Cash and cash equivalents, short term investments and security deposits</b>	\$ -	\$ -	\$ 898	\$ 292	\$ -	\$ -	\$ 1,190	\$ 1,190
<b>Accounts receivable</b>	-	-	14	-	853	-	867	867
<b>Other financial assets</b>	-	-	-	-	40	-	40	40
<b>Available for sale securities</b>	-	-	-	7	-	-	7	7
<b>Derivatives</b>	98	45	-	-	-	-	143	143
<b>Total financial assets</b>	\$ 98	\$ 45	\$ 912	\$ 299	\$ 893	\$ -	\$ 2,247	\$ 2,247
<b>Short term borrowings</b>	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 242	\$ 242	\$ 242
<b>Accounts payable and accrued liabilities</b>	-	92	-	-	-	2,731	2,823	2,823
<b>Long term debt</b>	-	-	-	-	-	4,235	4,235	3,746
<b>Capital Securities</b>	-	-	-	-	-	219	219	212
<b>Derivatives (see note 24)</b>	-	51	-	-	-	7	58	58
<b>Total financial liabilities</b>	\$ -	\$ 143	\$ -	\$ -	\$ -	\$ 7,434	\$ 7,577	\$ 7,081

The equity investment in franchises is measured at a cost of \$72 because quoted market prices in an active market are not available. These investments are classified as available-for-sale, and the Company has no intention of disposing of these equity investments.

## Notes to the Consolidated Financial Statements

As at December 29, 2007

	Financial derivatives designated in a cash flow hedge	Financial instruments required to be classified as held-for-trading	Financial instruments designated as held-for-trading	Available-for-sale instruments measured at fair value	Loans and receivables	Other financial liabilities	Total carrying amount	Total fair value
Cash and cash equivalents, short term investments and security deposits	\$ -	\$ -	\$ 533	\$ 444	\$ -	\$ -	\$ 977	\$ 977
Accounts receivable	-	-	8	-	877	-	885	885
Other financial assets	-	-	-	-	75	-	75	75
Available for sale securities	-	-	-	16	-	-	16	16
Derivatives	184	101	-	-	-	-	285	285
<b>Total financial assets</b>	<b>\$ 184</b>	<b>\$ 101</b>	<b>\$ 541</b>	<b>\$ 460</b>	<b>\$ 952</b>	<b>\$ -</b>	<b>\$ 2,238</b>	<b>\$ 2,238</b>
Short term borrowings	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 421	\$ 421	\$ 421
Accounts payable and accrued liabilities (see note 1)	-	91	-	-	-	2,769	2,860	2,860
Long term debt	-	-	-	-	-	4,284	4,284	4,216
Derivatives (see note 24)	-	29	-	-	-	7	36	36
<b>Total financial liabilities</b>	<b>\$ -</b>	<b>\$ 120</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 7,481</b>	<b>\$ 7,601</b>	<b>\$ 7,533</b>

The equity investment in franchises is measured at a cost of \$75 because quoted market prices in an active market are not available. These investments are classified as available-for-sale, and the Company has no intention of disposing of these equity investments.

During the year ended January 3, 2009, the net unrealized and realized gain on held-for-trading financial assets designated as held-for-trading, recognized in net earnings before income taxes and minority interest was \$169 (2007 – loss of \$76). In addition, the net unrealized and realized loss on held-for-trading financial assets and financial liabilities, including non-financial derivatives, required to be classified as held-for-trading, recognized in net earnings before income taxes and minority interest was \$233 (2007 – loss of \$7).

### Note 26. Financial Risk Management

The Company is exposed to the following risks as a result of holding financial instruments: credit risk, market risk and liquidity risk. The following is a description of those risks and how the exposures are managed:

**Credit Risk** The Company is exposed to credit risk resulting from the possibility that counterparties may default on their financial obligations. Exposure to credit risk relates to derivative instruments, cash and cash equivalents, short term investments, security deposits included in other assets, pension assets held in the Company's defined benefit plans, PC Bank's credit card receivables and other receivables from independent franchisees, associated stores and independent accounts.

The Company may be exposed to losses if a counterparty to the Company's financial or non-financial derivative agreements fails to fulfill its obligations.

The Company has sought to minimize potential counterparty risk and losses by conducting transactions for its derivative agreements with counterparties that have at minimum a long term "A" credit rating from a recognized credit rating agency and by placing risk adjusted limits on its exposure to any single counterparty for its financial derivative agreements. The Company has internal policies, controls and reporting processes which require ongoing assessment and corrective action, if necessary, with respect to derivative transactions. In addition, net obligations and asset amounts on cross currency swaps and equity forwards are each netted by agreement with swap counterparties.

