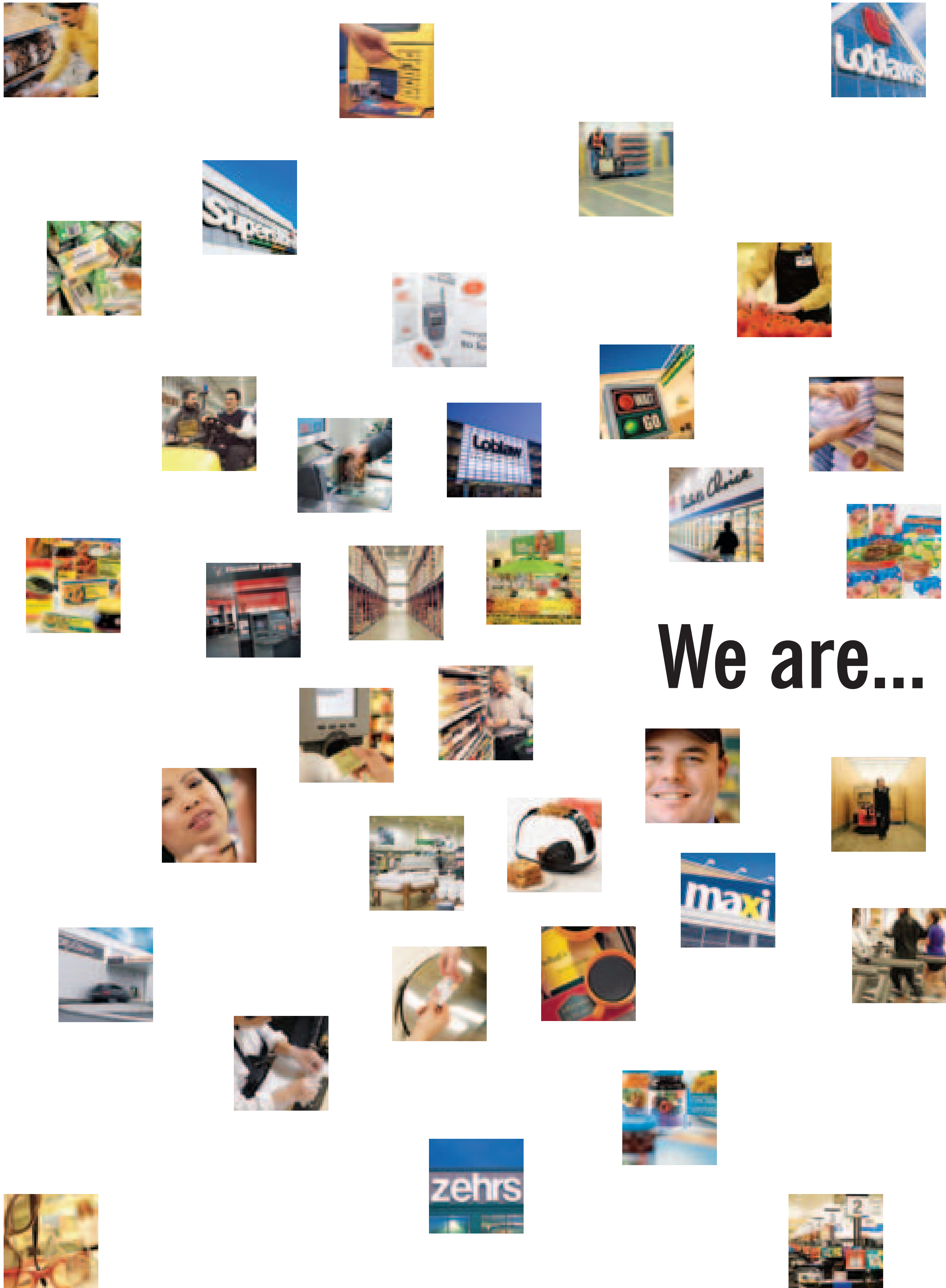



# We are...

Loblaw® COMPANIES LIMITED

**Loblaw Companies Limited** 2005 Annual Summary

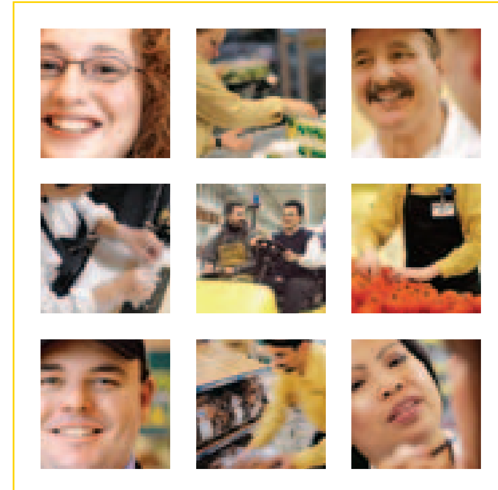
Loblaw Companies Limited ("Loblaw" or the "Company") is Canada's largest food distributor and a leading provider of general merchandise products, drugstore and financial products and services. Through its various operating banners, Loblaw is committed to providing Canadians with a one-stop destination in meeting their food and everyday household needs. This goal is pursued through a portfolio of store formats across the country. Loblaw is known for the quality, innovation and value of its food offering. It also offers Canada's strongest control label program, including the unique *President's Choice* and *no name* brands.

