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

1. Forward-Looking Statements

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

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

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

2. Overview

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

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

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

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

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

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

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

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

3. Vision and Strategies

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

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

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

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

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

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

4. Key Performance Indicators

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

Key financial performance indicators are set out below:

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

5. Financial Performance

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

5.1 Results of Operations

Sales

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

Total Sales, Sales Growth and Same-Store Sales Growth

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

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

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

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

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

Operating Income

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

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

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

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

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

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

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

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

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

EBITDA[1]

2008 EBITDA[1] increased by $307 million, or 23.2%, to $1,631 million compared to $1,324 million in 2007. EBITDA margin[1] increased to 5.3% compared to 4.5% in 2007. The increase is a result of the increase in operating income which is described above.

Interest Expense and Other Financing Charges

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

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

Income Taxes

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

Net Earnings

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

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

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

5.2 Financial Condition

Financial Ratios

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

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

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

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

Capital Securities

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

First Preferred Shares

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

Common Share Capital

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

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

Dividends

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

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

6. Liquidity and Capital Resources

6.1 Cash Flows

Major Cash Flow Components

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

Cash Flows from Operating Activities

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

Cash Flows used in Investing Activities

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

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

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

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

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

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

Capital Investment and Store Activity

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

Cash Flows used in Financing Activities

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

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

Net Debt[(1)]

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

6.2 Sources of Liquidity

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

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

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

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

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

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

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

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

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

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

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

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

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

Independent Funding Trust

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

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

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

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

6.3 Contractual Obligations

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

Summary of Contractual Obligations

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

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

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

6.4 Off-Balance Sheet Arrangements

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

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

Guarantees

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

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

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

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

Securitization of Credit Card Receivables

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

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

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

Independent Funding Trust

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

7. Quarterly Results of Operations

7.1 Results by Quarter

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

Summary of Quarterly Results
(unaudited)

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

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

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

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

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

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

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

7.2 Fourth Quarter Results

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

Selected Consolidated Information for the Fourth Quarter

(unaudited)

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

Total Sales, Sales Growth and Same-Store Sales Growth

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

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

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

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

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

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

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

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

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

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

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

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

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

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

8. Controls and Procedures

Disclosure Controls and Procedures

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

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

9. Internal Control over Financial Reporting

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

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

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

Changes in Internal Control over Financial Reporting

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

10. Risks and Risk Management

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

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

10.1 Operating Risks and Risk Management

Competitive Environment

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

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

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

Economic Environment

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

Change Management and Execution

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

Distribution and Supply Chain

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

Information Technology

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

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

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

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

Colleague Development and Retention

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

Food Safety and Public Health

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

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

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

Environmental, Health and Safety

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

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

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

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

Labour Relations

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

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

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

Trademark or Brand Erosion

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

Legal, Taxation and Accounting

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

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

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

Merchandising and Excess Inventory

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

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

Business Continuity

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

Vendor Management

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

Franchise Independence

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

Employee Future Benefit Contributions

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

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

Multi-Employer Pension Plans

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

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

Third-Party Suppliers

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

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

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

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

Real Estate and Store Renovations

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

Seasonality

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

Utility and Fuel Prices

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

Ethical Business Conduct

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

Insurance

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

Holding Company Structure

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

10.2 Financial Risks and Risk Management

Liquidity

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

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

Credit

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

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

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

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

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

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

Commodity Price

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

Interest Rate

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

Common Share Market Price

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

Foreign Currency Exchange Rate

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

Derivative Instruments

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

11. Related Party Transactions

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

Inventory Purchases

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

Cost Sharing Agreements

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

Real Estate Matters

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

Borrowings/Lendings

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

Income Tax Matters

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

Supply Agreement

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

Management Agreements

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

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

12. Critical Accounting Estimates

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

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

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

12.1 Inventories

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

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

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

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

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

12.2 Employee Future Benefits

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

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

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

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

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

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

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

12.3 Goodwill

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

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

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

12.4 Income Taxes

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

12.5 Goods and Services Tax and Provincial Sales Taxes

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

12.6 Fixed Assets

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

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

13. Accounting Standards

13.1 Accounting Standards Implemented in 2008

Capital Disclosures and Financial Instruments – Disclosure and Presentation

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

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

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

Inventories

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

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

13.2 Future Accounting Standards

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

Goodwill and Intangible Assets

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

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

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

International Financial Reporting Standards ("IFRS")

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

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

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

14. Outlook(1)

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

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

15. Non-GAAP Financial Measures

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

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

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

EBITDA and EBITDA Margin

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

EBITDA margin is calculated as EBITDA divided by sales.

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

Net Debt

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

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

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

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

Free Cash Flow

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

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

Total Assets

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

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

16. Additional Information

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

March 12, 2009
Toronto, Canada

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