Credit risk associated with the Company's cash equivalents, short term investments and security deposits included in other assets results from the possibility that a counterparty may default on the repayment of a security. The Company attempts to mitigate this risk through policies and guidelines that require issuers of permissible investments to have at minimum a long term "A" credit rating from a recognized credit rating agency and that specify minimum and maximum exposures to specific industries, issuers and types of investment instruments. The Company purchases and holds these investments directly in custody accounts, and has limited exposure to any third party money market portfolios and funds.

Credit risk from *PC Bank's* credit card receivables and receivables from independent franchisees, associated stores and independent accounts results from the possibility that customers may default on their payment obligation. *PC Bank* manages the credit card receivable risk by employing stringent credit scoring techniques, actively monitoring the credit card portfolio, and reviewing techniques and technology that can improve the effectiveness of the collection process. In addition, these receivables are dispersed among a large, diversified group of credit card customers.

Accounts receivable from independent franchisees, associated stores and independent accounts are actively monitored on an ongoing basis and settled on a frequent basis in accordance with the terms specified in the applicable agreements.

The Company's maximum exposure to credit risk as it relates to derivative instruments is represented by the positive fair market value of the derivatives on the balance sheet (see note 25).

Refer to note 10 for additional information on the credit quality performance of credit card receivables and other receivables from independent franchisees, associated stores and independent accounts.

**Market Risk** Market risk is the loss that may arise from changes in factors such as interest rates, foreign currency exchange rates, commodity prices, common share price and the impact these factors may have on other counterparties.

*Interest Rate Risk* The Company is exposed to interest rate risk which it manages through the use of interest rate swaps. Loblaw's interest rate risk arises from the issuance of short term debt and equity forwards, net of its cash and cash equivalents, short term investments and security deposits included in other assets. The Company manages fluctuations in its interest expense through its exposure to a mix of fixed and floating interest rates, by managing the duration of its financial instruments and by entering into interest rate swaps. The Company estimates that a 100 basis point increase (decrease) in interest rates, with all other variables held constant, would result in an increase (decrease) of \$5 to interest expense.

*Foreign Currency Exchange Rate Risk* The Company is exposed to foreign currency exchange rate variability, primarily on its United States dollar denominated cash and cash equivalents, short term investments, security deposits included in other assets, foreign denominated purchases in accounts payable and accrued liabilities, and USD private placement notes included in long term debt. To manage its foreign currency exchange rate exposure, the Company enters into cross currency swaps. As a result, a significant strengthening (weakening) of the Canadian dollar against the US dollar, with all other variables held constant, would not have a significant impact on earnings before income taxes and minority interest.

## Notes to the Consolidated Financial Statements

At year end, the Company had \$1,096 (2007 – \$801) in cash and cash equivalents, short term investments and security deposits included in other assets held by Glenhuron. To manage this risk, the Company designates a portion of its cross currency swaps in a cash flow hedge of the exposure to fluctuations in the foreign currency exchange rate on a portion of its United States dollar denominated cash equivalents, short term investments and security deposits included in other assets. The remaining undesignated cross currency swaps economically hedge exposure to fluctuations in the foreign currency exchange rate on the remaining United States dollar denominated cash and cash equivalents, short term investments, security deposits included in other assets and the USD private placement notes.

During the year, the unrealized foreign currency exchange gain of \$50 (2007 – loss of \$79), related to the cash and cash equivalents, short term investments and security deposits included in other assets classified as available-for-sale is recognized in other comprehensive income and was partially offset by the unrealized foreign currency exchange rate loss of \$51 (2007 – gain of \$72) before income taxes relating to the designated cross currency swaps also deferred in other comprehensive income. The unrealized foreign currency exchange gain of \$160 (2007 – loss of \$76) on the designated held-for-trading cash and cash equivalents, short term investments and security deposits included in other assets is partially offset in operating income by the unrealized foreign currency exchange rate loss of \$157 (2007 – gain of \$79) relating to the cross currency swaps which are not designated in a cash flow hedge. During the year, the Company realized a foreign currency exchange gain of \$26 (2007 – \$46) relating to cross currency swaps that matured or were terminated.

During 2008, the Company recognized in operating income an unrealized foreign currency exchange loss of \$65 related to the USD \$300 million fixed-rate private placement notes. This was partially offset by both the effective portion of the designated cross currency swaps that was reclassified from other comprehensive income to operating income and the fair value gain of the cross currency swaps that are not designated in a hedging relationship. At the inception of the cash flow hedge, a nominal amount of ineffectiveness was recognized in operating income.

