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## Management's Statement of Responsibility for Financial Reporting

The management of Loblaw Companies Limited is responsible for the preparation and fair presentation 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 ("GAAP"). It also includes ensuring that the financial information presented elsewhere in the Annual Report is consistent with that in the consolidated financial statements.

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. 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  
February 23, 2011

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

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

**[signed]**  
**Sarah R. Davis**  
Chief Financial Officer

## Independent Auditors' Report

To the Shareholders:

We have audited the accompanying consolidated financial statements of Loblaw Companies Limited, which comprise the consolidated balance sheets as at January 1, 2011 and January 2, 2010, the consolidated statements of earnings, changes in shareholders' equity, comprehensive income and the consolidated cash flow statements for the 52 week years ended January 1, 2011 and January 2, 2010, and a summary of significant accounting policies and other explanatory information.

### Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's Responsibility

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 comply with ethical requirements and plan and perform an audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinions.

### Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Loblaw Companies Limited as at January 1, 2011 and January 2, 2010, and the consolidated results of its operations and its consolidated cash flows for the 52 week years then ended in accordance with Canadian generally accepted accounting principles.

Toronto, Canada  
February 23, 2011



Chartered Accountants, Licensed Public Accountants

## Consolidated Statements of Earnings

For the years ended January 1, 2011 and January 2, 2010

(\$ millions except where otherwise indicated)

|   | 2010<br>(52 weeks) | 2009<br>(52 weeks) |
|---|--------------------|--------------------|
| <b>Sales</b>  | <b>\$ 30,997</b>   | <b>\$ 30,735</b>   |
| <b>Cost of Merchandise Inventories Sold</b> (note 9)      | <b>23,393</b>      | <b>23,539</b>      |
| <b>Gross Profit</b>                                       | <b>7,604</b>       | <b>7,196</b>       |
| <b>Operating Expenses</b>                                 |                    |                    |
| Selling and administrative expenses                       | 5,680              | 5,402              |
| Depreciation and amortization                             | 655                | 589                |
|   | <b>6,335</b>       | <b>5,991</b>       |
| <b>Operating Income</b>                                   | <b>1,269</b>       | <b>1,205</b>       |
| Interest expense and other financing charges (note 4)     | 273                | 269                |
| <b>Earnings Before Income Taxes and Minority Interest</b> | <b>996</b>         | <b>936</b>         |
| Income Taxes (note 5)                                     | 297                | 269                |
| <b>Net Earnings Before Minority Interest</b>              | <b>699</b>         | <b>667</b>         |
| Minority Interest   | 18                 | 11                 |
| <b>Net Earnings</b>                                       | <b>\$ 681</b>      | <b>\$ 656</b>      |
| <b>Net Earnings Per Common Share</b> (\$) (note 6)        |                    |                    |
| Basic   | <b>\$ 2.45</b>     | <b>\$ 2.39</b>     |
| Diluted   | <b>\$ 2.44</b>     | <b>\$ 2.38</b>     |

See accompanying notes to the consolidated financial statements.

## Consolidated Statements of Changes in Shareholders' Equity

| For the years ended January 1, 2011 and January 2, 2010<br>(\$ millions except where otherwise indicated) | 2010<br>(52 weeks) | 2009<br>(52 weeks) |
|---|--------------------|--------------------|
| <b>Common Share Capital, Beginning of Year</b>  | <b>\$ 1,308</b>    | <b>\$ 1,196</b>    |
| Common shares issued (note 19)  | 167                | 120                |
| Purchased for cancellation (note 19)  | -                  | (8)                |
| <b>Common Share Capital, End of Year</b>  | <b>\$ 1,475</b>    | <b>\$ 1,308</b>    |
| <b>Retained Earnings, Beginning of Year</b>   | <b>\$ 4,948</b>    | <b>\$ 4,577</b>    |
| Cumulative impact of implementing new accounting standards (note 2)                                       | -                  | (6)                |
| Net earnings  | 681                | 656                |
| Dividends declared per common share – \$0.84 (2009 – \$0.84)  | (234)              | (231)              |
| Premium on common shares purchased for cancellation (note 19)   | -                  | (48)               |
| <b>Retained Earnings, End of Year</b>   | <b>\$ 5,395</b>    | <b>\$ 4,948</b>    |
| <b>Accumulated Other Comprehensive Income, Beginning of Year</b>  | <b>\$ 17</b>       | <b>\$ 30</b>       |
| Cumulative impact of implementing new accounting standards (note 2)                                       | -                  | (2)                |
| Other comprehensive loss  | (7)                | (11)               |
| <b>Accumulated Other Comprehensive Income, End of Year</b> (note 22)                                      | <b>\$ 10</b>       | <b>\$ 17</b>       |
| <b>Total Shareholders' Equity</b>   | <b>\$ 6,880</b>    | <b>\$ 6,273</b>    |

See accompanying notes to the consolidated financial statements.

## Consolidated Statements of Comprehensive Income

| For the years ended January 1, 2011 and January 2, 2010<br>(\$ millions)                                 | 2010<br>(52 weeks) | 2009<br>(52 weeks) |
|--|--------------------|--------------------|
| Net earnings   | <b>\$ 681</b>      | <b>\$ 656</b>      |
| Other comprehensive income   |                    |                    |
| Net unrealized loss on available-for-sale financial assets   | (12)               | (23)               |
| Reclassification of loss on available-for-sale financial assets to net earnings                          | 13                 | 2                  |
|  | 1                  | (21)               |
| Net gain on derivative instruments designated as cash flow hedges  | 1                  | 8                  |
| Reclassification of (gain) loss on derivative instruments designated as cash flow hedges to net earnings | (9)                | 2                  |
|  | (8)                | 10                 |
| Other comprehensive loss (note 22)   | (7)                | (11)               |
| <b>Total Comprehensive Income</b>  | <b>\$ 674</b>      | <b>\$ 645</b>      |

See accompanying notes to the consolidated financial statements.

## Consolidated Balance Sheets

As at January 1, 2011 and January 2, 2010

(\$ millions)

|   | 2010             | 2009             |
|---|------------------|------------------|
| <b>Assets</b>   |                  |                  |
| Current Assets  |                  |                  |
| Cash and cash equivalents (note 7)                      | \$ 932           | \$ 776           |
| Short term investments                                  | 735              | 614              |
| Accounts receivable (note 8)                            | 724              | 774              |
| Inventories (note 9)                                    | 2,114            | 2,112            |
| Future income taxes (note 5)                            | 39               | 38               |
| Prepaid expenses and other assets                       | 82               | 92               |
| <b>Total Current Assets</b>                             | <b>4,626</b>     | 4,406            |
| Fixed Assets (note 10)                                  | 9,123            | 8,559            |
| Goodwill and Intangible Assets (notes 11)               | 1,029            | 1,026            |
| Security Deposits                                       | 354              | 250              |
| Other Assets (note 12)                                  | 787              | 750              |
| <b>Total Assets</b>                                     | <b>\$ 15,919</b> | <b>\$ 14,991</b> |
| <b>Liabilities</b>                                      |                  |                  |
| Current Liabilities                                     |                  |                  |
| Bank indebtedness                                       | \$ 3             | \$ 2             |
| Accounts payable and accrued liabilities                | 3,416            | 3,279            |
| Income taxes payable (note 5)                           | -                | 41               |
| Long term debt due within one year (note 15)            | 433              | 343              |
| <b>Total Current Liabilities</b>                        | <b>3,852</b>     | 3,665            |
| Long Term Debt (note 15)                                | 4,213            | 4,162            |
| Other Liabilities (note 16)                             | 534              | 497              |
| Future Income Taxes (note 5)                            | 178              | 143              |
| Capital Securities (note 18)                            | 221              | 220              |
| Minority Interest                                       | 41               | 31               |
| <b>Total Liabilities</b>                                | <b>9,039</b>     | 8,718            |
| <b>Shareholders' Equity</b>                             |                  |                  |
| Common Share Capital (note 19)                          | 1,475            | 1,308            |
| Retained Earnings                                       | 5,395            | 4,948            |
| Accumulated Other Comprehensive Income (notes 2 and 22) | 10               | 17               |
| <b>Total Shareholders' Equity</b>                       | <b>6,880</b>     | 6,273            |
| <b>Total Liabilities and Shareholders' Equity</b>       | <b>\$ 15,919</b> | <b>\$ 14,991</b> |

Contingencies, commitments and guarantees (note 26). Leases (note 17).

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 1, 2011 and January 2, 2010  
(\$ millions)

|  | 2010<br>(52 weeks) | 2009<br>(52 weeks) |
|--|--------------------|--------------------|
| <b>Operating Activities</b>  |                    |                    |
| Net earnings before minority interest  | \$ 699             | \$ 667             |
| Depreciation and amortization  | 655                | 589                |
| Future income taxes  | 42                 | (29)               |
| Settlement of equity forward contracts (note 23)                                       | –                  | (55)               |
| Change in non-cash working capital   | 66                 | 707                |
| Fixed assets and other related impairments   | 72                 | 46                 |
| Other  | 60                 | 20                 |
| <b>Cash Flows from Operating Activities</b>  | <b>1,594</b>       | <b>1,945</b>       |
| <b>Investing Activities</b>  |                    |                    |
| Fixed asset purchases  | (1,280)            | (971)              |
| Short term investments   | (159)              | (181)              |
| Proceeds from fixed asset sales  | 90                 | 27                 |
| Credit card receivables, after securitization (note 8)                                 | 7                  | 8                  |
| Business acquisitions – net of cash acquired (note 29)                                 | –                  | (204)              |
| Franchise investments and other receivables  | (11)               | 6                  |
| Security deposits  | (115)              | 148                |
| Other  | 20                 | (45)               |
| <b>Cash Flows used in Investing Activities</b>   | <b>(1,448)</b>     | <b>(1,212)</b>     |
| <b>Financing Activities</b>  |                    |                    |
| Bank indebtedness  | 1                  | (50)               |
| Short term debt  | –                  | (190)              |
| Long term debt (note 15)   |                    |                    |
| Issued   | 450                | 402                |
| Retired  | (368)              | (167)              |
| Common shares retired (note 19)  | –                  | (56)               |
| Dividends  | (65)               | (112)              |
| <b>Cash Flows from (used in) Financing Activities</b>                                  | <b>18</b>          | <b>(173)</b>       |
| Effect of foreign currency exchange rate changes on cash and cash equivalents (note 7) | (8)                | (27)               |
| Change in Cash and Cash Equivalents  | 156                | 533                |
| Cash and Cash Equivalents, Beginning of Year   | 776                | 243                |
| <b>Cash and Cash Equivalents, End of Year</b>  | <b>\$ 932</b>      | <b>\$ 776</b>      |

See accompanying notes to the consolidated financial statements.

## Notes to the Consolidated Financial Statements

For the years ended January 1, 2011 and January 2, 2010  
(\$ millions except where otherwise indicated)

### Note 1. Summary of Significant Accounting Policies

The Company is a subsidiary of George Weston Limited (“Weston”) and is Canada’s largest food distributor and a leading provider of drugstore, general merchandise and financial products and services.

**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 the Company 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 1, 2011 and January 2, 2010 both contained 52 weeks.

**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 the Company. The Company recognizes revenue at its corporate and VIE stores at the time the sale is made to its customers and at the time of delivery of inventory to its associated and franchised stores.