While food remains at the heart of its offering, Loblaw seeks to change Canadians' perceptions of what a supermarket can be. Loblaw stores provide a wide, growing and successful range of products and services to meet the everyday household needs of Canadian consumers. In addition, *President's Choice Financial* services offer core banking, a popular MasterCard®, *PC Financial* auto, home, travel and pet insurance as well as the *PC* points loyalty program.

Loblaw seeks to achieve its business objectives through stable, sustainable and long term growth. Its willingness to assume prudent operating risks is equaled by its commitment to the maintenance of a strong balance sheet position. In executing its strategies, Loblaw allocates the resources needed to invest in and expand its existing markets. It also maintains an active product development program. Loblaw is highly selective in its consideration of acquisitions and other business opportunities. Given the competitive nature of its industry, Loblaw also strives to make its operating environment as stable and as cost effective as possible. It works to ensure that its technology systems and logistics enhance the efficiency of its operations.

Over 134,000 full-time and part-time employees execute its business strategy in more than 1,000 corporate and franchised stores from coast to coast. This makes Loblaw one of Canada's largest private sector employers. It strives to contribute to the communities it serves and to exercise responsible corporate citizenship.

## Store Formats



## Many Strengths, One Vision

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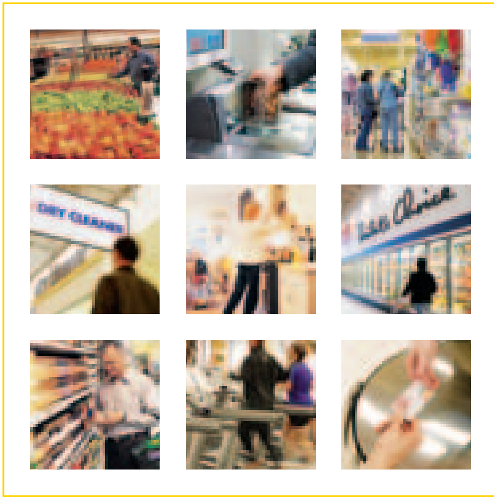
2005 Annual Summary


2 Financial Highlights
5 Report to Shareholders
7 Operational Directory
9 Operational Review
16 Community Support
17 Corporate Social Responsibility
18 Summary of Corporate Governance Practices
20 Board of Directors and Corporate Officers


The 2005 Annual Report consists of this 2005 Annual Summary and the 2005 Financial Report.

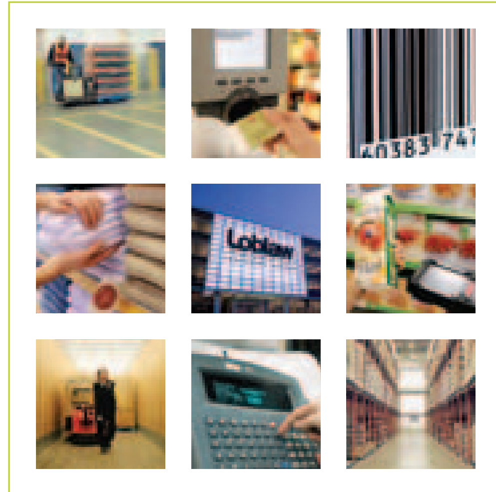
## Customer Focus



## Strategic Business Initiatives

# ...aligning for success.

## Product Innovation




## National Systems and Supply Chain

## Financial Highlights[1]

| For the years ended December 31, 2005 and January 1, 2005<br>($ millions except where otherwise indicated) | 2005<br>(52 weeks) | 2004<br>(52 weeks) |
|---|---|---|
| **Operating Results** | | |
| Sales | **$ 27,801** | $ 26,209 |
| Sales excluding impact of variable interest entities[2] | **27,423** | 26,209 |
| Adjusted EBITDA[2] | **2,132** | 2,125 |
| Operating income | **1,401** | 1,652 |
| Adjusted operating income[2] | **1,600** | 1,652 |
| Interest expense | **252** | 239 |
| Net earnings | **746** | 968 |
| **Cash Flow** | | |
| Cash flows from operating activities | **1,489** | 1,443 |
| Capital investment | **1,156** | 1,258 |
| **Per Common Share** ($) | | |
| Basic net earnings | **2.72** | 3.53 |
| Adjusted basic net earnings[2] | **3.35** | 3.48 |
| Dividend rate at year end | **.84** | .76 |
| Cash flows from operating activities | **5.43** | 5.26 |
| Book value | **21.48** | 19.74 |
| Market price at year end | **56.37** | 72.02 |
| **Financial Ratios** | | |
| Adjusted EBITDA margin[2] | **7.8%** | 8.1% |
| Operating margin | **5.0%** | 6.3% |
| Adjusted operating margin[2] | **5.8%** | 6.3% |
| Return on average total assets[2] | **11.2%** | 14.2% |
| Return on average shareholders' equity | **13.2%** | 19.2% |
| Interest coverage | **5.6:1** | 6.9:1 |
| Net debt[2] to equity | **.66:1** | .71:1 |
| **Operating Statistics** | | |
| Retail square footage (in millions) | **48.5** | 45.7 |
| Average corporate store size (square feet) | **56,100** | 53,600 |
| Corporate stores sales per average square foot ($) | **579** | 592 |
| Same-store sales growth | **0.2%** | 1.5% |
| Number of corporate stores | **670** | 658 |
| Number of franchised stores | **402** | 400 |

(1) For financial definitions and ratios refer to the Glossary of Terms on page 68 of the 2005 Financial Report.
(2) See Non-GAAP Financial Measures on page 33 of the 2005 Financial Report.