*Commodity Price Risk* The Company is exposed to increases in the prices of commodities in operating its stores and distribution centres, as well as the indirect link of commodities to its consumer products. To manage this exposure, the Company uses purchase commitments for a portion of its needs for certain consumer products that may be commodities based and the Company expects to take delivery of these consumer products in the normal course of business. A non-financial derivative contract with a notional value of \$25 is used to hedge electricity price risk for a portion of the Company's expected electricity consumption in Alberta. The Company also enters into exchange traded futures contracts and option contracts to minimize cost volatility on fuel prices. The Company estimates that a 10% increase (decrease) in relevant commodity prices, with all other variables held constant, would result in a gain (loss) of \$4 on earnings before income taxes and minority interest.

*Common Share Price Risk* The Company enters into equity forwards to manage its exposure to fluctuations in its stock-based compensation cost as a result of changes in the market price of its common shares. The equity forwards allow for settlement in cash, common shares or net settlement. These forwards change in value as the market price of the Company's common shares changes and provide a partial offset to fluctuations in Loblaw's stock-based compensation cost, including RSU plan expense. The partial offset between the Company's stock-based compensation costs, including RSU plan expense, and the equity forwards is effective when the market price of the Company's common shares exceeds the exercise price of the related employee stock options. When the market price of the common shares is lower than the exercise price of the related employee stock options, only RSUs will provide a partial offset to these equity forwards. The amount of net stock-based compensation cost recorded in operating income is mainly dependent upon the number of unexercised stock options and RSUs, their vesting schedules relative to the number of underlying common shares on the equity forwards, and the level of fluctuations in the market price of the underlying common shares. The impact on the equity forwards of a one dollar increase (decrease) of the market value in the Company's underlying common shares, with all other variables held constant, would result in a gain (loss) of \$5 in earnings before income taxes and minority interest.

**Liquidity Risk** Liquidity risk is the risk that the Company cannot meet a demand for cash or fund its obligations as they come due. Liquidity risk also includes the risk of not being able to liquidate assets in a timely manner at a reasonable price.

Should the Company's financial performance and condition deteriorate or downgrades in the Company's credit ratings occur, the Company's ability to obtain funding from external sources may be restricted. In addition, credit and capital markets are subject to inherent global risks that may negatively affect the Company's access and ability to fund its short term and long term debt maturities. The Company mitigates these risks by maintaining appropriate levels of cash and cash equivalents and short term investments, by actively monitoring market conditions and diversifying its sources of funding and maturity profile. The Company also employs risk management strategies including forward-looking liquidity contingency plans.

**Maturity Analysis** The following are the undiscounted contractual maturities of significant financial liabilities as at January 3, 2009:

	2009	2010	2011	2012	2013	Thereafter <sup>(4)</sup>	Total
Interest rate swaps payable <sup>(1)</sup>	\$ 13	\$ 13	\$ 13	\$ 13	\$ 5	\$ -	\$ 57
Equity forward contracts <sup>(2)</sup>	261	-	-	-	-	-	261
Long term debt including fixed interest payments <sup>(3)</sup>	437	591	606	230	569	6,185	8,618
	\$ 711	\$ 604	\$ 619	\$ 243	\$ 574	\$ 6,185	\$ 8,936

(1) Based on the pay fixed interest which will be partially offset by the floating interest received.

(2) Based on the average cost base as at January 3, 2009.

(3) Based on the maturing face values and annual interest for each instrument as well as annual payment obligations for VIEs, mortgages, and capital leases.

(4) Capital securities and their related dividends have been excluded as the Company is not contractually obligated to pay these amounts.

The Company's bank indebtedness, short term debt, accounts payable and accrued liabilities are short term in nature, which are due within the next 12 months, and thus not included above.

## Note 27. Contingencies, Commitments and Guarantees

The Company is involved in and potentially subject to various claims by third parties arising out of the normal course and conduct of its business including, but not limited to, product liability, labour and employment, regulatory and environmental claims. In addition, the Company is involved in and potentially subject to regular audits from federal and provincial tax authorities relating to income, capital and commodity taxes and as a result of these audits may receive assessments and reassessments.

Although such matters cannot be predicted with certainty, management currently considers the Company's exposure to such claims and litigation, to the extent not covered by the Company's insurance policies or otherwise provided for, not to be material to these consolidated financial statements, with the exception of the items disclosed in legal proceedings below.

At year end, the Company has committed approximately \$46 (2007 – \$113) with respect to capital investment projects such as the construction, expansion and renovation of buildings and the purchase of real property.

The Company establishes standby letters of credit used in connection with certain obligations mainly related to real estate transactions and benefit programs. The aggregate gross potential liability related to these standby letters of credit is approximately \$216 (2007 – \$221). Other standby letters of credit related to the financing program for the Company's independent franchisees and securitization of PC Bank's credit card receivables have been identified as guarantees and are discussed further in the Guarantees section below.

**Guarantees** The Company has provided to third parties the following significant guarantees as defined pursuant to AcG 14, "Disclosure of Guarantees".