**Net Earnings per Common 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 and a component of other liabilities 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 from the date of acquisition. Cash equivalents are either designated as held-for-trading financial assets or classified as available-for-sale financial assets which approximates the fair value of these instruments. See note 7 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 which approximates the fair value of these instruments.

**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.

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.

PC Bank securitizes credit card receivables through the sale of a portion of the total interest in certain receivables to independent trusts. These trusts are either not controlled by PC Bank or are qualifying special purpose entities. 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 retains servicing responsibilities, certain administrative responsibilities and 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 and accordingly a servicing liability is recorded. The servicing 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 securitization of the receivables depends, in part, on the previous carrying amount of the receivables involved in the transfer, allocated between the assets sold and retained interest, based on their relative fair values at the date of transfer. The fair value of the retained interest 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 net yield, 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 interest is primarily designated as a held-for-trading financial asset and is 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 merchandise inventories sold 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** The Company values merchandise inventories at the lower of cost and net realizable value. Cost includes the costs of purchases net of vendor allowances, plus other costs 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.

**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 and buildings under capital leases are depreciated over the term of the lease.

## Notes to the Consolidated Financial Statements

Fixed assets are reviewed for impairment annually and 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. 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 any of these assets are determined to be impaired, the impairment loss is measured as the excess of the carrying value over fair value.

**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 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 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 the carrying value of goodwill exceeds the implied fair value 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 ("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.

**Intangible Assets** The Company assesses intangible assets for legal, regulatory, contractual, competitive or other factors to determine if the useful life is definite. Intangible assets which are determined to have a definite life are amortized over the related assets' estimated useful lives, to a maximum of 17 years.

Intangible assets with indefinite useful lives, consisting of T&T Supermarket Inc. ("T&T") trademarks and brand names, are assessed for impairment at least annually. Any potential intangible asset impairment is identified by comparing the fair value of the indefinite life intangible asset to its carrying value. If the carrying value of the intangible asset exceeds its fair value, impairment is identified as the difference between the fair value and the carrying value and will result in the recognition of an impairment charge in operating income.

The Company determines the fair value of its trademarks and brand names by using the "Relief from Royalty" method, a discounted cash flow model. The process of determining the fair values requires management to make assumptions of a long term nature regarding projected future sales, terminal growth rates, royalty rates and discount rates. Projected future sales are consistent with strategic plans presented to the Board and discount rates are based on an industry after-tax cost of equity. These estimates and assumptions may change in the future due to uncertain competitive and economic market conditions or changes in business strategies.

**Security Deposits** Security deposits consist primarily of cash, government treasury bills and government-sponsored debt securities held as security for certain of the Company's derivatives or securitized receivables. Security deposits are either designated as held-for-trading financial assets or classified as available-for-sale financial assets which approximates the fair value of these instruments.

**Financial Instruments** Financial instruments are classified as held-for-trading financial assets or financial liabilities, held-to-maturity investments, loans and receivables, available-for-sale financial assets, or other financial liabilities. Financial instruments are 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. Financial assets and financial liabilities have been initially remeasured as at January 4, 2009 to take into account the appropriate Company's credit risk and counterparty credit risk (see note 2). 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.

The following classifications have been applied:

- Cash and cash equivalents, short term investments and security deposits are designated as held-for-trading with the exception of certain United States dollar denominated cash equivalents, short term investments and security deposits 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, certain other liabilities 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** Financial derivative instruments in the form of cross currency swaps, foreign exchange forwards, interest rate swaps and equity forwards partially offset exposure to fluctuations in foreign currency exchange rates, interest rates and the market price of the Company's common shares. Financial and non-financial derivative instruments in the form of futures contracts, option contracts and forward contracts mitigate current and anticipated exposure to fluctuations in commodity prices and foreign currency exchange rates. Policies and guidelines prohibit the use of any derivative instruments for trading or speculative purposes.

All financial derivative instruments are recorded at fair value on the consolidated balance sheet taking into account the appropriate Company's credit risk and counterparty credit risk (see note 24). 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 which are not closely related to the host contract 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 (see note 24). 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 exposure to fluctuations in the foreign currency exchange rate and variable interest rates (see note 23). The Company assesses whether these derivative instruments are highly effective in offsetting the change in the cash flows of hedged items at the inception of the hedging relationship and on an ongoing basis. 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 items which are designated in a cash flow hedge which 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 Company accounts for income taxes using the asset and liability method of accounting. 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 other employee benefit plans comprised of post-retirement and post-employment benefit plans which are generally unfunded and non-contributory. Post-retirement benefit plans include health care, life insurance and dental benefits during retirement while post-employment benefit plans include long term disability benefits and the continuation of health and dental benefits while on disability. 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 and post-employment, 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 rates, 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 and then adjusted for employer contributions made between the measurement date and the fiscal year end. 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, unless the plan covers mostly inactive members in which case life expectancy is used. The amortization period for the defined benefit pension plans ranges from 7 to 18 years, with a weighted average of 11 years. The amortization period for the post-retirement benefit plans ranges from 8 to 16 years, with a weighted average of 15 years. The unamortized net actuarial gain or loss for post-employment benefits is amortized over a period not exceeding three 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 over the vesting period of the options.

**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 (“ESOP”)** 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.

**Director Deferred Share Unit (“DSU”) Plan** Members of the Board, 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 Unit (“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 an 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 and intangible assets, income and other 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.

**Future Accounting Standards** The Company will adopt International Financial Reporting Standards (“IFRS”) effective January 2, 2011.

## **Note 2. Implementation of New Accounting Standards**

### **Accounting Standards Implemented in 2009**

**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, in conjunction with Section 3064, provide guidance for the recognition of intangible assets, including internally developed assets from research and development activities, ensuring consistent treatment of all intangible assets, whether separately acquired or internally developed. The Company implemented these requirements effective 2009, retroactively with restatement.

## Notes to the Consolidated Financial Statements

**Credit Risk and the Fair Value of Financial Assets and Financial Liabilities** On January 20, 2009 EIC Abstract No.173 “Credit Risk and the Fair Value of Financial Assets and Financial Liabilities” (“EIC 173”) was issued. 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. The transitional provisions required the abstract to be applied retrospectively without restatement of prior periods. Financial assets and financial liabilities, including derivative instruments, were remeasured as at January 4, 2009 to take into account the appropriate Company’s credit risk and counterparty credit risk. As a result, a decrease in other assets of \$12 million, a decrease in other liabilities of \$4 million, a decrease net of income taxes in accumulated other comprehensive income of \$2 million and a decrease in retained earnings of \$6 million were recorded in the consolidated balance sheet.

**Financial Instruments – Disclosures** In June 2009, the CICA amended Section 3862, “Financial Instruments – Disclosures,” to include additional disclosure relating to the measurement of fair value for financial instruments and liquidity risk. The amendment establishes a three level hierarchy that reflects the significance of the inputs used in fair value measurements on financial instruments. The amendment was effective for annual financial statements relating to fiscal years ending after September 30, 2009. See note 24 for disclosures.

### Note 3. Distribution Network Costs

During 2010, the Company announced changes to its distribution network in Quebec. In connection with these changes a certain distribution centre was closed and an asset impairment charge in 2010 of \$26 million was recorded in operating income as the carrying value of the facility exceeded the fair value. In addition, employee termination charges and other costs of \$16 million were recorded in operating income. As at January 1, 2011, \$7 million was recorded on the consolidated balance sheet in accounts payable and accrued liabilities related to these charges.

### Note 4. Interest Expense and Other Financing Charges

| (\$ millions)   | 2010   | 2009   |
|---|--------|--------|
| Interest on long term debt                                    | \$ 288 | \$ 282 |
| Interest expense (income) on financial derivative instruments | -      | 2      |
| Net short term interest (income) expense                      | (8)    | (6)    |
| Interest income on security deposits                          | -      | (2)    |
| Dividends on capital securities                               | 14     | 14     |
| Capitalized to fixed assets                                   | (21)   | (21)   |
| Interest expense  | \$ 273 | \$ 269 |

During 2010, net interest expense of \$271 million (2009 – \$263 million) was recorded related to the financial assets and financial liabilities not classified as held-for-trading. In addition, \$2 million (2009 – \$2 million) of income from cash and cash equivalents and short term investments, held by Glenhuron Bank Limited (“Glenhuron”), a wholly owned subsidiary of the Company, were recognized in net short term interest income.

Cash interest and dividends on capital securities paid in 2010 were \$371 million (2009 – \$365 million), and cash interest received in 2010 was \$52 million (2009 – \$73 million).

## Note 5. 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:

|  | 2010         | 2009  |
|--|--------------|-------|
| Weighted average basic Canadian federal and provincial statutory income tax rate                   | <b>29.9%</b> | 30.7% |
| Net increase (decrease) resulting from:  |              |       |
| Earnings in jurisdictions taxed at rates different<br>from the Canadian statutory income tax rates | <b>(1.4)</b> | (0.6) |
| Non-deductible amounts including cash settled stock options  | <b>1.8</b>   | 0.2   |
| Impact of statutory income tax rate changes on future income tax balances                          | –            | (0.4) |
| Other  | <b>(0.5)</b> | (1.2) |
| Effective income tax rate  | <b>29.8%</b> | 28.7% |

Net cash income taxes paid in 2010 were \$298 million (2009 – \$199 million).

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 2010 a \$nil (2009 – \$3 million) 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:

| (\$ millions)   | 2010            | 2009     |
|---|-----------------|----------|
| Accounts payable and accrued liabilities                | <b>\$ 35</b>    | \$ 35    |
| Other liabilities                                       | <b>152</b>      | 158      |
| Fixed assets  | <b>(296)</b>    | (281)    |
| Other assets  | <b>(140)</b>    | (103)    |
| Losses carried forward (expiring 2015 to 2030)          | <b>91</b>       | 92       |
| Other   | <b>19</b>       | (6)      |
| Net future income tax liabilities                       | <b>\$ (139)</b> | \$ (105) |
| (\$ millions)   | 2010            | 2009     |
| Recorded on the consolidated balance sheets as follows: |                 |          |
| Current future income tax assets                        | <b>\$ 39</b>    | \$ 38    |
| Non-current future income tax liabilities               | <b>(178)</b>    | (143)    |
| Net future income tax liabilities                       | <b>\$ (139)</b> | \$ (105) |

## Notes to the Consolidated Financial Statements

### Note 6. Basic and Diluted Net Earnings per Common Share (\$, except where otherwise indicated)

|  | 2010    | 2009    |
|--|---------|---------|
| Net earnings for basic earnings per share (\$ millions)              | \$ 681  | \$ 656  |
| Dividends on capital securities (\$ millions) (note 18)              | 14      | 14      |
| Net earnings for diluted earnings per share (\$ millions)            | 695     | 670     |
| Weighted average common shares outstanding (in millions) (note 19)   | 277.9   | 275.0   |
| Dilutive effect of stock-based compensation (in millions)            | 0.6     | 0.2     |
| Dilutive effect of capital securities (in millions) (note 18)        | 5.9     | 6.6     |
| Dilutive effect of certain other liabilities (in millions) (note 16) | 0.9     | 0.3     |
| Diluted weighted average common shares outstanding (in millions)     | 285.3   | 282.1   |
| Basic net earnings per common share (\$)                             | \$ 2.45 | \$ 2.39 |
| Diluted net earnings per common share (\$)                           | \$ 2.44 | \$ 2.38 |

Stock options outstanding with an exercise price greater than the market price of the Company's common shares at January 1, 2011 were not recognized in the computation of diluted net earnings per common share. Accordingly, 2,840,638 (2009 – 4,118,464) stock options, with a weighted average exercise price of \$52.50 (2009 – \$52.64) per common share, were excluded from the computation of diluted net earnings per common share.