**Forward-Looking Statements**

This Annual Report, which consists of the Annual Summary and the Financial Report, contains forward-looking statements which reflect management's expectations regarding the Company's objectives, plans, goals, strategies, future growth, results of operations, performance and business prospects and opportunities. These forward-looking statements include expected sales and earnings prospects for 2006. Forward-looking statements are typically identified by words or phrases such as "anticipates", "expects", "believes", "estimates", "intends" and other similar expressions.

These forward-looking statements are not guarantees, but only predictions. Although the Company believes that these statements are based on information and assumptions which are current, reasonable and complete, these statements are necessarily subject to a number of factors that could cause actual results to vary significantly from the estimates, projections and intentions. Such differences may be caused by factors which include, but are not limited to, changes in consumer spending and preferences, heightened competition including new competitors and expansion of current competitors, the ability to realize anticipated cost savings, including those resulting from restructuring and other cost reduction initiatives, the ability to execute restructuring plans effectively, the Company's relationship with its employees, results of labour negotiations including the terms of future collective bargaining agreements, changes to the regulatory environment in which the Company operates now or in the future, changes in the Company's tax liabilities, either through changes in tax laws or future assessments, performance of third-party service providers, public health events, the ability of the Company to attract and retain key executives, and supply and quality control issues with vendors. The Company cautions that this list of factors is not exhaustive. These factors 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 Company's Management's Discussion and Analysis in its Financial Report.

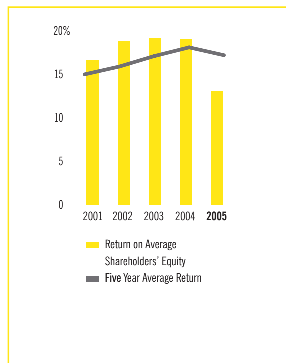
The assumptions applied in making the forward-looking statements contained in this Annual Report include the following: economic conditions in 2006 do not materially change from those expected, patterns of consumer spending are reasonably consistent with historical trends, no new significant competitors enter our markets nor does any existing competitor significantly increase its presence, anticipated cost savings from restructuring activities are realized as planned, continuing future restructuring activities are effectively executed, there are no material work stoppages in 2006 and the performance of third-party service providers is in accordance with expectations in the upcoming year.

Potential investors and other readers are urged to consider these factors carefully in evaluating these forward-looking statements and are cautioned not to place undue reliance on them. The forward-looking statements included in this Annual Report are made only as of the filing date of this Annual Report and the Company does not undertake to publicly update these forward-looking statements to reflect new information, future events or otherwise. In light of these risks, uncertainties and assumptions, the forward-looking events contained in these forward-looking statements may or may not occur. The Company cannot assure that projected results or events will be achieved.

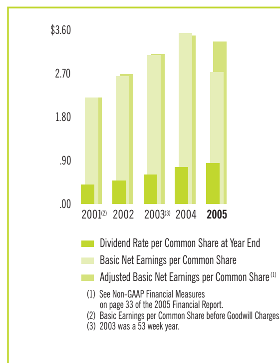
**Aligning for success involves...**

- offering four distinct store formats while continuing to operate under a multi-banner approach;
- relocating 132 employees and their families from Calgary to Toronto, and from Vancouver to Calgary in order to focus operational efforts towards maximizing opportunities;
- a multi-year restructuring of the Company's supply chain to a more efficient network of fewer, yet larger facilities;
- consolidating seven administrative offices from across southern Ontario into one national head office and Store Support Centre; and
- investing resources in repositioning the Company for the longer term in response to today's changing competitive landscape, and absorbing the short term costs associated with that investment.

**Return on Average Shareholders' Equity**

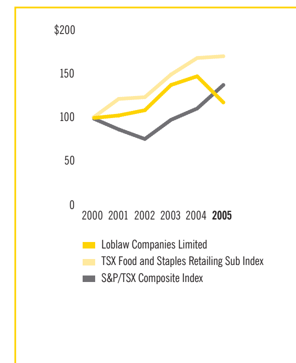



**Basic Net Earnings, Adjusted Basic Net Earnings[1] and Dividend Rate per Common Share** ($)




(1) See Non-GAAP Financial Measures on page 33 of the 2005 Financial Report.
(2) Basic Earnings per Common Share before Goodwill Charges.
(3) 2003 was a 53 week year.