## Notes to the Consolidated Financial Statements

**Independent Funding Trust** Certain independent franchisees of the Company obtain financing through a structure involving independent trusts, which were created to provide loans to the independent franchisees to facilitate their purchase of inventory and fixed assets, consisting mainly of fixtures and equipment. These trusts are administered by a major Canadian chartered bank.

During the first quarter of 2008, the Company was notified that an Event of Termination of the independent funding trust agreement for the Company's franchisees had occurred as a result of the Company's long term credit rating downgrade by Dominion Bond Rating Service to "BBB (high)" from "A (low)". As a result of the Event of Termination, during the second quarter of 2008, the Company finalized an alternative financing arrangement for the independent funding trust in the form of a \$475, 364-day revolving committed credit facility provided by a syndicate of banks.

The gross principal amount of loans issued to the Company's independent franchisees outstanding as of January 3, 2009 was \$388 (2007 – \$418) including \$152 (2007 – \$153) of loans payable by VIEs consolidated by the Company. Based on a formula, the Company has agreed to provide credit enhancement in the form of a standby letter of credit for the benefit of the independent funding trust equal to approximately 15% (2007 – 10%) of the principal amount of the loans outstanding at any point in time, \$66 (2007 – \$44) as of January 3, 2009. The standby letter of credit has not been drawn upon. This credit enhancement allows the independent funding trust to provide favourable financing terms to the Company's independent franchisees. As well, each independent franchisee provides security to the independent funding trust for its obligations by way of a general security agreement. In the event that an independent franchisee defaults on its loan and the Company has not, within a specified time period, assumed the loan, or the default is not otherwise remedied, the independent funding trust would assign the loan to the Company and draw upon this standby letter of credit. The Company has agreed to reimburse the issuing bank for any amount drawn on the standby letter of credit. This new alternative financing structure has been reviewed and the Company determined there were no material implications with respect to the consolidation of VIEs. In accordance with Canadian GAAP, the financial statements of the independent funding trust are not consolidated with those of the Company.

**Standby Letter of Credit** Standby letters of credit for the benefit of independent trusts with respect to the credit card receivables securitization program of PC Bank have been issued by major Canadian chartered banks. These standby letters of credit could be drawn upon in the event of a major decline in the income flow from or in the value of the securitized credit card receivables. The Company has agreed to reimburse the issuing banks for any amount drawn on the standby letters of credit. The aggregate gross potential liability under these arrangements, which represents 9% (2007 – 9%) on a portion of the securitized credit card receivables amount, is approximately \$116 (2007 – \$89) (see note 9).

**Lease Obligations** In connection with historical dispositions of certain of its assets, the Company has assigned leases to third parties. The Company remains contingently liable for these lease obligations in the event any of the assignees are in default of their lease obligations. The estimated amount for minimum rent, which does not include other lease related expenses such as property tax and common area maintenance charges, is in aggregate \$63 (2007 – \$79).

**Indemnification Provisions** The Company from time to time enters into agreements in the normal course of its business, such as service and outsourcing arrangements and leases, in connection with business or asset acquisitions or dispositions. These agreements by their nature may provide for indemnification of counterparties. These indemnification provisions may be in connection with breaches of representation and warranty or with future claims for certain liabilities, including liabilities related to tax and environmental matters. The terms of these indemnification provisions vary in duration and may extend for an unlimited period of time. Given the nature of such indemnification provisions, the Company is unable to reasonably estimate its total maximum potential liability as certain indemnification provisions do not provide for a maximum potential amount and the amounts are dependent on the outcome of future contingent events, the nature and likelihood of which cannot be determined at this time. Historically, the Company has not made any significant payments in connection with these indemnification provisions.



**Legal Proceedings** In 2007, the Company was one of 17 defendants served with an action brought in the Superior Court of Ontario by certain beneficiaries of a multi-employer pension plan in which the Company's employees and those of its independent franchisees participate. In their claim against the employers and the trustees of the multi-employer pension plan, the plaintiffs claimed that assets of the multi-employer pension plan had been mismanaged and were seeking, among other demands, damages of \$1 billion. The action was framed as a representative action on behalf of all the beneficiaries of the multi-employer pension plan. In 2008, the Company received confirmation that the actions against the Company and against the plan trustees have been dismissed. In addition to the civil proceedings described above, the trustees of this multi-employer pension plan are involved in proceedings brought by the Financial Services Commission of Ontario whereby it has been alleged that the trustees violated certain provisions of the Pensions Benefits Act (Ontario) in its management of the plan's funds. One of the trustees, an officer of Loblaw, is entitled to indemnification from the Company.

The Company is the subject of various legal proceedings and claims that arise in the ordinary course of business. The outcome of all of these proceedings is uncertain. However, based on information currently available, these claims, individually and in the aggregate, are not expected to have a material impact on the Company.