### Note 7. Cash and Cash Equivalents

The components of cash and cash equivalents as at January 1, 2011 and January 2, 2010 were as follows:

| (\$ millions)              | 2010   | 2009   |
|----------------------------|--------|--------|
| Cash                       | \$ 150 | \$ 219 |
| Cash equivalents:          |        |        |
| Bankers' acceptances       | 240    | 296    |
| Government treasury bills  | 224    | 71     |
| Bank term deposits         | 200    | 45     |
| Corporate commercial paper | 113    | 116    |
| Other                      | 5      | 29     |
| Cash and cash equivalents  | \$ 932 | \$ 776 |

The Company recognized an unrealized foreign currency exchange loss of \$52 million (2009 – \$146 million) as a result of translating United States dollar denominated cash and cash equivalents, short term investments and security deposits, of which a loss of \$8 million (2009 – \$27 million) is related to cash and cash equivalents. The resulting unrealized foreign currency exchange loss on cash and cash equivalents, short term investments and security deposits is offset in operating income and accumulated other comprehensive income by the unrealized foreign currency exchange gain of \$52 million (2009 – \$145 million) on the cross currency swaps as described in note 23.

## Note 8. Accounts Receivable

The components of accounts receivable as at January 1, 2011 and January 2, 2010 were as follows:

| (\$ millions)               | 2010     | 2009     |
|-----------------------------|----------|----------|
| Credit card receivables     | \$ 2,015 | \$ 2,128 |
| Amount securitized          | (1,635)  | (1,725)  |
| Net credit card receivables | 380      | 403      |
| Other receivables           | 344      | 371      |
| Accounts receivable         | \$ 724   | \$ 774   |

**Credit Card Receivables** The Company, through PC Bank, securitizes certain credit card receivables as described in note 1.

In 2010, \$600 million (2009 – nil) of credit card receivables were securitized which yielded a net loss of \$3 million (2009 – nil). During 2010, PC Bank repurchased \$690 million (2009 – \$50 million) of the co-ownership interest in the securitized receivables from several independent trusts. A portion of the securitized receivables that is held by an independent trust facility was renewed for two years during 2010. During 2010, PC Bank received income of \$245 million (2009 – \$235 million) related primarily to PC Bank's rights to excess cash flows earned on the securitized credit card receivables. A decrease in servicing liability of nil (2009 – \$3 million) was recognized during the year on securitization and as at year end the servicing liability was \$8 million (2009 – \$8 million). The independent trusts' recourse to PC Bank's assets is limited to PC Bank's excess collateral of \$114 million (2009 – \$121 million) as well as standby letters of credit for \$48 million (2009 – \$116 million) based on a portion of the securitized amount (see note 26).

On March 17, 2011, the five-year \$500 million senior notes and subordinated notes issued by Eagle Credit Card Trust will mature. In conjunction with the upcoming maturity, the Company accumulated \$167 million of cash on December 1, 2010. Subsequent to the end of the year, the Company accumulated \$167 million in January 2011 and will continue to accumulate a further \$166 million by the end of February 2011. In addition, subsequent to year end, the Company increased its securitization of accounts receivable by approximately \$230 million under one of the independent trusts and expects to securitize further amounts coincident with the maturity of the Eagle Credit Card Trust Notes.

Net credit loss experience of \$16 million (2009 – \$21 million) includes \$110 million (2009 – \$139 million) of credit losses on the total portfolio of credit card receivables net of credit losses of \$94 million (2009 – \$118 million) relating to securitized credit card receivables.

The following table displays the sensitivity of the current fair value of the retained interest to an immediate 10% and 20% adverse change in the 2010 key 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.

|   | 2010   | Change in Assumptions |        |
|---|--------|-----------------------|--------|
|   |        | 10%                   | 20%    |
| Carrying value of retained interest (\$ millions)   | \$ 21  |                       |        |
| Payment rate (monthly)                              | 49%    | \$ (2)                | \$ (3) |
| Weighted average life (years)                       | 0.7    |                       |        |
| Expected credit losses                              | 5.67%  | \$ (1)                | \$ (3) |
| Annual discount rate applied to residual cash flows | 9.13%  |                       |        |
| Net Yield   | 14.11% | \$ (4)                | \$ (8) |
| Cost of Funds                                       | 2.60%  | \$ (1)                | \$ (1) |

## Notes to the Consolidated Financial Statements

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

| (\$ millions)                                | 2010     | 2009    |
|--|----------|---------|
| Proceeds from new securitizations            | \$ 600   | \$ –    |
| Repurchase of co-ownership interests         | \$ (690) | \$ (50) |
| Net cash flows received on retained interest | \$ 250   | \$ 244  |

**Other Receivables** Other receivables consist mainly of receivables from vendors, independent franchisees, associated stores and independent accounts.

**Allowances for Receivables** The allowance for credit card receivables recorded in accounts receivable on 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 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

| (\$ millions)                   | January 1, 2011 | January 2, 2010 |
|---------------------------------|-----------------|-----------------|
| Allowance, at beginning of year | \$ (16)         | \$ (15)         |
| Provision for losses            | (16)            | (21)            |
| Recoveries                      | (11)            | (9)             |
| Write-offs                      | 27              | 29              |
| Allowance, at end of year       | \$ (16)         | \$ (16)         |

### Other Receivables

| (\$ millions)                   | January 1, 2011 | January 2, 2010 |
|---------------------------------|-----------------|-----------------|
| Allowance, at beginning of year | \$ (20)         | \$ (24)         |
| Provision for losses            | (107)           | (101)           |
| Write-offs                      | 111             | 105             |
| Allowance, at end of year       | \$ (16)         | \$ (20)         |

**Aging of Receivables** The following is an aging of the Company's credit card and other receivables as at January 1, 2011 and January 2, 2010:

|                         | 2010    |           |           |       | 2009    |           |           |       |
|-------------------------|---------|-----------|-----------|-------|---------|-----------|-----------|-------|
|                         | Current | > 30 days | > 60 days | Total | Current | > 30 days | > 60 days | Total |
| Credit card receivables | 370     | 3         | 7         | 380   | 390     | 4         | 9         | 403   |
| Other receivables       | 276     | 16        | 52        | 344   | 273     | 47        | 51        | 371   |
| Total                   | 646     | 19        | 59        | 724   | 663     | 51        | 60        | 774   |

Credit card receivables that are past due but not impaired totaled \$10 million (2009 – \$13 million) as at January 1, 2011 as they are either less than 90 days past due or are reasonably expected to remedy the past due status. Any credit card receivable balances that are 180 days in arrears or where the likelihood of collection is considered remote are written-off. Credit risk on the credit card receivables is managed as described in note 25.

Other receivables that are past due but not impaired totaled \$10 million as at January 1, 2011 (2009 – \$46 million).

### Note 9. Inventories

For inventories recorded as at January 1, 2011, the Company recorded \$17 million (2009 – \$15 million) as an expense for the write-down of inventories below cost to net realizable value. There were no reversals of inventories written down previously that are no longer estimated to sell below cost.

### Note 10. Fixed Assets

| (\$ millions)                            | January 1, 2011  |                          |                 | January 2, 2010  |                          |                 |
|--|------------------|--------------------------|-----------------|------------------|--------------------------|-----------------|
|  | Cost             | Accumulated Depreciation | Net Book Value  | Cost             | Accumulated Depreciation | Net Book Value  |
| Assets under construction                | \$ 1,172         | \$ –                     | \$ 1,172        | \$ 685           | \$ –                     | \$ 685          |
| Land                                     | 1,761            | –                        | 1,761           | 1,840            | –                        | 1,840           |
| Buildings                                | 5,947            | 1,770                    | 4,177           | 5,871            | 1,614                    | 4,257           |
| Equipment and fixtures                   | 5,268            | 3,662                    | 1,606           | 4,744            | 3,316                    | 1,428           |
| Building and leasehold improvements      | 606              | 329                      | 277             | 559              | 272                      | 287             |
|  | <b>14,754</b>    | <b>5,761</b>             | <b>8,993</b>    | <b>13,699</b>    | <b>5,202</b>             | <b>8,497</b>    |
| Capital leases – buildings and equipment | 247              | 117                      | 130             | 179              | 117                      | 62              |
|  | <b>\$ 15,001</b> | <b>\$ 5,878</b>          | <b>\$ 9,123</b> | <b>\$ 13,878</b> | <b>\$ 5,319</b>          | <b>\$ 8,559</b> |

Included in land and buildings is \$73 million (2009 – \$58 million) of properties held for sale. During the year, fixed asset impairment charges of \$28 million (2009 – \$27 million) and other related charges of \$18 million (2009 – \$19 million) were recognized in operating income. In addition, in 2010 the Company recorded in operating income an asset impairment charge of \$26 million related to the closure of a distribution centre in Quebec (see note 3).

During 2009, the Company completed the purchase of a distribution centre for consideration of \$140 million plus closing costs. The Company assumed a mortgage of \$96 million in connection with the purchase, of which \$2 million (2009 – \$2 million) is included in long term debt due within one year (see note 15).

### Note 11. Goodwill and Intangible Assets

In 2010 and 2009, the Company performed its annual goodwill and indefinite life intangible assets impairment test and determined that there was no impairment to the carrying value of goodwill and indefinite life intangible assets.

## Notes to the Consolidated Financial Statements

During 2010, the Company acquired nil (2009 – 3) franchisee stores for cash consideration of nil (2009 – \$6 million) resulting in goodwill acquired of nil (2009 – \$5 million).

The following table discloses the components of goodwill and intangible assets as at January 1, 2011 and January 2, 2010:

| (\$ millions)  | 2010            | 2009            |
|--|-----------------|-----------------|
| Goodwill, beginning of year  | \$ 943          | \$ 807          |
| Acquisition of T&T (note 29)   | (2)             | 131             |
| Other  | 1               | 5               |
| Goodwill, end of year  | \$ 942          | \$ 943          |
| Indefinite life intangible assets - trademarks and brand names (note 29) | 51              | 51              |
| Other definite life intangible assets                                    | 36              | 32              |
| <b>Goodwill and Intangible Assets</b>                                    | <b>\$ 1,029</b> | <b>\$ 1,026</b> |

### Note 12. Other Assets

| (\$ millions)  | January 1, 2011 | January 2, 2010 |
|--|-----------------|-----------------|
| Accrued benefit plan asset (note 13)                 | \$ 355          | \$ 319          |
| Franchise investments and other receivables          | 203             | 225             |
| Unrealized cross currency swaps receivable (note 23) | 172             | 142             |
| Other  | 57              | 64              |
|  | <b>\$ 787</b>   | <b>\$ 750</b>   |

### Note 13. 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.

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 other employee benefit plans comprised of post-retirement and post-employment benefit plans which are generally unfunded and non-contributory. Post retirement benefit plans include health care, life insurance and dental benefits during retirement while post-employment benefit plans include long term disability benefits and the continuation of health and dental benefits while on disability. Employees eligible for post-retirement benefits are those who retire at certain retirement ages having met certain service requirements 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.