**Total Return on $100 Investment (includes dividend reinvestment)** ($)



W. Galen Weston, Chairman and John A. Lederer, President

**In 2005, Loblaw Companies Limited moved closer to completing one of the largest transformations in its history. We were challenged by the size and impact of the short term costs associated with executing certain elements of the transformation.**

At the same time, we were confident that this initiative was absolutely necessary to ensure that Loblaw can continue to compete successfully, to grow and to generate meaningful value over the longer term.

We had anticipated and disclosed that the impact of our transformation would adversely affect sales and earnings during the past year. We also indicated our willingness to incur these consequences in order to complete the process and to realize the long term benefits associated with it. Nonetheless, the short term costs turned out to be greater and more prolonged than expected, as evidenced by our results for 2005. Sales excluding the impact of variable interest entities[1] rose by 4.6% to $27.4 billion. Adjusted operating income[1] decreased 3.1% to $1.6 billion. And adjusted basic net earnings per common share[1] fell 3.7% to $3.35. On an unadjusted basis, sales, operating income and basic net earnings per common share were $27.8 billion, $1.4 billion and $2.72, respectively.

#### Anticipating a Changing Environment

Loblaw has long demonstrated an ability to anticipate change in the marketplace and to act accordingly. The Company's transformation of recent years reflects a thorough analysis of the fast-changing retail landscape and of our place in it. That landscape is increasingly marked by such factors as an over-supply of retail square footage, the consumer's desire for a value-driven shopping experience, and the presence of low-cost global retailers.

Based on this assessment, the Company developed a comprehensive strategy designed to fortify its competitive position, maintain its leadership role in meeting the food and everyday household needs of Canadians, and generate long-term value for shareholders.

In pursuit of this strategy, Loblaw implemented a number of transformative changes to its structure and operations. These changes were designed to align the different yet connected parts of our business into a more unified, efficient, cost-effective and nationally-focused organization.

We made significant progress in pursuit of these goals in 2005. A number of office facilities were consolidated. A number of functions were reorganized. A national general merchandise organizational structure was established and a new head office and Store Support Centre in Brampton, Ontario that is now home to 2,000 employees was completed.

We have acknowledged on previous occasions that the Company may have taken on too much, too quickly during the past year. This was especially evident in the delays surrounding the execution of planned changes to our national systems platform and supply chain. These delays disrupted the flow of inventory to our stores, which affected sales and earnings. We concluded, however, that the long term interests of the business, our shareholders and other stakeholders would be best served by our completing these measures as quickly as practicable.

These execution-centred challenges are being addressed and resolved. We expect that the negative impact of these changes will be absorbed by the end of the second quarter of 2006. We expect that adjusted basic net earnings per common share[1] performance will improve during the second half of 2006. And we are confident that Loblaw will emerge from this process as a stronger and even more competitive company.

#### Acting on Our Strategic Imperatives

Even as the Company worked through this transformation during the past year, it remained focused on the day-to-day business of serving customers. These efforts were guided by a number of strategic imperatives reflecting the Company's commitment to becoming more relevant in meeting the food and everyday household needs of Canadians. Significant progress was recorded in pursuit of this objective and against these imperatives during the past year.

Strengthening Our Food Offering Food remains at the heart of our business. In 2005, a number of steps were taken to strengthen that offering and a renewed commitment was made to the fresh component. New products and programs were introduced in the produce, meat, bakery, seafood and deli departments and other areas. Centralized food merchandising teams were established to realize opportunities of scale and develop common practices. And new collaborative initiatives were undertaken with suppliers.

The Company also increased the number of food offerings under two of Canada's most trusted and recognized control label brand names – *President's Choice* and *no name*. These products reinforced the qualities for which the brands are known – innovation, quality, value and focus on the customer.

This focus was especially evident in the Company's response to the consumer's interest in health and nutrition. Well-received initiatives included the publication of the first Healthy *Insider's Report*, featuring *PC Blue Menu*, *PC Mini Chefs* and additional *PC Organics* products.

Growing Our General Merchandise and Drugstore Business Loblaw has demonstrated that an excellent food offering can generate general merchandise and drugstore sales. In 2005, the Company moved to grow these increasingly important elements of our business. A national, integrated organizational structure was established and was relocated to the new head office and Store Support Centre.

The general merchandise offering was focused on conveying such qualities as product innovation, great value and differentiation in the marketplace. The number of products and services offered continued to increase. More than 1,000 of these items are now offered under the *President's Choice* brand. In addition, we continued to build the scope and credibility of our everyday household items to supplement our powerful seasonal offerings.

(1) See Non-GAAP Financial Measures on page 33 of the 2005 Financial Report.

**We believe that the strategic transformation will fully align the elements of our business. This will provide the concentration of focus and resources needed to achieve the desired levels of growth going forward.**

As a result, the general merchandise and drugstore business helped Loblaw become more important in more aspects of the home. In 2005, we introduced the *PC* Bath and Body line of products, issued the first *PC* Home *Insider's Report*, and launched the *PC Mobile* line of prepaid cellular phone services and related accessories. Most recently, the *Joe Fresh Style* line of apparel for adults has been introduced, offering unique style at value-oriented prices in an easy shopping environment.