#### **Note 28. Variable Interest Entities**

Pursuant to AcG 15, the Company consolidates all VIEs for which it is the primary beneficiary. AcG 15 defines a VIE as an entity that either does not have sufficient equity at risk to finance its activities without subordinated financial support or where the holders of the equity at risk lack the characteristics of a controlling financial interest. AcG 15 requires the primary beneficiary to consolidate VIEs and considers an entity to be the primary beneficiary of a VIE if it holds variable interests that expose it to a majority of the VIE's expected losses or that entitle it to receive a majority of the VIE's expected residual returns or both. The Company has identified the following significant VIEs:

**Independent Franchisees** The Company enters into various forms of franchise agreements that generally require the independent franchisee to purchase inventory from the Company and pay certain fees in exchange for services provided by the Company and for the right to use certain trademarks and licenses owned by the Company. Independent franchisees generally lease the land and building from the Company, and when eligible, may obtain financing through a structure involving independent trusts to facilitate the purchase of the majority of their inventory and fixed assets, consisting mainly of fixtures and equipment (see note 27). These trusts are administered by a major Canadian chartered bank. Under the terms of certain franchise agreements, the Company may also lease equipment to independent franchisees. Independent franchisees may also obtain financing through operating lines of credit with traditional financial institutions or through issuing preferred shares or notes payable to the Company. The Company monitors the financial condition of its independent franchisees and provides for estimated losses or write-downs on its accounts and notes receivable or investments when appropriate.

As at year end 2008, 154 (2007 – 137) of the Company's independent franchise stores met the criteria for a VIE and were consolidated pursuant to AcG 15.

**Warehouse and Distribution Agreements** The Company has warehouse and distribution agreements with third-party entities to provide to the Company distribution and warehousing services from dedicated facilities. The Company has no equity interest in these third-party entities; however, the terms of the agreement with the third-party entities are such that the Company has determined that the third-party entities meet the criteria for a VIE that requires consolidation by the Company. The impact of the consolidation of the warehouse and distribution entities was not material.

Accordingly, the Company has included the results of these independent franchisees and these third-party entities that provide distribution and warehousing services in its consolidated financial statements. The consolidation of these VIEs by the Company does not result in any change to its tax, legal or credit risks, nor does it result in the Company assuming any obligations of these third parties.

## Notes to the Consolidated Financial Statements

**Independent Trusts** The Company has also identified that it holds variable interests, by way of standby letters of credit in independent trusts which are used to securitize credit card receivables for PC Bank. In these securitizations, PC Bank sells a portion of its credit card receivables to the independent trusts in exchange for cash. Although these independent trusts have been identified as a VIE, it was determined that the Company is not the primary beneficiary and therefore these VIEs are not subject to consolidation by the Company. The Company's maximum exposure to loss as a result of its involvement with these independent trusts is disclosed in note 27.

### Note 29. Related Party Transactions

The Company's majority shareholder, George Weston Limited and its affiliates other than Loblaw are related parties. It is the Company's policy to conduct all transactions and settle all balances with related parties on market terms and conditions. Related party transactions include:

**Inventory Purchases** Purchases of inventory from related parties for resale in the distribution network represented approximately 3% (2007 – 3%) of the cost of sales, selling and administrative expenses.

**Cost Sharing Agreements** Weston has entered into certain contracts with third parties for administrative and corporate services, including telecommunication services and information technology related matters on behalf of the Company. Through cost sharing agreements that have been established between the Company and Weston concerning these costs, the Company has agreed to be responsible to Weston for its proportionate share of the costs incurred on its behalf. Payments by the Company pursuant to these cost sharing agreements in 2008 were approximately \$28 (2007 – \$27).

**Real Estate Matters** The Company leases certain properties from an affiliate of Weston, namely office space for approximately \$2 (2007 – \$2).

**Borrowings/Lending** The Company, from time to time, may borrow funds from or may lend funds to Weston on a short term basis at short term market borrowing rates. There were no such amounts outstanding as at year end.

**Income Tax Matters** From time to time, the Company and Weston and its affiliates may make elections that are permitted or required under applicable income tax legislation with respect to affiliated corporations, and as a result, may enter into agreements in that regard. These elections and accompanying agreements did not have any material impact on the Company.

**Management Agreements** The Company has entered into an agreement with Weston to provide certain administrative services by each company to the other. The services to be provided under this agreement include those related to commodity management, pension and benefits, tax, medical, travel, information system, risk management, treasury and legal. Payments are made quarterly based on the actual costs of providing these services. Where services are provided on a joint basis for the benefit of the Company and Weston together, each party pays the appropriate proportion of such costs. Net payments under this agreement in 2008 were \$13 (2007 – \$9). Fees paid under this agreement are reviewed each year by the Audit Committee.