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, 2007 and December 31, 2009. The Company is required to file funding valuations at least every three years; accordingly, the next funding valuations will be performed as at December 31, 2010 and 2012, respectively.

Total cash paid or payable by the Company for 2010, consisting of contributions to registered funded defined benefit pension plans, defined contribution pension plans, multi-employer pension plans and benefits paid directly to beneficiaries of the supplemental unfunded defined benefit pension plans and other benefit plans, were \$200 million (2009 – \$183 million).

**Pension and Other Benefit Plans Status** Information on the Company's defined benefit pension plans and other benefit plans, in aggregate, was as follows:

| (\$ millions)   | 2010                  |                                    |          | 2009                  |                                    |          |
|---|-----------------------|------------------------------------|----------|-----------------------|------------------------------------|----------|
|   | 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                           | \$ 1,120              | \$ 9                               | \$ 1,129 | \$ 1,056              | \$ 23                              | \$ 1,079 |
| Actual return on plan assets                            | 89                    | –                                  | 89       | 51                    | 1                                  | 52       |
| Employer contributions                                  | 103                   | 23                                 | 126      | 104                   | 11                                 | 115      |
| Employee contributions                                  | 2                     | –                                  | 2        | 2                     | –                                  | 2        |
| Benefits paid   | (71)                  | (29)                               | (100)    | (93)                  | (26)                               | (119)    |
| Fair value, end of year                                 | \$ 1,243              | \$ 3                               | \$ 1,246 | \$ 1,120              | \$ 9                               | \$ 1,129 |
| <b>Accrued Benefit Plan Obligations</b>                 |                       |                                    |          |                       |                                    |          |
| Balance, beginning of year                              | \$ 1,242              | \$ 319                             | \$ 1,561 | \$ 1,161              | \$ 323                             | \$ 1,484 |
| Current service cost                                    | 45                    | 27                                 | 72       | 43                    | 32                                 | 75       |
| Interest cost   | 71                    | 17                                 | 88       | 70                    | 19                                 | 89       |
| Benefits paid   | (71)                  | (29)                               | (100)    | (93)                  | (26)                               | (119)    |
| Actuarial loss (gain)                                   | 155                   | 23                                 | 178      | 57                    | (29)                               | 28       |
| Contractual termination benefits <sup>(2)</sup>         | 3                     | –                                  | 3        | –                     | –                                  | –        |
| Plan amendments   | –                     | –                                  | –        | 4                     | –                                  | 4        |
| Balance, end of year                                    | \$ 1,445              | \$ 357                             | \$ 1,802 | \$ 1,242              | \$ 319                             | \$ 1,561 |
| <b>Deficit of Plan Assets Versus Plan Obligations</b>   |                       |                                    |          |                       |                                    |          |
|   | \$ (202)              | \$ (354)                           | \$ (556) | \$ (122)              | \$ (310)                           | \$ (432) |
| Unamortized past service costs                          | 5                     | (4)                                | 1        | 6                     | (5)                                | 1        |
| Unamortized net actuarial loss                          | 507                   | 88                                 | 595      | 393                   | 65                                 | 458      |
| Net accrued benefit plan asset (liability)              | \$ 310                | \$ (270)                           | \$ 40    | \$ 277                | \$ (250)                           | \$ 27    |
| Recorded in the consolidated balance sheets as follows: |                       |                                    |          |                       |                                    |          |
| Other assets (note 12)                                  | \$ 355                | \$ –                               | \$ 355   | \$ 319                | \$ –                               | \$ 319   |
| Other liabilities (note 16)                             | (45)                  | (270)                              | (315)    | (42)                  | (250)                              | (292)    |
| Net accrued benefit plan asset (liability)              | \$ 310                | \$ (270)                           | \$ 40    | \$ 277                | \$ (250)                           | \$ 27    |

(1) Other benefit plans include post-retirement and post-employment benefit plans.

(2) Contractual termination benefits resulted from distribution centre closures in 2010.

## 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:

| (\$ millions)                                  | 2010                  |                                    | 2009                  |                                    |
|--|-----------------------|------------------------------------|-----------------------|------------------------------------|
|  | Pension Benefit Plans | Other Benefit Plans <sup>(1)</sup> | Pension Benefit Plans | Other Benefit Plans <sup>(1)</sup> |
| Fair Value of Benefit Plan Assets              | \$ 1,224              | \$ 3                               | \$ 1,037              | \$ 9                               |
| Accrued Benefit Plan Obligations               | 1,426                 | 357                                | 1,161                 | 319                                |
| Deficit of Plan Assets versus Plan Obligations | \$ (202)              | \$ (354)                           | \$ (124)              | \$ (310)                           |

(1) Other benefit plans include post-retirement and post-employment 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 | 2010                  |                                    | 2009                  |                                    |
|---------------------------|-----------------------|------------------------------------|-----------------------|------------------------------------|
|                           | Pension Benefit Plans | Other Benefit Plans <sup>(1)</sup> | Pension Benefit Plans | Other Benefit Plans <sup>(1)</sup> |
| Asset Category            |                       |                                    |                       |                                    |
| Equity securities         | 58%                   | –%                                 | 55%                   | –%                                 |
| Debt securities           | 40%                   | –%                                 | 43%                   | 98%                                |
| Cash and cash equivalents | 2%                    | 100%                               | 2%                    | 2%                                 |
| Total                     | 100%                  | 100%                               | 100%                  | 100%                               |

(1) Other benefit plans include post-employment benefit plans.

Pension benefit plan assets include securities issued by the Company having a fair value of \$4 million (2009 – \$2 million) as at September 30, 2010. Other benefit plan assets do not include any of the Company's 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:

| (\$ millions)   | 2010                  |                                    | 2009                  |                                    |
|---|-----------------------|------------------------------------|-----------------------|------------------------------------|
|   | 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   | \$ 43                 | \$ 27                              | \$ 41                 | \$ 32                              |
| Interest cost on plan obligations   | 71                    | 17                                 | 70                    | 19                                 |
| Actual return on plan assets  | (89)                  | -                                  | (51)                  | (1)                                |
| Actuarial loss (gain)   | 155                   | 23                                 | 57                    | (29)                               |
| Contractual termination benefits <sup>(2)</sup>   | 3                     | -                                  | -                     | -                                  |
| Plan amendments   | -                     | -                                  | 4                     | -                                  |
| Defined benefit plan cost, before adjustments to recognize the long term nature of employee future benefit costs          | 183                   | 67                                 | 121                   | 21                                 |
| Excess (shortfall) of actual return over expected return on plan assets   | 15                    | -                                  | (23)                  | -                                  |
| (Shortfall) excess of amortized net actuarial loss (gain) over actual actuarial loss (gain) on accrued benefit obligation | (129)                 | (23)                               | (36)                  | 32                                 |
| Excess (shortfall) of amortized past service costs over actual past service costs   | 1                     | (1)                                | (4)                   | -                                  |
| Net defined benefit plan cost   | 70                    | 43                                 | 58                    | 53                                 |
| Defined contribution plan cost  | 16                    | -                                  | 13                    | -                                  |
| Multi-employer pension plan cost  | 58                    | -                                  | 55                    | -                                  |
| Net benefit plan cost   | \$ 144                | \$ 43                              | \$ 126                | \$ 53                              |

(1) Other benefit plans include post-retirement and post-employment benefit plans.

(2) Contractual termination benefits resulted from distribution centre closures in 2010.

**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:

| (\$ millions)                                    | 2010                  |                                    | 2009                  |                                    |
|--|-----------------------|------------------------------------|-----------------------|------------------------------------|
|  | Pension Benefit Plans | Other Benefit Plans <sup>(1)</sup> | Pension Benefit Plans | Other Benefit Plans <sup>(1)</sup> |
| Accrued Benefit Plan Obligations                 |                       |                                    |                       |                                    |
| Discount rate                                    | 5.00%                 | 4.8%                               | 5.75%                 | 5.5%                               |
| Rate of compensation increase                    | 3.5%                  |                                    | 3.5%                  |                                    |
| Net Defined Benefit Plan Cost                    |                       |                                    |                       |                                    |
| Discount rate                                    | 5.75%                 | 5.5%                               | 6.0%                  | 5.7%                               |
| Expected long term rate of return on plan assets | 6.75%                 | 5.0%                               | 7.25%                 | 5.0%                               |
| Rate of compensation increase                    | 3.5%                  |                                    | 3.5%                  |                                    |

(1) Other benefit plans include post-retirement and post-employment benefit plans.

## Notes to the Consolidated Financial Statements

The growth rate of health care costs, primarily drug and other medical costs for other benefit plans, for the net benefit plan cost was estimated at 9.0% (2009 – 9.5%) and is assumed to gradually decrease to 5.0% by 2015 (2009 – 5.0% by 2015), remaining at that level thereafter.

**Sensitivity of Key Assumptions** The following table outlines the key assumptions for 2010 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 Benefits 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         |                                  | 6.75%                            |                                    | 5.0%                             |
| Impact of: 1% increase                                   | n/a                              | \$ (11)                          | n/a                                | –                                |
| 1% decrease  | n/a                              | \$ 11                            | n/a                                | –                                |
| Discount rate  | 5.00%                            | 5.75%                            | 4.8%                               | 5.5%                             |
| Impact of: 1% increase                                   | \$ (194)                         | \$ (7)                           | \$ (40)                            | \$ (2)                           |
| 1% decrease  | \$ 225                           | \$ 7                             | \$ 45                              | \$ 2                             |
| Expected growth rate of health care costs <sup>(3)</sup> |                                  |                                  | 8.0%                               | 9.0%                             |
| Impact of: 1% increase                                   | n/a                              | n/a                              | \$ 35                              | \$ 4                             |
| 1% decrease  | n/a                              | n/a                              | \$ (31)                            | \$ (4)                           |

n/a – not applicable

(1) Other benefit plans include post-retirement and post-employment 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 (2009 – 5.0% by 2015) for the accrued benefit plan obligation and the benefit plan cost, and remaining at that level thereafter.

### Note 14. Short Term Debt

The Company has an \$800 million committed credit facility expiring in March of 2013 provided by a syndicate of third party lenders which contains certain financial covenants (see note 20). This facility is a potential 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. As at January 1, 2011 and January 2, 2010, the Company had not drawn on the committed credit facility.

## Note 15. Long Term Debt

| (\$ millions)  | January 1, 2011 | January 2, 2010 |
|--|-----------------|-----------------|
| <b>Loblaw Companies Limited Notes</b>                              |                 |                 |
| 7.10%, due 2010  | \$ –            | \$ 300          |
| 6.50%, due 2011  | 350             | 350             |
| 5.40%, due 2013  | 200             | 200             |
| 6.00%, due 2014  | 100             | 100             |
| 4.85%, due 2014  | 350             | 350             |
| 7.10%, due 2016  | 300             | 300             |
| 5.22%, due 2020  | 350             | –               |
| 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                                      | (81)            | (67)            |
| 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)                                 | 150             | 158             |
| 6.86%, due 2015 (US \$150 million)                                 | 150             | 158             |
| <b>Long Term Debt Secured by Mortgage</b>                          |                 |                 |
| 5.49%, due 2018 (see note 10)                                      | 93              | 96              |
| Guaranteed investment certificates due 2011 – 2015 (1.55% - 3.15%) | 18              | –               |
| VIE loans payable <sup>(1)</sup> (see note 26)                     | 202             | 163             |
| Capital lease obligations <sup>(1)</sup> (see note 17)             | 132             | 64              |
| Other  | 1               | 2               |
| <b>Total long term debt</b>  | <b>4,646</b>    | 4,505           |
| <b>Less amount due within one year</b>                             | <b>433</b>      | 343             |
|  | <b>\$ 4,213</b> | <b>\$ 4,162</b> |

(1) Pursuant to the requirements of AcG 15, the consolidated balance sheet as at January 1, 2011 includes \$221 million (2009 – \$181 million) of loans payable and capital lease obligations of VIEs consolidated by the Company, \$39 million (2009 – \$37 million) of which is due within one year.