Tailoring Formats to Individual Markets In 2005, the Company continued to execute its proven strategy of offering four distinct store formats: superstores, hard discount stores, conventional stores and warehouse clubs. This multi-format approach provides us with the flexibility to serve the needs of specific markets in each region of the country.

Our format strategy was supported by a capital investment program exceeding $1 billion. Under this program, steps were taken to increase our emphasis on value footage. This reflected the consumer's increasing preference for value and a one-stop shopping experience. We continued the successful expansion of *The Real Canadian Superstore* model into Ontario. As well, discussions continued with organized labour to explore competitive opportunities. These opportunities include converting existing conventional stores into superstores in response to local market conditions and where it makes economic sense to do so. In addition, Loblaw will continue to invest, where appropriate, in its strong conventional format.

Supporting Our Stores Steps were taken in 2005 to provide consumers with a consistent and unique shopping experience across the store network. New and re-formatted banner identities were developed, store exteriors were remodeled, store architecture and decor were updated, and new in-store signage was introduced. As well, a 40,000 square foot facility was established to provide opportunities to pre-test department layouts and signage, as well as to conduct product education and other training programs. These and other measures helped to convey the selection, quality, service and value underlying the Company's offering to consumers.

Work also continued on the conversion to one national systems platform across a number of functions, including store ordering, purchasing, and inventory tracking. In addition, the Company moved forward on the restructuring of its supply chain. Upon completion, this measure is expected to improve the movement of inventory, reduce wait times, improve service levels to the stores, and lower costs. Measures were also taken to simplify the Company's distribution network. This entailed the closure of several smaller facilities and the transfer of various functions to larger and more cost-effective centres. The year also saw the opening of a new, third-party owned and operated general merchandise warehouse and distribution centre for eastern Canada. In addition, the Company began a process that will examine how to simplify its business operations, including the flow of goods from vendors to store shelves.

Developing Our Greatest Resource During the past year, we introduced a number of measures designed to develop our greatest resource – our employees. The Leadership Means Business program continued to expand. This program is designed to enhance the capabilities of managers in leading and engaging the men and women on the Company's front line. Its goal is to identify, train, support and strengthen leadership at the store level.

The Store Managers' Council completed its first full year of operation in 2005. This group of twelve managers from different regions focuses on such issues as improving communication, leadership development and training programs for store personnel. The Council also attended and reported to the Company's annual management conference in 2005. These actions reflected the commitment made by senior management to consult with and listen to people in the stores, and to act on their feedback and recommendations.

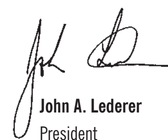
Other leadership-related initiatives of the past year were designed to encourage collaboration, alignment and leadership across the store network. These measures included off-site leadership sessions for store personnel as well as visits to and tours of individual stores. The Company also took steps that will provide a common approach to leadership coaching, program execution and business development at the store level.

**Aligning for Success**

While the past year had its share of short term challenges, it also saw a number of positive developments that bode well for the future. We believe that the strategic transformation will fully align the elements of our business. It will provide the concentration of focus and resources needed to achieve the desired levels of growth going forward. It also reflects our commitment to manage the business for the longer term. As we have done successfully in the past, we believe that we are taking the significant steps required to ensure that Loblaw continues to grow, to succeed and to provide sustainable value in a changing landscape.

The Company's achievements in any given year are attributable to our employees, shareholders, customers, vendors and other partners. We are especially appreciative of their efforts and commitment during the past year, which was marked by short term challenge and long term opportunity. We are confident that the benefits of our transformation will reward the confidence shown by all our valued stakeholders in this great Canadian enterprise.

**W. Galen Weston**
Chairman



**John A. Lederer**
President

## Operational Directory

(includes age and years of service)

**John A. Lederer**
(50 and 29 years)
President

**Mark Butler**
(45 and 30 years)
Atlantic Operations

**Preston D. McLean**
(44 and 20 years)
Atlantic Superstore
and Dominion*
*in Newfoundland and Labrador

**Tom Cogswell**
(56 and 39 years)
Atlantic SaveEasy
and Cash & Carry

**Bernard J. McDonell**
(51 and 12 years)
Quebec Operations

**Dave Mock**
(46 and 23 years)
Quebec Merchandising

**André Fortier**
(48 and 5 years)
Maxi

**Daniel Dufresne**
(48 and 4 years)
Retail Operations

**Jocyanne Bourdeau**
(38 and 2 years)
Loblaws and Maxi & Cie.

**Serge Racette**
(47 and 3 years)
Provigo, L'intermarché, Axep

**Carmen Fortino**
(47 and 21 years)
Ontario Operations

**N. Deane Collinson**
(51 and 21 years)
Loblaws

**Vince Scorniaenchi**
(47 and 33 years)
Zehrs Markets
and Fortinos

**Robert Adams**
(45 and 22 years)
No Frills

**Tim R. Staffen**
(47 and 17 years)
Your Independent Grocer
and Valu-mart

**R. Glen Gonder**
(47 and 28 years)
Western Operations

**Raymond P. Daoust**
(52 and 34 years)
The Real Canadian Superstore

**David A. Berg**
(44 and 28 years)
Extra Foods

**Robert Pols**
(47 and 7 years)
SuperValu, Shop Easy Foods
and Lucky Dollar Foods

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**Robert A. Balcom**
(44 and 12 years)
General Counsel