The Company, through Glenhuron, manages certain United States cash, cash equivalents and short term investments for wholly owned non-Canadian subsidiaries of Weston and management fees earned are based on market rates. As at January 3, 2009, Glenhuron had an agreement with a subsidiary of Weston for the administration of a loan portfolio of third-party long term loans receivable. Subsequent to year end the subsidiary of Weston sold the business to which this loan portfolio related, and as a result, the agreement is now between Glenhuron and a third party and is no longer a related party transaction.

**Supply Agreement** The Company entered into a long term supply agreement with a subsidiary of Weston and in exchange received cash proceeds of \$65 which will be recognized into income over the term of the agreement as goods are purchased, of which \$1 was recognized in 2008. As at January 3, 2009, \$8 was included in accounts payable and accrued liabilities and \$56 in other liabilities. Certain assets and liabilities of a wholly-owned subsidiary were subsequently sold by Weston.

**Note 30. Disposition of Food Service Business**

In 2008, the Company disposed of its food service business for proceeds of \$36 which resulted in a pre-tax gain of \$22 in operating income (\$16, net of tax).

**Note 31. Other Information**

**Segment Information** The only reportable operating segment is merchandising, which primarily includes food, general merchandise and drugstore products and services. All sales to external parties were generated in Canada and all fixed assets and goodwill were attributable to Canadian operations.

## Five Year Summary<sup>(1)</sup>

Year <sup>(2)</sup> (\$ millions except where otherwise indicated)	2008 <sup>(6)</sup>	2007 <sup>(6)</sup>	2006 <sup>(6)</sup>	2005 <sup>(6)</sup>	2004 <sup>(6)</sup>
<b>Operating Results</b>					
Sales <sup>(4)</sup>	30,802	29,384	28,640	27,627	26,030
Operating expenses <sup>(4)</sup>	29,756	28,648	28,351	26,226	24,378
Operating income	1,046	736	289	1,401	1,652
Interest expense and other financing charges	263	252	259	252	239
Net earnings (loss)	545	330	(219)	746	968
<b>Financial Position</b>					
Working capital <sup>(5)</sup>	730	58	338	210	(139)
Fixed assets	8,045	7,953	8,055	7,785	7,113
Goodwill	807	806	794	1,587	1,621
Total assets	13,985	13,674	13,486	13,761	12,949
Net debt <sup>(3)</sup>	3,287	3,728	3,891	3,901	3,828
Shareholders' equity	5,830	5,545	5,441	5,886	5,414
<b>Cash Flow</b>					
Cash flows from operating activities	989	1,245	1,180	1,489	1,443
Free cash flow <sup>(3)</sup>	(49)	402	70	103	(24)
Fixed asset purchases	750	613	937	1,156	1,258
<b>Per Common Share (\$)</b>					
Basic net earnings (loss)	1.99	1.20	(.80)	2.72	3.53
Dividend rate at year end	.84	.84	.84	.84	.76
Cash flows from operating activities	3.61	4.55	4.31	5.43	5.26
Fixed asset purchases	2.74	2.24	3.42	4.22	4.59
Book value	21.26	20.22	19.85	21.48	19.74
Market price at year end	35.23	34.07	48.79	56.37	72.02
<b>Financial Ratios</b>					
EBITDA <sup>(3)</sup>	1,631	1,324	879	1,959	2,125
EBITDA margin <sup>(3)</sup> (%)	5.3	4.5	3.1	7.1	8.2
Operating margin (%)	3.4	2.5	1.0	5.1	6.3
Return on average total assets (%) <sup>(3)</sup>	8.2	5.8	2.3	11.2	14.2
Return on average shareholders' equity (%)	9.4	6.0	(3.9)	13.2	19.2
Interest coverage	3.7	2.7	1.0	5.1	6.4
Net debt <sup>(3)</sup> to equity	.54	.67	.72	.66	.71
Cash flows from operating activities activities to net debt <sup>(3)</sup>	.30	.33	.30	.38	.38
Price/net earnings ratio at year end	17.7	28.4	(61.0)	20.7	20.4
Market/book ratio at year end	1.7	1.7	2.5	2.6	3.6
<b>Operating Statistics</b>					
Retail square footage (in millions)	49.8	49.6	49.7	48.5	45.7
Average corporate store size (square feet)	61,900	60,800	57,400	56,100	53,600
Average franchise store size (square feet)	28,400	28,000	27,400	27,100	26,000
Corporate stores sales per average square foot (\$)	624	591	585	579	592
Same-store sales growth <sup>(4)</sup>	4.2%	2.4%	0.8%	0.2%	1.5%
Number of corporate stores	609	628	672	670	658
Number of franchised stores	427	408	405	402	400

(1) For financial definitions and ratios refer to the Glossary of Terms on page 83.

(2) 2008 was a 53 week year.