During the second quarter of 2010, the Company issued \$350 million principal amount of unsecured Medium Term Notes, Series 2-B pursuant to its Medium Term Notes, Series 2 program. The Series 2-B notes pay a fixed rate of interest of 5.22% payable semi-annually commencing on December 18, 2010 until maturity on June 18, 2020. During the second quarter of 2009, the Company issued \$350 million principal amount of unsecured Medium Term Notes, Series 2-A which pay a fixed rate of interest of 4.85% payable semi-annually.

The Series 2-A and 2-B notes are subject to certain covenants and are unsecured obligations of the Company and rank equally with all the unsecured indebtedness that has not been subordinated. The Series 2-A and 2-B notes may be redeemed at the option of the Company, in whole at any time or in part from time to time, upon not less than 30 days and not more than 60 days notice to the holders of the notes.

## Notes to the Consolidated Financial Statements

During the third quarter of 2010, PC Bank began accepting deposits under a new Guaranteed Investment Certificate (“GIC”) program. The GICs, which are sold through independent brokers, are issued with fixed terms ranging from 12 to 60 months and are non-redeemable prior to maturity. Individual balances up to \$100,000 are Canada Deposit Insurance Corporation (CDIC) insured. As at January 1, 2011, \$18 million was recorded as long term debt on the consolidated balance sheet of which \$5 million is due within one year.

In 2010, the \$300 million 7.10% medium term note due May 11, 2010 matured and was repaid. In 2009, the \$125 million 5.75% medium term note due January 22, 2009 matured and was repaid. Subsequent to the end of 2010, the \$350 million 6.50% medium term note due January 19, 2011 matured and was repaid.

The schedule of repayment of long term debt, inclusive of VIE and other debt, based on maturity is as follows: 2011 – \$433 million; 2012 – \$77 million; 2013 – \$419 million; 2014 – \$482 million; 2015 - \$182 million; thereafter – \$3,053 million.

See note 24 for the fair value of long term debt.

### Note 16. Other Liabilities

| (\$ millions)                                     | January 1, 2011 | January 2, 2010 |
|---|-----------------|-----------------|
| Accrued benefit plan liability (note 13)          | \$ 315          | \$ 292          |
| Deferred vendor allowances                        | 40              | 48              |
| Unrealized interest rate swap liability (note 23) | 24              | 31              |
| Stock-based compensation (note 21)                | 51              | 23              |
| Other   | 104             | 103             |
|   | <b>\$ 534</b>   | <b>\$ 497</b>   |

Included in Other above is the liability associated with the preferred shares issued by T&T (see note 29) and amounts related to various insurance matters.

### Note 17. Leases

**As Lessee** Future minimum lease payments relating to the Company’s operating leases are as follows:

| (\$ millions)                | Payments due by year |        |        |        |        |            | 2010<br>Total | 2009<br>Total |
|------------------------------|----------------------|--------|--------|--------|--------|------------|---------------|---------------|
|                              | 2011                 | 2012   | 2013   | 2014   | 2015   | Thereafter |               |               |
| Operating lease payments     | \$ 219               | \$ 199 | \$ 177 | \$ 156 | \$ 128 | \$ 629     | \$ 1,508      | \$ 1,505      |
| Sub-lease income             | (34)                 | (31)   | (28)   | (23)   | (15)   | (43)       | (174)         | (204)         |
| Net operating lease payments | \$ 185               | \$ 168 | \$ 149 | \$ 133 | \$ 113 | \$ 586     | \$ 1,334      | \$ 1,301      |

**As Lessor** Fixed assets on the consolidated balance sheets include cost of properties which are currently leased to third parties of \$885 million (2009 – \$755 million) and related accumulated depreciation of \$230 million (2009 – \$211 million). Rental income for the year ended January 1, 2011 from these operating leases totaled \$47 million (2009 – \$47 million).

**Capital Leases** Capital lease obligations of \$132 million (2009 – \$64 million) are included in the consolidated balance sheet as at year end (see note 15). The amount due within one year is \$40 million (2009 – \$8 million).

**Note 18. Preferred Shares** (\$, except where otherwise indicated)

**First Preferred Shares (authorized – 1.0 million shares)** There were no non-voting First Preferred Shares outstanding at year end.

**Second Preferred Shares, Series A (authorized – 12.0 million shares)** There are 9.0 million 5.95% non-voting Second Preferred Shares, Series A outstanding 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. The Second Preferred Shares, Series A are classified as Capital Securities on the Consolidated Balance Sheets. During 2010, the Board declared dividends of \$1.4875 (2009 – \$1.4875) per second preferred share which are included as a component of interest expense and other financing charges on the Consolidated Statement of Earnings for the year ended January 1, 2011 (see note 4). Subsequent to year end, the Board declared a dividend of \$0.37 per Second Preferred Share, Series A payable April 30, 2011.

**Note 19. Common Share Capital (authorized – unlimited)**

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

|   | 2010                          |   | 2009                          |   |
|---|-------------------------------|---|-------------------------------|---|
|   | Number of<br>Common<br>Shares | Common<br>Share<br>Capital<br>(\$ millions) | Number of<br>Common<br>Shares | Common<br>Share<br>Capital<br>(\$ millions) |
| Issued and outstanding, beginning of year | 276,188,258                   | \$ 1,308                                    | 274,173,564                   | \$ 1,196                                    |
| Common shares issued                      | 4,389,872                     | \$ 167                                      | 3,713,094                     | \$ 120                                      |
| Purchased for cancellation                | –                             | \$ –  | (1,698,400)                   | \$ (8)                                      |
| Issued and outstanding, end of year       | 280,578,130                   | \$ 1,475                                    | 276,188,258                   | \$ 1,308                                    |
| Weighted average outstanding              | 277,875,697                   |   | 275,028,991                   |   |

During 2009, the Company purchased for cancellation 1,698,400 of its common shares for \$56 million at a premium of \$48 million which has been charged to retained earnings.

Approximately 63% (2009 – 63%) of the common shares are owned by Weston; the remaining shares are widely held.

**Common Share Dividends (\$)** 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. During 2010, the Board declared common share dividends of \$0.84 (2009 – \$0.84) per common share. Subsequent to year end, the Board declared a quarterly dividend of \$0.21 per common share payable April 1, 2011.

## Notes to the Consolidated Financial Statements

**Dividend Reinvestment Plan** During the second quarter of 2009, the Company commenced a Dividend Reinvestment Plan (“DRIP”) with the objective of raising \$300 million in common share equity. Under the terms of the DRIP, eligible holders of common shares may elect to automatically reinvest their regular quarterly dividends in additional common shares of the Company without incurring any commissions, service charges or brokerage fees. The common shares issued to shareholders under the DRIP will be, at the Company’s option, either issued from treasury or purchased on the open market. The Board may from time to time approve a discount on the issuance of common shares from treasury under the DRIP. During the year, the Company issued 4,389,872 (2009 – 3,713,094) common shares from treasury under the DRIP at a three percent (3%) discount to market resulting in incremental common share equity of \$167 million (2009 – \$120 million). Subsequent to January 1, 2011, the Board approved discontinuing the Company’s DRIP after the dividend payment on April 1, 2011 when approximately \$300 million in common share equity will be raised through the program as planned.

**Normal Course Issuer Bids (“NCIB”)** In the second quarter of 2010, the Company renewed its NCIB to purchase on the Toronto Stock Exchange, or enter into equity derivatives to purchase, up to 13,865,435 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, the Company may purchase its shares at the then market price of such shares. During 2010, the Company did not purchase any common shares for cancellation (2009 – 1,698,400) at a price of nil (2009 – \$33.14).

### Note 20. Capital Management

The Company defines capital as net debt<sup>(1)</sup> 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 1, 2011 | As at January 2, 2010 |
|--|-----------------------|-----------------------|
| Interest coverage                                | 4.3x                  | 4.2x                  |
| Net debt <sup>(1)</sup> to equity <sup>(1)</sup> | 0.4:1                 | 0.4:1                 |
| Net debt <sup>(1)</sup> to EBITDA <sup>(1)</sup> | 1.3:1                 | 1.6:1                 |

The Company manages debt on a net basis as outlined below. The net debt<sup>(1)</sup> to equity<sup>(1)</sup> ratio is consistent with 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 38 of the Company’s Management’s Discussion & Analysis.

**Net Debt<sup>(1)</sup>** The following table details the net debt<sup>(1)</sup> calculation used in the net debt<sup>(1)</sup> to equity<sup>(1)</sup> and the net debt<sup>(1)</sup> to EBITDA<sup>(1)</sup> ratios:

| (\$ millions)  | As at January 1, 2011 | As at January 2, 2010 |
|--|-----------------------|-----------------------|
| Bank indebtedness  | \$ 3                  | \$ 2                  |
| Long term debt due within one year                       | 433                   | 343                   |
| Long term debt   | 4,213                 | 4,162                 |
| Certain other liabilities                                | 35                    | 36                    |
| Fair value of financial derivatives related to the above | 37                    | 58                    |
|  | <b>4,721</b>          | <b>4,601</b>          |
| Less: Cash and cash equivalents                          | 932                   | 776                   |
| Short term investments                                   | 735                   | 614                   |
| Security deposits  | 354                   | 250                   |
| Fair value of financial derivatives related to the above | 187                   | 178                   |
|  | <b>2,208</b>          | <b>1,818</b>          |
| <b>Net debt<sup>(1)</sup></b>                            | <b>\$ 2,513</b>       | <b>\$ 2,783</b>       |

The capital securities are excluded from the calculation of net debt<sup>(1)</sup>. For purposes of calculating net debt, fair value of financial derivatives is not credit value adjusted in accordance with EIC 173 (see note 2). As at January 1, 2011, the credit value adjustment was \$4 million (January 2, 2010 – \$4).

**EBITDA<sup>(1)</sup>** The following table reconciles EBITDA<sup>(1)</sup> used in the net debt<sup>(1)</sup> to EBITDA<sup>(1)</sup> ratio to Canadian generally accepted accounting principles (“GAAP”) measures reported in the audited consolidated financial statements for the years ended:

| (\$ millions)                                | 2010<br>(52 weeks) | 2009<br>(52 weeks) |
|--|--------------------|--------------------|
| Net earnings                                 | \$ 681             | \$ 656             |
| Add impact of the following:                 |                    |                    |
| Minority interest                            | 18                 | 11                 |
| Income taxes                                 | 297                | 269                |
| Interest expense and other financing charges | 273                | 269                |
| Operating income                             | 1,269              | 1,205              |
| Add impact of the following:                 |                    |                    |
| Depreciation and amortization                | 655                | 589                |
| <b>EBITDA<sup>(1)</sup></b>                  | <b>\$ 1,924</b>    | <b>\$ 1,794</b>    |

(1) See Non-GAAP Financial Measures on page 38 of the Company's Management's Discussion & Analysis.