**David C. Boone**
(36 and 13 years)
The Real Canadian Wholesale Club
and Cash & Carry

**David K. Bragg**
(57 and 22 years)
Real Estate

**Roy R. Conliffe**
(55 and 24 years)
Labour Relations

**Joseph Jackman**
(46 and 1 year)
Marketing

**David R. Jeffs**
(48 and 27 years)
General Merchandise Operations

**Richard P. Mavrinac**
(53 and 23 years)
Treasury, Tax, Risk Management
and Investor Relations

**Peter McMahon**
(effective February 2006)
Supply Chain

**Paul D. Ormsby**
(54 and 23 years)
Information Technology and
Food Sourcing and Procurement

**Pietro Satriano**
(43 and 4 years)
Control Label Development

**Stephen A. Smith**
(48 and 20 years)
Financial Control and Reporting,
Employee Development and
Services and Loss Prevention

**Galen G. Weston**
(33 and 8 years)
Corporate Development

**National Head Office and Store Support Centre opened in 2005.**

At *The Real Canadian Superstore*, customers enjoy an exciting shopping experience where “Super never cost so little”.

## As the heart of its business, the Company took steps in 2005 to further strengthen its store network and to make those stores more relevant to Canadian consumers.

This was pursued, in large part, through the Company's assortment of formats operating under a number of banners. This multi-format approach ensures that the Company can provide the store model and the product offerings that best suit the consumer preferences and business environment in any given market area.

Throughout 2005, the Company continued to execute a significant capital investment program in support of its stores and formats. A particular focus of this program was the growth of the superstore format in Ontario. This strategic initiative continued to be well received and to generate positive results. In addition, the Company continued its collaborative dialogue with the representatives of its unionized employees. This dialogue focused on such business opportunities as expanding the superstore format by converting conventional locations where it makes sense to do so. This strategy helps to address the consumer's increasing preference for value and convenience. It also reflects the Company's stated commitment to provide Canadians with a one-stop shopping destination in meeting their food and everyday household needs.

In support of that commitment, Loblaw refreshed the appearance of many of its stores during the past year. These alterations were designed to reinforce the stores' position in the marketplace as destinations for value, quality and selection. Store exteriors were enhanced through remodeling and new signage. Interiors featured new architecture, decor and in-store signage. And several banners received new or re-formatted identities as part of this multi-faceted process.

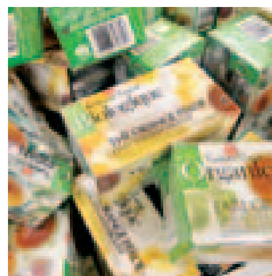
In 2005, the Company took other, less visible, steps to support its store network. A number of operational and administrative functions were brought together so that they could work more effectively. A new head office and Store Support Centre was opened in Brampton, Ontario. And a testing facility was opened, in which training programs can be conducted and potential department layouts can be examined before being introduced into the stores. These measures were taken to ensure that the Company's many strengths support the vision of a more aligned organization.

**Over 48 million**

square feet of retail space from coast to coast.

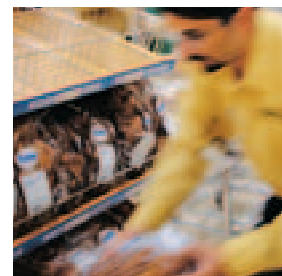
**Over 134,000**

employees contribute to Loblaw's successes.



**Over 1,700,000**

customers enjoy the convenience of shopping at our stores every day.



*PC* products deliver great taste and real value in every aisle.

Healthy eating never tasted so good! Our *PC Blue Menu* line of over 200 products offers Canadians a healthier alternative.

**Loblaw has a proven ability to anticipate and respond to changing consumer preferences in an increasingly competitive landscape and is committed to meeting more of the food and everyday household needs of consumers from coast to coast.**

The Company fulfills this commitment by providing an increasing range of food, general merchandise and drugstore offerings, many under the extremely successful *President's Choice*, *no name* and *Exact* control label brand names.

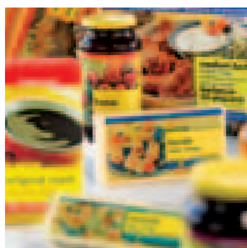
Along with its store network, food remains at the heart of the Company. In 2005, Loblaw continued its focus on the fresh component of its food business by introducing new products and programs and implementing a number of operational measures. These measures included the creation of a centralized food merchandising function designed to achieve opportunities of scale and to identify common practices. In addition, the Company engaged its suppliers in developing more effective ways of working together.

These measures were aimed at further reinforcing consumer confidence in the Company's food offering and increasing customer loyalty to its stores. This loyalty was earned by building on the proven success of the *President's Choice* brand, especially in addressing the growing consumer interest in nutrition and health. A number of measures initiated in 2005 demonstrated the continuing leadership role played by the Company and by *President's Choice*. The *PC Blue Menu* line of healthier, nutritious foods was launched and the *PC Mini Chefs* portfolio was expanded. And the Company's first Healthy *Insider's Report* was published. These actions further enhanced the reputation of *President's Choice* for innovative, affordable and convenient products. In addition, the *PC* points program offered through *President's Choice Financial* services continued to play an important part in the Company's consumer loyalty initiative.