(3) See Non-GAAP Financial Measures on page 33.

(4) During 2006, the Company implemented Emerging Issues Committee Abstract 156, "Accounting by a Vendor for Consideration Given to a Customer (Including a Reseller of the Vendor's Products)" on a retroactive basis. Accordingly certain sales incentives paid to independent franchisees, associates and independent accounts for prior years have been reclassified between sales and cost of sales, selling and administrative expenses.

(5) Certain prior year information has been reclassified to conform with current year presentation. Prior to 2007, security deposits were presented as cash and cash equivalents and short term investments, and are now included in other assets on the consolidated balance sheets. Prior to 2007, the unrealized equity forwards liability was presented as other long term liabilities, and is now included in accounts payable and accrued liabilities. See note 1 of the 2008 consolidated financial statements for more information.

(6) In 2008, the Company adopted Canadian Institute of Chartered Accountants ("CICA") Section 3031 "Inventories" without restatement of prior periods. In 2007, the Company implemented CICA Section 3855 "Financial Instruments – Recognition and Measurement", CICA Section 3865 "Hedges", CICA Section "1530 – Comprehensive Income", and CICA Section 3251 "Equity" without restatement of prior periods. In 2005, the Company adopted Accounting Guideline 15 "Consolidation of Variable Interest Entities", without restatement of prior periods.

## Glossary of Terms

Term	Definition	Term	Definition
<b>Annual Report</b>	For 2008, the Annual Report consists of a Business Review and a Financial Review.	<b>Net debt</b>	Bank indebtedness, commercial paper, long term debt due within one year, long term debt and debt equivalents less cash and cash equivalents, short term investments and security deposits included in other assets (see Non-GAAP Financial Measures on page 33).
<b>Basic net (loss) earnings per common share</b>	Net (loss) earnings available to common shareholders divided by the weighted average number of common shares outstanding during the year.	<b>Net debt to equity</b>	Net debt divided by total shareholders' equity.
<b>Book value per common share</b>	Shareholders' equity divided by the number of common shares outstanding at year end.	<b>New store</b>	A newly constructed store, conversion or major expansion.
<b>Capital investment</b>	Fixed asset purchases.	<b>Operating income</b>	Earnings before interest expense, income taxes and minority interest.
<b>Capital investment per common share</b>	Capital investment divided by the weighted average number of common shares outstanding during the year.	<b>Operating margin</b>	Operating income divided by sales.
<b>Cash flows from operating activities per common share</b>	Cash flows from operating activities divided by the weighted average number of common shares outstanding during the year.	<b>Price/net (loss) earnings ratio at year end</b>	Market price per common share at year end divided by basic net (loss) earnings per common share for the year.
<b>Cash flows from operating activities to net debt</b>	Cash flows from operating activities divided by net debt.	<b>Renovation</b>	A capital investment in a store resulting in no change to the store square footage.
<b>Control label</b>	A brand and associated trademark that is owned by the Company for use in connection with its own products and services.	<b>Retail sales</b>	Combined sales of stores owned by the Company and those owned by the Company's independent franchisees.
<b>Conversion</b>	A store that changes from one Company banner to another Company banner.	<b>Retail square footage</b>	Retail square footage includes corporate and independent franchised stores.
<b>Corporate stores sales per average square foot</b>	Sales by corporate stores divided by the average corporate stores' square footage at year end.	<b>Return on average total assets</b>	Operating income divided by average total assets excluding cash and cash equivalents, short term investments and security deposits included in other assets (see Non-GAAP Financial Measures on page 33).
<b>Diluted net (loss) earnings per common share</b>	Net (loss) earnings available to common shareholders divided by the weighted average number of common shares outstanding during the period minus the dilutive impact of outstanding stock option grants and capital securities at period end.	<b>Return on average shareholders' equity</b>	Net (loss) earnings available to common shareholders divided by average total common shareholders' equity.
<b>Dividend rate per common share at year end</b>	Dividend per common share declared in the fourth quarter multiplied by four.	<b>Same-store sales</b>	Retail sales from the same physical location for stores in operation in that location in both periods being compared by excluding sales from a store that has undergone a conversion or major expansion in the period.
<b>EBITDA</b>	Operating income before depreciation and amortization (see Non-GAAP Financial Measures on page 33).	<b>Variable interest entity ("VIE")</b>	An entity that either does not have sufficient equity at risk to finance its activities without subordinated financial support or where the holders of the equity at risk lack the characteristics of a controlling financial interest (see note 28 to the consolidated financial statements).
<b>EBITDA margin</b>	EBITDA divided by sales (see Non-GAAP Financial Measures on page 33).	<b>Weighted average common shares outstanding</b>	The number of common shares outstanding determined by relating the portion of time within the year the common shares were outstanding to the total time in that year.
<b>Free cash flow</b>	Cash flows from operating activities less fixed asset purchases and dividends (see Non-GAAP Financial Measures on page 33).	<b>Working capital</b>	Total current assets less total current liabilities.
<b>Gross margin</b>	Sales less cost of sales and inventory shrinkage divided by sales.	<b>Year</b>	A fiscal year ends on the Saturday closest to December 31, usually 52 weeks in duration, but includes 53 weeks every 5 to 6 years. The year ended January 3, 2004 and January 3, 2009 contained 53 weeks.
<b>Interest coverage</b>	Operating income divided by interest expense adding back interest capitalized to fixed assets.		
<b>Major expansion</b>	Expansion of a store that results in an increase in square footage that is greater than 25% of the square footage of the store prior to the expansion.		
<b>Market/book ratio at year end</b>	Market price per common share at year end divided by book value per common share at year end.		
<b>Minor expansion</b>	Expansion of a store that results in an increase in square footage that is less than or equal to 25% of the square footage of the store prior to the expansion.		