## Notes to the Consolidated Financial Statements

**Equity<sup>(1)</sup>**The following table reconciles equity used in the net debt<sup>(1)</sup> to equity<sup>(1)</sup> ratio to Canadian GAAP measures reported in the audited consolidated financial statements as at the years ended.

Equity<sup>(1)</sup> is calculated as the sum of capital securities and shareholder's equity as follows:

| (\$ millions)         | As at<br>January 1, 2011 | As at<br>January 2, 2010 |
|-----------------------|--------------------------|--------------------------|
| Capital securities    | 221                      | 220                      |
| Shareholders' equity  | 6,880                    | 6,273                    |
| Equity <sup>(1)</sup> | 7,101                    | 6,493                    |

During the fourth quarter of 2010, the Company filed a Short Form Base Shelf Prospectus ("Prospectus") allowing for the potential issue of up to \$1.0 billion of unsecured debentures and/or preferred shares subject to the availability of funding by capital markets. As at January 1, 2011, no amounts have been drawn on the Prospectus.

**Covenants and Regulatory Requirements** The committed credit facility which the Company entered into during 2008, the USD \$300 million fixed-rate private placement notes which the Company issued during 2008, the Company's Medium Term Notes and certain of the Company's letters of credit contain certain financial and non-financial covenants. Certain 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 1, 2011, the Company was in compliance with the covenants under these agreements.

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 generated by its credit card loan portfolio and to meet all regulatory capital requirements as defined by OSFI. PC Bank is subject to the Basel II regulatory capital management framework which includes a Tier 1 capital ratio of 7% and a total capital ratio of 10%. PC Bank has met all applicable capital targets as at the end of 2010. 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 1, 2011.

### Note 21. Stock-Based Compensation (\$, except where otherwise indicated)

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

| (\$ millions)                                    | 2010  | 2009  |
|--|-------|-------|
| Stock option plan expense                        | \$ 33 | \$ 6  |
| Restricted share unit plan expense               | 15    | 10    |
| Equity forwards (gain) loss <sup>(note 23)</sup> | (11)  | 6     |
| Net stock-based compensation cost                | \$ 37 | \$ 22 |

(1) See Non-GAAP Financial Measures on page 38 of the Company's Management's Discussion & Analysis.

**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 for 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% or 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 agreement, 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. Subsequent to the end of the year, the right to receive a cash payment in lieu of exercising an option for shares was removed.

In 2010, the share appreciation value of \$6 million (2009 – \$1 million) was paid on the exercise of 603,787 (2009 – 127,513) stock options. In 2010 and 2009, the Company did not issue common shares or receive cash consideration on the exercise of stock options. At year end, a total of 9,320,865 (2009 – 9,207,816) stock options were outstanding, and represented approximately 3.3% (2009 – 3.3%) of the Company's issued and outstanding common shares, which was within the Company's guideline of 5%.

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

|  | 2010                             |   | 2009                             |   |
|--|----------------------------------|---|----------------------------------|---|
|  | Options<br>(number of<br>shares) | Weighted<br>Average Exercise<br>Price/Share | Options<br>(number of<br>shares) | Weighted<br>Average Exercise<br>Price/Share |
| Outstanding options, beginning of year | 9,207,816                        | \$ 40.14                                    | 7,892,660                        | \$ 43.29                                    |
| Granted                                | 2,571,203                        | \$ 36.52                                    | 2,787,970                        | \$ 31.13                                    |
| Exercised                              | (603,787)                        | \$ 29.68                                    | (127,513)                        | \$ 29.00                                    |
| Forfeited/cancelled                    | (1,854,367)                      | \$ 46.48                                    | (1,345,301)                      | \$ 40.99                                    |
| Outstanding options, end of year       | 9,320,865                        | \$ 38.56                                    | 9,207,816                        | \$ 40.14                                    |
| Options exercisable, end of year       | 2,938,014                        | \$ 46.33                                    | 2,940,474                        | \$ 50.15                                    |

|                          | 2010 Outstanding Options            |  |   | 2010 Exercisable Options            |   |
|--------------------------|-------------------------------------|--|---|-------------------------------------|---|
|                          | Number of<br>Options<br>Outstanding | Weighted<br>Average Remaining<br>Contractual<br>Life (years) | Weighted<br>Average Exercise<br>Price/Share | Number of<br>Exercisable<br>Options | Weighted<br>Average Exercise<br>Price/Share |
| Range of Exercise Prices |                                     |  |   |                                     |   |
| \$ 28.95 – \$ 31.77      | 3,878,261                           | 5  | \$ 29.97                                    | 972,010                             | \$ 29.56                                    |
| \$ 31.78 – \$ 46.72      | 2,705,513                           | 6  | \$ 36.40                                    | 55,194                              | \$ 36.26                                    |
| \$ 46.73 – \$ 69.75      | 2,737,091                           | 3  | \$ 52.88                                    | 1,910,810                           | \$ 55.16                                    |
|                          | 9,320,865                           |  |   | 2,938,014                           |   |

**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.

## Notes to the Consolidated Financial Statements

The RSU activity during the year is as follows:

| Number of Awards                | 2010      | 2009      |
|---------------------------------|-----------|-----------|
| RSUs, beginning of year         | 973,351   | 829,399   |
| Granted                         | 381,712   | 453,680   |
| Cancelled                       | (111,328) | (104,785) |
| Cash settled                    | (198,389) | (204,943) |
| RSUs, end of year               | 1,045,346 | 973,351   |
| RSUs Cash Settled (\$ millions) | \$ 8      | \$ 7      |

**Employee Share Ownership Plan** 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% (2009 – 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 (2009 – \$6 million) related to this plan was recognized in operating income.

**Director Deferred Share Unit Plan** Members of the Board, 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, 147,358 (2009 – 110,303) DSUs were outstanding. The year-over-year change in the deferred share unit compensation liability was \$2 million (2009 – \$1 million) and was recognized in operating income.

**Executive Deferred Share Unit 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 an 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. As at the end of 2010 and 2009, there were 29,143 and nil EDSUs outstanding, respectively. A compensation cost of \$1 million (2009 – nil) related to this plan was recognized in operating income.

## Note 22. Accumulated Other Comprehensive Income

The following table provides further detail regarding the composition of accumulated other comprehensive income for the years ended January 1, 2011 and January 2, 2010:

| (\$ millions)  | 2010             |                           |       | 2009             |                           |       |
|--|------------------|---------------------------|-------|------------------|---------------------------|-------|
|  | Cash Flow Hedges | Available-for-sale Assets | Total | Cash Flow Hedges | Available-for-sale Assets | Total |
| Balance, beginning of year   | \$ 22            | \$ (5)                    | \$ 17 | \$ 14            | \$ 16                     | \$ 30 |
| Cumulative impact of implementing new accounting standards [net of income taxes recovered of nil (2009 – \$1 million)] (note 2)                  | -                | -                         | -     | (2)              | -                         | (2)   |
| Net unrealized loss on available-for-sale financial assets [net of income taxes of nil (2009 – \$1 million)]                                     | -                | (12)                      | (12)  | -                | (23)                      | (23)  |
| Reclassification of loss on available-for-sale financial assets [net of income taxes recovered of nil (2009 – \$3 million)]                      | -                | 13                        | 13    | -                | 2                         | 2     |
| Net gain on derivatives designated as cash flow hedges [net of income taxes recovered of \$1 million (2009 –\$9 million)]                        | 1                | -                         | 1     | 8                | -                         | 8     |
| Reclassification of (gain) loss on derivatives designated as cash flow hedges [net of income taxes recovered of \$3 million (2009 –\$6 million)] | (9)              | -                         | (9)   | 2                | -                         | 2     |
| Balance, end of year   | \$ 14            | \$ (4)                    | \$ 10 | \$ 22            | \$ (5)                    | \$ 17 |

An estimated gain of \$3 million (2009 –\$8 million) recorded in accumulated other comprehensive income related to interest rate swaps as at January 1, 2011, is expected to be reclassified to net earnings during the next 12 months. A gain of \$4 million (2009 – \$5 million) recorded in accumulated other comprehensive income on cross currency swaps will be reclassified to net earnings over the next 12 months but will be partially offset by the losses reclassified from accumulated other comprehensive income to net earnings on available-for-sale assets. Remaining amounts on the cross currency swaps will be reclassified to net earnings over periods up to three years.

## Note 23. Financial Derivative Instruments

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

| (\$ millions)                  | Notional Amounts Maturing |        |          |        |          |            | 2010     | 2009     |
|--------------------------------|---------------------------|--------|----------|--------|----------|------------|----------|----------|
|                                | 2011                      | 2012   | 2013     | 2014   | 2015     | Thereafter | Total    | Total    |
| Cross currency swap receivable | \$ 56                     | \$ 166 | \$ 75    | \$ 145 | \$ 236   | \$ 528     | \$ 1,206 | \$ 1,149 |
| Cross currency swap payable    | \$ -                      | \$ -   | \$ (148) | \$ -   | \$ (148) | \$ -       | \$ (296) | \$ (296) |
| Interest rate swaps receivable | \$ 200                    | \$ -   | \$ -     | \$ -   | \$ -     | \$ -       | \$ 200   | \$ 250   |
| Interest rate swaps payable    | \$ -                      | \$ -   | \$ (150) | \$ -   | \$ -     | \$ -       | \$ (150) | \$ (150) |
| Equity forwards                | \$ (84)                   | \$ -   | \$ -     | \$ -   | \$ -     | \$ -       | \$ (84)  | \$ (99)  |
| Foreign Exchange Forwards      | \$ (66)                   | \$ -   | \$ -     | \$ -   | \$ -     | \$ -       | \$ (66)  | \$ (5)   |
| Electricity forward contract   | \$ (8)                    | \$ -   | \$ -     | \$ -   | \$ -     | \$ -       | \$ (8)   | \$ (17)  |

## Notes to the Consolidated Financial Statements

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** Glenhuron entered into cross currency swaps (see note 25) to exchange United States dollars for \$1,206 million (2009 – \$1,149 million) Canadian dollars, which mature by 2017. Cross currency swaps totalling \$200 million (2009 – \$250 million) are designated in a cash flow hedge and the remaining undesignated \$1,006 million (2009 – \$899 million) are classified as held-for-trading financial assets. Currency adjustments receivable or payable arising from these swaps are settled in cash on maturity. As at January 1, 2011, a cumulative unrealized foreign currency exchange rate receivable of \$161 million (2009 – \$123 million) was recorded in other assets (see note 12), and a receivable of \$15 million (2009 – \$40 million) was recorded in prepaid expenses and other assets.

In 2008, the Company entered into fixed cross currency swaps to exchange \$296 million Canadian dollars for \$300 million 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 15). As at January 1, 2011, a cumulative unrealized foreign currency exchange rate receivable of \$11 million (2009 – \$19 million) was recorded in other assets (see note 12).