To complement its excellent food offering, the Company continued to add to its assortment of general merchandise, drugstore and financial products and services, a number of which were offered under the *President's Choice* brand. New offerings, like the *PC Mobile* line of prepaid cellular phone services and the *Joe Fresh Style* line of apparel for adults, are helping the Company become more relevant to its customers' varied lifestyles.

**Over 300**

items featured in the *PC* Home *Insider's Report*.



**Over 1,900**

new control label products introduced in 2005.

**Over 500,000**

*President's Choice* Chicago Deep Dish Pizzas sold at launch.

A wide variety of breads and rolls are baked fresh daily in-store.

## While many of the Company's transformative changes are visible to the consumer, some less visible but equally important initiatives were completed in 2005 while others will continue into the first half of 2006.

These measures are designed to assist in the pursuit of the Company's strategic imperatives, making Loblaw more streamlined, efficient and cost-effective in everything it does.

These transformative changes include the conversion to a national systems platform across a number of functions, such as store ordering, purchasing, and inventory tracking. The Company also moved forward on the restructuring of its supply chain network. Upon completion, this measure will improve the movement of inventories, enhance efficiencies, and lower costs. The Company also continued to simplify its distribution network in 2005 with the closure of a number of smaller facilities and the transfer of their functions to larger, more cost-effective centres. The past year also saw the opening of a third-party owned and operated general merchandise warehouse and distribution centre serving eastern Canada. In addition, the Company began a process that will examine how to simplify the flow of goods to stores.

Loblaw has also taken steps to strengthen the leadership skills among its employees. An in-house, tailored leadership program has been developed to enhance the capabilities of managers. This program is designed to identify, support and strengthen leadership at the store level reflecting the commitment of senior management to engage in dialogue with store personnel, and to act on their feedback and recommendations. An important aspect of this leadership program is the Store Managers' Council. The Council's rotating membership of twelve managers meets to discuss and develop recommendations on ways to improve and better serve the Company's stores. During 2005, these discussions covered issues such as training programs, leadership development and communication among employees.

Other store-focused leadership initiatives are equally important in promoting leadership and cooperation. A number of these measures were pursued during the past year. In order to ensure consistency, common approaches were developed in such areas as leadership coaching, business development and program execution.

### Number of Stores

| | |
|---|---|
| **53** | Atlantic SaveEasy |
| **51** | Atlantic Superstore |
| **14** | Dominion* (in Newfoundland and Labrador) |
| **103** | Extra Foods |
| **21** | Fortinos |
| **95** | Loblaws |
| **67** | Lucky Dollar Foods |
| **97** | Maxi |
| **15** | Maxi & Cie |
| **130** | No Frills |
| **107** | Provigo |
| **88** | The Real Canadian Superstore |
| **37** | The Real Canadian Wholesale Club |
| **52** | Shop Easy Foods |
| **25** | SuperValu |
| **68** | Valu-mart |
| **51** | Your Independent Grocer |
| **52** | Zehrs Markets |
| **418** | Cash & Carry and other banners |

*Trademark used under license.

## Geographic Divisions and Banners

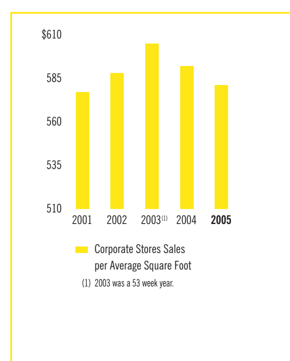
| | Corporate Stores | Franchised Stores | Associated Stores | Independent Accounts | Warehouses |
|---|---|---|---|---|---|
| British Columbia | 41 | 43 | 18 | | 2 |
| Yukon | 1 | 2 | | | |
| Northwest Territories | 3 | | 1 | 1 | |
| Alberta | 67 | 4 | 14 | 2,096 | 5 |
| Saskatchewan | 34 | 15 | 26 | 1,657 | 2 |
| Manitoba | 24 | 4 | 39 | 15 | 1 |
| Ontario | 169 | 257 | 16 | 86 | 6 |
| Quebec | 252 | 22 | 341 | 2,533 | 4 |
| New Brunswick | 22 | 23 | 6 | 296 | 2 |
| Nova Scotia | 36 | 22 | 1 | 523 | 2 |
| Prince Edward Island | 5 | 3 | 1 | 151 | |
| Newfoundland and Labrador | 16 | 7 | 9 | 500 | 2 |
| **Total** | **670** | **402** | **472** | **7,858** | **26** |