**National Head Office and Store Support Centre**

Loblaw Companies Limited  
1 President's Choice Circle  
Brampton, Canada  
L6Y 5S5  
Tel: (905) 459-2500  
Fax: (905) 861-2206  
Internet: www.loblaw.ca

**Stock Exchange Listing and Symbol**

The Company's common shares and second preferred shares are listed on the Toronto Stock Exchange and trade under the symbols "L" and "L.PR.A", respectively.

**Common Shares**

W. Galen Weston directly and indirectly through his controlling interest in Weston, owns 63% of the Company's common shares.

At year end 2008 there were 274,173,564 common shares issued and outstanding and 100,901,429 common shares available for public trading.

The average daily trading volume of the Company's common shares for 2008 was 529,242.

**Preferred Shares**

At year end 2008 there were 9,000,000 second preferred shares issued and outstanding and available for public trading.

The average daily trading volume of the Company's second preferred shares for 2008 was 20,052.

**Trademarks**

Loblaw Companies Limited and its subsidiaries own a number of trademarks. Several subsidiaries are licensees of additional trademarks. These trademarks are the exclusive property of Loblaw Companies Limited or the licensor and where used in this report are in italics.

**Common Dividend Policy**

The declaration and payment of dividends and the amount thereof are at the discretion of the Board which takes into account the Company's financial results, capital requirements, available cash flow and other factors the Board considers relevant from time to time. Over the long term, the Company's objective is for its dividend payment ratio to be in the range of 20% to 25% of the prior year's basic net earnings per common share adjusted as appropriate for items which are not regarded to be reflective of ongoing operations giving consideration to the year end cash position, future cash flow requirements and investment opportunities.

**Common Dividend Dates**

The declaration and payment of quarterly dividends are made subject to approval by the Board of Directors. The anticipated record and payment dates for 2009 are:

Record Date	Payment Date
March 15	April 1
June 15	July 1
Sept. 15	Oct. 1
Dec. 15	Dec. 30

**Investor Relations**

Shareholders, security analysts and investment professionals should direct their requests to Inge van den Berg, Vice President, Public Affairs and Investor Relations at the Company's National Head Office or by e-mail at: investor@loblaw.ca

**Preferred Share Dividend Dates**

The declaration and payment of quarterly dividends are made subject to approval by the Board of Directors. The anticipated payment dates for 2009 are: January 31, April 30, July 31 and October 31.

**Normal Course Issuer Bid**

The Company has a Normal Course Issuer Bid on the Toronto Stock Exchange.

**Value of Common Shares**

For capital gains purposes, the valuation day (December 22, 1971) cost base for the Company is \$0.958 per common share. The value on February 22, 1994 was \$7.67 per common share.

**Registrar and Transfer Agent**

Computershare Investor Services Inc.  
100 University Avenue  
Toronto, Canada  
M5J 2Y1  
Tel: (416) 263-9200  
Toll free: 1-800-663-9097  
Fax: (416) 263-9394  
Toll free fax: 1-888-453-0330

To change your address, eliminate multiple mailings, or for other shareholder account inquiries, please contact Computershare Investor Services Inc.

Additional financial information has been filed electronically with various securities regulators in Canada through the System for Electronic Document Analysis and Retrieval (SEDAR) and with the Office of the Superintendent of Financial Institutions (OSFI) as the primary regulator for the Company's subsidiary, *President's Choice Bank*.

**Independent Auditors**

KPMG LLP  
Chartered Accountants  
Toronto, Canada

**Annual Meeting**

The 2009 Annual Meeting of Shareholders of Loblaw Companies Limited will be held on Wednesday, May 6, 2009 at 11:00 a.m. (EST), at the Metro Toronto Convention Centre, Toronto, Ontario, Canada.