**Interest Rate Swaps** Glenhuron maintains interest rate swaps (see note 25) that convert a notional \$200 million (2009 – \$250 million) of floating rate available-for-sale cash and cash equivalents, short term investments and security deposits to average fixed rate investments at 4.74% (2009 – 5.11%), which are part of a hedging relationship that matures in 2011. As at January 1, 2011, the fair value of these interest rate swaps of \$7 million (2009 – \$15 million) was recorded in other assets and the unrealized fair value gain of \$7 million (2009 – \$15 million) is deferred, net of tax, in accumulated other comprehensive income. When realized, these unrealized gains are reclassified to net earnings.

The Company also maintains a notional \$150 million (2009 – \$150 million) in interest rate swaps, on which it pays a fixed rate of 8.38% that are not part of a hedging relationship. At January 1, 2011, the fair value of these interest rate swaps of \$24 million (2009 – \$31 million) was recorded in other liabilities (see note 16).

**Equity Forwards (\$, except where otherwise indicated)** At year end 2010, Glenhuron had cumulative equity forwards (see note 21) to buy 1.5 million (2009 – 1.5 million) of the Company's common shares at a cumulative average forward price of \$56.26 (2009 – \$66.25) including \$0.04 (2009 – \$10.03) per common share of interest expense and dividends that has been recognized in net earnings and will be paid at each reset date. The equity forwards provide for settlement of net amounts owing between Glenhuron and its counterparty in cash or common shares. The equity forwards change in value as the market price of Loblaw's common shares changes (see note 25). The equity forwards provide a partial offset to fluctuations in the Company's stock-based compensation cost, including RSU plan expense which 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, dividends and the unrealized market loss of \$24 million (2009 – \$48 million) is included in accounts payable and accrued liabilities relating to these equity forwards. During 2010, Glenhuron paid \$16 million to its counterparty to settle the interest and dividends accrued on outstanding equity forwards. During 2009, Glenhuron paid \$55 million to terminate equity forwards representing 3.3 million shares, which led to the extinguishment of a corresponding portion of the associated liability.

**Foreign Exchange Forward** During 2010, the Company entered into forward contracts to hedge a portion of its United States dollar fixed asset and inventory purchases. As at January 1, 2011, the fair value of the foreign exchange forward contracts of \$1 million (2009 – \$nil) was recorded in accounts payable and accrued liabilities. During 2010, a \$2 million loss (2009 – \$nil) was recorded in operating income.

**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 at approximately 2006 rates. This electricity forward contract has an initial term of five years and expires in December 2011. As at January 1, 2011, the fair value of this forward contract of \$1 million (2009 – \$3 million) was recorded in other liabilities. During 2010, a gain in value of \$2 million (2009 – loss of \$10 million) was recorded in operating income.

**Fuel Exchange Traded Futures and Options** The Company from time to time enters 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 1, 2011, the Company did not hold any outstanding fuel exchange traded future or option contracts (2009 – nil). During 2010, a gain in value of \$1 million (2009 –\$4 million) was recorded in operating income.

#### **Note 24. 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 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 1, 2011 and January 2, 2010, and an analysis of financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

- Fair Value Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities
- Fair Value Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices)
- Fair Value Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs)

The following describes the fair value determinations of financial instruments:

**Cash and Cash Equivalents, Short Term Investments and Security Deposits** Fair value is primarily based on interest rates for similar instruments. Due to the short term maturity of these instruments, the carrying amount approximates fair value.

**Accounts Receivable, Accounts Payable and Accrued Liabilities and Short Term Borrowings** The carrying amount approximates fair value due to the short term maturity of these instruments.

**Long-Term Debt and Capital Securities** Fair value is based on the Company's current incremental borrowing rate for similar types of borrowing arrangements or, where applicable, quoted market prices.

**Derivative Financial Instruments** The fair values for the derivative assets and liabilities are estimated using industry standard valuation models. Where applicable, these models project future cash flows and discount the future amounts to a present value using market-based observable inputs including interest rate curves, credit spreads, foreign exchange rates, and forward and spot prices for currencies.

Notes to the Consolidated Financial Statements

As at January 1, 2011

| (\$ millions)  | 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> | \$ -  | \$ -  | \$ 1,874   | \$ 147  | \$ -                  | \$ -                        | \$ 2,021              | \$ 2,021         |
| Accounts receivable  | -   | -   | 21   | -   | 703                   | -                           | 724                   | 724              |
| Derivatives  | 64  | 133   | -  | -   | -                     | -                           | 197                   | 197              |
| <b>Total financial assets</b>  | <b>\$ 64</b>  | <b>\$ 133</b>   | <b>\$ 1,895</b>                                      | <b>\$ 147</b>   | <b>\$ 703</b>         | <b>\$ -</b>                 | <b>\$ 2,942</b>       | <b>\$ 2,942</b>  |
| Fair value level 1   | \$ -  | \$ -  | \$ -   | \$ -  | n/a                   | n/a                         | n/a                   | \$ -             |
| Fair value level 2   | 64  | 130   | 1,874  | 147   | n/a                   | n/a                         | n/a                   | 2,215            |
| Fair value level 3   | -   | 3   | 21   | -   | n/a                   | n/a                         | n/a                   | 24               |
| <b>Fair Value Total</b>  | <b>\$ 64</b>  | <b>\$ 133</b>   | <b>\$ 1,895</b>                                      | <b>\$ 147</b>   | <b>n/a</b>            | <b>n/a</b>                  | <b>n/a</b>            | <b>\$ 2,239</b>  |
| <b>Short term borrowings</b>   | \$ -  | \$ -  | \$ -   | \$ -  | \$ -                  | \$ 3                        | \$ 3                  | \$ 3             |
| Accounts payable and accrued liabilities                                       | -   | 24  | -  | -   | -                     | 3,392                       | 3,416                 | 3,416            |
| Long term debt   | -   | -   | -  | -   | -                     | 4,646                       | 4,646                 | 5,142            |
| Certain other liabilities  | -   | -   | -  | -   | -                     | 35                          | 35                    | 35               |
| Capital Securities   | -   | -   | -  | -   | -                     | 221                         | 221                   | 252              |
| Derivatives (see note 23)  | -   | 26  | -  | -   | -                     | 7                           | 33                    | 33               |
| <b>Total financial liabilities</b>   | <b>\$ -</b>   | <b>\$ 50</b>  | <b>\$ -</b>  | <b>\$ -</b>   | <b>\$ -</b>           | <b>\$ 8,304</b>             | <b>\$ 8,354</b>       | <b>\$ 8,881</b>  |
| Fair value level 1   | \$ -  | \$ -  | \$ -   | \$ -  | n/a                   | n/a                         | n/a                   | \$ -             |
| Fair value level 2   | -   | 50  | -  | -   | n/a                   | n/a                         | n/a                   | 50               |
| Fair value level 3   | -   | -   | -  | -   | n/a                   | n/a                         | n/a                   | -                |
| <b>Fair Value Total</b>  | <b>\$ -</b>   | <b>\$ 50</b>  | <b>\$ -</b>  | <b>\$ -</b>   | <b>n/a</b>            | <b>n/a</b>                  | <b>n/a</b>            | <b>\$ 50</b>     |

The equity investment in franchises is measured at a cost of \$85 because quoted market prices in an active market are not available. These investments are classified as available-for-sale.

As at January 2, 2010

| (\$ millions)   | 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 | \$ -  | \$ -  | \$ 1,448   | \$ 192  | \$ -                  | \$ -                        | \$ 1,640              | \$ 1,640         |
| Accounts receivable   | -   | -   | 13   | -   | 761                   | -                           | 774                   | 774              |
| Derivatives   | 83  | 116   | -  | -   | -                     | -                           | 199                   | 199              |
| <b>Total financial assets</b>   | <b>\$ 83</b>  | <b>\$ 116</b>   | <b>\$ 1,461</b>                                      | <b>\$ 192</b>   | <b>\$ 761</b>         | <b>\$ -</b>                 | <b>2,613</b>          | <b>\$ 2,613</b>  |
| Fair value level 1  | \$ -  | \$ -  | \$ -   | \$ -  | n/a                   | n/a                         | n/a                   | \$ -             |
| Fair value level 2  | 83  | 115   | 1,448  | 192   | n/a                   | n/a                         | n/a                   | 1,838            |
| Fair value level 3  | -   | 1   | 13   | -   | n/a                   | n/a                         | n/a                   | 14               |
| <b>Fair Value Total</b>   | <b>\$ 83</b>  | <b>\$ 116</b>   | <b>\$ 1,461</b>                                      | <b>\$ 192</b>   | <b>n/a</b>            | <b>n/a</b>                  | <b>n/a</b>            | <b>\$ 1,852</b>  |
| Short term borrowings   | \$ -  | \$ -  | \$ -   | \$ -  | \$ -                  | \$ 2                        | \$ 2                  | \$ 2             |
| Accounts payable and accrued liabilities                                | -   | 48  | -  | -   | -                     | 3,231                       | 3,279                 | 3,279            |
| Long term debt  | -   | -   | -  | -   | -                     | 4,505                       | 4,505                 | 4,801            |
| Certain other liabilities   | -   | -   | -  | -   | -                     | 36                          | 36                    | 36               |
| Capital Securities  | -   | -   | -  | -   | -                     | 220                         | 220                   | 244              |
| Derivatives (see note 23)   | -   | 34  | -  | -   | -                     | 7                           | 41                    | 41               |
| <b>Total financial liabilities</b>                                      | <b>\$ -</b>   | <b>\$ 82</b>  | <b>\$ -</b>  | <b>\$ -</b>   | <b>\$ -</b>           | <b>\$ 8,001</b>             | <b>\$ 8,083</b>       | <b>\$ 8,403</b>  |
| Fair value level 1  | \$ -  | \$ -  | \$ -   | \$ -  | n/a                   | n/a                         | n/a                   | \$ -             |
| Fair value level 2  | -   | 82  | -  | -   | n/a                   | n/a                         | n/a                   | 82               |
| Fair value level 3  | -   | -   | -  | -   | n/a                   | n/a                         | n/a                   | -                |
| <b>Fair Value Total</b>   | <b>\$ -</b>   | <b>\$ 82</b>  | <b>\$ -</b>  | <b>\$ -</b>   | <b>n/a</b>            | <b>n/a</b>                  | <b>n/a</b>            | <b>\$ 82</b>     |

The equity investment in franchises is measured at a cost of \$75 million because quoted market prices in an active market are not available. These investments are classified as available-for-sale.

The financial instruments classified as level 3 are as follows:

- The retained interest from the securitization of PC Bank receivables, for which a reconciliation and sensitivity analysis are included in note 8.
- The fair value of the embedded foreign currency derivative was \$3 million included in other assets (2009 - \$1 million), of which the fair value gain of \$2 million (2009 - \$4 million) was recognized in operating income. A 100 basis point increase (decrease) in foreign currency exchange rates would result in a \$1 gain (loss) in fair value.

There were no significant transfers between the fair value hierarchy levels during the year ended January 1, 2011.

During the year ended January 1, 2011, the net unrealized and realized loss on held-for-trading financial assets designated as held-for-trading, recognized in net earnings before income taxes and minority interest was \$32 million (2009 - \$122 million). In addition, the net unrealized and realized gain 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 \$53 million (2009 - \$88 million).

## Notes to the Consolidated Financial Statements

### Note 25. Financial Instrument Risk Management

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

**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 and PC Bank's financial performance and condition deteriorate or downgrades in the Company's credit ratings occur, the Company's and PC Bank's ability to obtain funding from external sources may be restricted. In addition, credit and capital markets are subject to inherent risks that may negatively affect the Company's access and ability to fund its derivative and non-derivative financial liabilities. The Company mitigates these risks by maintaining appropriate levels of cash and cash equivalents and short term investments, committed line of credit, actively monitoring market conditions, and diversifying its sources of funding and maturity profile of its debt and capital obligations.

*Maturity Analysis* The following are the undiscounted contractual maturities of significant financial liabilities as at January 1, 2011:

|   | 2011   | 2012   | 2013   | 2014   | 2015   | Thereafter <sup>(5)</sup> | Total    |
|---|--------|--------|--------|--------|--------|---------------------------|----------|
| <b>Derivative Financial Liabilities</b>                         |        |        |        |        |        |                           |          |
| Interest rate swaps payable <sup>(1)</sup>                      | \$ 13  | \$ 13  | \$ 5   | \$ -   | \$ -   | \$ -                      | \$ 31    |
| Equity forward contracts <sup>(2)</sup>                         | 84     | -      | -      | -      | -      | -                         | 84       |
| Foreign Exchange forward contracts                              | 66     | -      | -      | -      | -      | -                         | 66       |
| <b>Non-Derivative Financial Liabilities</b>                     |        |        |        |        |        |                           |          |
| Long term debt including fixed interest payments <sup>(3)</sup> | 685    | 315    | 655    | 688    | 366    | 6,136                     | 8,845    |
| Other Liabilities <sup>(4)</sup>                                | -      | -      | -      | 35     | -      | -                         | 35       |
|   | \$ 848 | \$ 328 | \$ 660 | \$ 723 | \$ 366 | \$ 6,136                  | \$ 9,061 |

(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 1, 2011.

(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) Contractual amount of obligation related to certain other liabilities.

(5) 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.

**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, pension assets held in the Company's defined benefit plans, PC Bank's credit card receivables and other receivables from vendors, independent franchisees, associated stores and independent accounts.

The Company may be exposed to losses if a counterparty to financial or non-financial derivative agreements fails to fulfill its obligations. Potential counterparty risk and losses are limited to the net amounts recoverable under such derivative agreements with any specific counterparty. These risks are further reduced by entering into agreements with counterparties that have at minimum long term "A" credit rating from a recognized credit rating agency and by placing risk adjusted limits on exposure to any single counterparty for financial derivative agreements. Internal policies, controls and reporting processes are in place and require ongoing assessment and corrective action, if necessary, with respect to derivative transactions.

Credit risk associated with cash equivalents, short term investments and security deposits results from the possibility that a counterparty may default on the repayment of a security. Policies and guidelines that require issuers of permissible investments to have a minimum 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 mitigate credit risk. These investments are purchased and held directly in custody accounts, and have limited exposure to 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 approximated by the positive fair market value of the derivatives on the balance sheet (see note 24).

Refer to note 8 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* Interest rate risk arises from the issuance of short term debt by the Company and equity forwards by Glenhuron, net of cash and cash equivalents, short term investments and security deposits. The Company is exposed to changes in short term interest rate volatility which are offset partly by Glenhuron's and the Company's interest rate swaps. The Company estimates that a 100 basis point increase (decrease) in short term interest rates, with all other variables held constant, could result in a decrease (increase) of \$21 million to interest expense.

*Foreign Currency Exchange Rate Risk* The Company is exposed to foreign currency exchange rate variability, primarily on United States dollar denominated cash and cash equivalents, short term investments, security deposits held by Glenhuron, foreign denominated and foreign currency based purchases in accounts payable and accrued liabilities, and USD private placement notes included in long term debt. The Company and Glenhuron have cross currency swaps and foreign exchange forward contracts that partially offset their respective exposure to fluctuations in foreign currency exchange rates.

As at January 1, 2011, USD \$1,033 million (2009 – USD \$945 million) was included in cash and cash equivalents, short term investments and security deposits (see note 7). The Company designates a portion of the cross currency swaps in a cash flow hedge of the exposure to fluctuations in the foreign currency exchange rate on a portion of United States dollar denominated cash equivalents, short term investments and security deposits. The remaining undesignated cross currency swaps partially offset fluctuations in the foreign currency exchange rate on the remaining United States dollar denominated cash and cash equivalents, short term investments, security deposits and the USD private placement notes.

During the year, the unrealized foreign currency exchange loss of \$12 million (2009 – \$25 million), related to the cash and cash equivalents, short term investments and security deposits classified as available-for-sale is recognized in other comprehensive income and was partially offset by the unrealized foreign currency exchange rate gain of \$12 million (2009 –\$28 million) before income taxes relating to the designated cross currency swaps also deferred in other comprehensive income. The unrealized foreign currency exchange loss of \$40 million (2009 –\$121 million) on the designated held-for-trading cash and cash equivalents, short term investments and security deposits is partially offset in operating income by the unrealized foreign currency exchange rate gain of \$40 million (2009 – \$117 million) relating to the cross currency swaps which are not designated in a cash flow hedge.

## Notes to the Consolidated Financial Statements

During the year, the Company realized a foreign currency exchange loss of \$39 million (2009 – \$14 million) relating to cross currency swaps that matured or were terminated.

During 2010, the Company recognized in operating income an unrealized foreign currency exchange gain of \$16 million (2009 – \$45 million) 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 a portion of 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 \$8 million (2009 – \$17 million) 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 \$1 million on earnings before income taxes and minority interest.

*Common Share Price Risk* The Company issues stock-based compensation to its employees in the form of stock options and RSU's based on its common shares. Consequently, operating income is negatively impacted when the common share price increases and positively when the share price declines. Glenhuron's equity forwards provide a partial offset to fluctuations in stock-based compensation cost. 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 the Company'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 more effective when the market price of the Company's common shares exceeds the exercise price of the employee stock options. When the market price of the common shares is lower than the exercise price of the 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 \$1 million in earnings before income taxes and minority interest.

### **Note 26. 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 \$95 million (2009 – \$76 million) with respect to capital investment projects such as the construction, expansion and renovation of buildings and the purchase of real property.

The Company establishes letters of credit used in connection with certain obligations mainly related to real estate transactions, benefit programs, purchase orders and performance guarantees. The aggregate gross potential liability related to these letters of credit is approximately \$325 million (2009 – \$277 million). Additionally, the Company has a guarantee on behalf of PC Bank in the amount of US \$180 million. Other 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".

**Independent Funding Trusts** Certain independent franchisees of the Company obtain financing through a structure involving independent funding 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.

The gross principal amount of loans issued to the Company's independent franchisees by the independent funding trusts as at January 1, 2011 was \$405 million (2009 – \$390 million) including \$202 million (2009 – \$163 million) of loans payable by VIEs consolidated by the Company. 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 representing not less than 15% (2009 – 15%) of the principal amount of the loans outstanding. This standby letter of credit has never been drawn upon. This credit enhancement allows the independent funding trust to provide financing 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.

During the second quarter of 2010, the \$475 million, 364-day revolving committed credit facility that is the source of funding to the independent trusts was renewed. This facility has a further 12 month repayment term upon maturity. The financing structure has been reviewed and the Company determined there were no additional VIEs to consolidate as a result of this financing. In accordance with Canadian GAAP, the financial statements of the independent funding trust are not consolidated with those of the Company.

**Letters of Credit** Letters of credit for the benefit of independent trusts with respect to credit card receivables securitization programs 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% (2009 – 9%) on a portion of the securitized credit card receivables amount, is approximately \$48 million (2009 – \$116 million) (see note 8).

**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 \$26 million (2009 – \$41 million).

**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.

## Notes to the Consolidated Financial Statements

**Legal Proceedings** 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 and claims is uncertain. However, based on information currently available, these proceedings and claims, individually and in the aggregate, are not expected to have a material impact on the Company.

### Note 27. 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 VIEs' expected losses or that entitle it to receive a majority of the VIEs' expected residual returns or both. The Company has identified the following significant VIEs:

**Franchisees** The Company enters into various forms of franchise agreements that generally require the 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. 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 26). These trusts are administered by a major Canadian chartered bank. Under the terms of certain franchise agreements, the Company may also lease equipment to franchisees. 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 franchisees and provides for estimated losses or write-downs on its accounts and notes receivable or investments when appropriate.

As at January 1, 2011, 214 (2009 – 166) of the Company's franchised 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.

**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 VIEs, 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 26.

### Note 28. Related Party Transactions

The Company's majority shareholder, Weston and its affiliates other than the Company are related parties. The Company's policy is 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% (2009 – 3%) of the cost of merchandise inventories sold.

**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 2010 were approximately \$9 million (2009 – \$10 million).

**Real Estate Matters** The Company leases office space from an affiliate of Weston for approximately \$3 million (2009 – \$3 million).

**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 amounts outstanding as at January 1, 2011 and January 2, 2010.

**Income Tax Matters** From time to time, the Company, Weston and its affiliates may enter into agreements to make elections that are permitted or required under applicable income tax legislation with respect to affiliated corporations. These elections and accompanying agreements did not have a material impact on the Company in 2010.

**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 2010 were \$16 million (2009 – \$16 million). Fees paid under this agreement are reviewed each year by the Audit Committee.

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.

**Dividend Reinvestment Plan** During the year, the Company issued 3,621,086 (2009 – 3,163,375) common shares to Weston under the DRIP (see note 19).

## **Note 29. Business Acquisitions and Dispositions**

**Acquisition of T&T** The Company acquired all of the outstanding common shares of T&T in the third quarter of 2009 for cash consideration of \$200 million, \$191 million of which was paid on the date of acquisition. The Company also assumed a liability of \$34 million associated with preferred shares issued by T&T to a vendor prior to the acquisition. The liability will increase with a favourable performance of the T&T business and the increase in the liability will be expensed as incurred. \$4 million of acquisition costs were incurred in connection with the acquisition. The acquisition was accounted for using the purchase method of accounting and its results of operations from the date of the acquisition have been included by the Company.

The preferred shares are classified as Other Liabilities on the Consolidated Balance Sheets. Redemption or purchase of the preferred shares may take place upon the occurrence of certain events, including the expiry of 5 years from the closing date of the acquisition. The preferred shareholder may increase this period up to a further 5 years if certain conditions are met. The preferred share liability may be satisfied in cash, the Company's common shares, or a combination thereof, at the option of the Company.

## Notes to the Consolidated Financial Statements

During 2010, the Company finalized the purchase price allocation related to the acquisition which resulted in a reduction of goodwill of \$2 million (see note 11). The final purchase price allocation, based on management's assessment of fair value is as follows:

### Net assets acquired (\$ millions):

|  |               |
|--|---------------|
| Inventory  | \$ 39         |
| Other current assets   | 9             |
| Fixed assets   | 73            |
| Goodwill   | 129           |
| Indefinite life intangible assets (trademarks and brand names) | 51            |
| Definite life intangible assets                                | 14            |
| Current liabilities  | (60)          |
| Other liabilities  | (39)          |
| Future income taxes  | (16)          |
| <b>Cash consideration</b>                                      | <u>\$ 200</u> |

In connection with the acquisition of T&T, the Company also acquired certain net assets for \$5 million.

The goodwill associated with these transactions is not deductible for tax purposes.

### Note 30. 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.