## Corporate Stores

| | **2005 Stores** | **2005 Sq. Ft. (in millions)** | 2004 Stores | 2004 Sq. Ft. (in millions) |
|---|---|---|---|---|
| **Corporate Stores** | | | | |
| Beginning of year | **658** | **35.3** | 646 | 32.6 |
| Opened | **47** | **3.6** | 53 | 4.2 |
| Closed | **(40)** | **(1.4)** | (43) | (1.5) |
| Transferred from franchised stores | **5** | **0.1** | 2 | |
| End of year | **670** | **37.6** | 658 | 35.3 |
| Average store size (in thousands) | | **56.1** | | 53.6 |
| Analysis by size: | | | | |
| More than 60,000 sq. ft. | **234** | **23.1** | 217 | 20.9 |
| 40,000–60,000 sq. ft. | **167** | **8.0** | 164 | 7.9 |
| 20,000–40,000 sq. ft. | **165** | **5.0** | 168 | 5.0 |
| Less than 20,000 sq. ft. | **104** | **1.5** | 109 | 1.5 |
| | **670** | **37.6** | 658 | 35.3 |
| Sales by corporate stores ($ millions) | **$ 21,110** | | $ 20,109 | |
| Sales per average square foot ($) | **$ 579** | | $ 592 | |

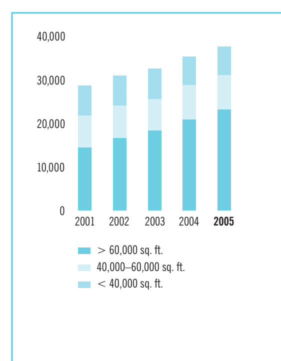
**Corporate Stores Sales per Average Square Foot**

($)




**Corporate Stores Square Footage**

(thousands of sq. ft.)

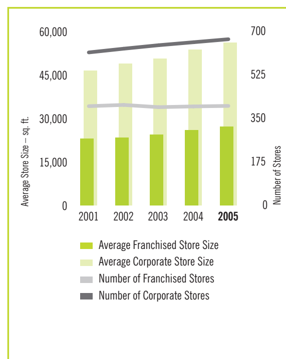


## Independent Stores and Accounts

| | 2005 Stores | 2005 Sq. Ft. (in millions) | 2004 Stores | 2004 Sq. Ft. (in millions) |
|---|---|---|---|---|
| **Franchised Stores** | | | | |
| Beginning of year | 400 | 10.4 | 397 | 9.7 |
| Opened | 22 | 0.9 | 33 | 1.3 |
| Closed | (17) | (0.3) | (28) | (0.6) |
| Transferred to corporate stores | (5) | (0.1) | (2) | |
| Transferred from associated stores and independent accounts | 2 | | | |
| End of year | 402 | 10.9 | 400 | 10.4 |
| Average store size (in thousands) | | 27.1 | | 26.0 |
| **Associated Stores** | 472 | | 519 | |
| **Independent Accounts** | 7,858 | | 6,669 | |
| **Warehouses** | 26 | | 32 | |
| Sales(1) to independent stores and accounts ($ millions) | $ 6,691 | | $ 6,100 | |

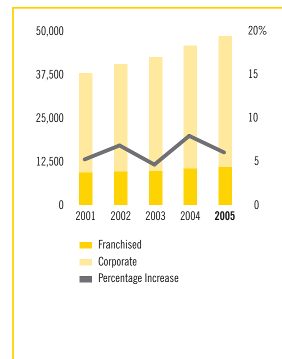
(1) Includes sales of variable interest entities at retail.

### Average Store Size and Number of Stores




### Retail Square Footage and Percentage Increase

(thousands of sq. ft.)



## Loblaw Companies Limited endeavours to be an active participant in the various communities which it serves and supports the philanthropic goals of the "IMAGINE" campaign.

Acting with its employees, the Company supports and contributes to local organizations through its various operating divisions by sponsoring numerous charitable fundraising activities and initiating work experience programs for the physically and developmentally challenged. The following are some examples of our community involvement in 2005.

A message from Peggy Hornell, Director, Fundraising and Administration, *President's Choice* Children's Charity:

***President's Choice*** **Children's Charity is dedicated to helping children who are physically or developmentally challenged.**

*President's Choice* Children's Charity had an outstanding year in 2005. Through the *President's Choice Decadent* cookie promotion, and other national and regional fundraising activities, the *President's Choice* Children's Charity raised $6.6 million.

This money will be directed towards helping more than 725 children across Canada.

One of the children helped in the past year is 18-year-old Justin, who has cerebral palsy. Confined to a wheelchair, he loves school and dreams of attending Northern Alberta Institute of Technology so he can become a computer game developer. Justin is unable to speak however, and finds himself separated from his classmates as a result.

*President's Choice* Children's Charity funded a computer communication device that allows him to participate in conversations with his classmates and teachers. Justin's Mom says that it has "given Justin independence and a chance to say what he is thinking and not have someone talk for him".

Thanks to the support of Loblaw, its employees and customers, *President's Choice* Children's Charity will continue to **make difficult lives a little easier**.

**Cambridge Memorial Hospital Foundation**
Supports the hospital in raising funds for medical equipment, infrastructure and education priorities in order to meet the healthcare needs of the community.

**Canadian Red Cross Tsunami Relief**
Organizing disaster recovery efforts for those affected by the tsunami in Asia by providing basic needs of food, clothing, shelter, and first aid, and participating in long term recovery programs, in union with international Red Cross agencies.

**Food Banks (Across Canada)**
Supporting non-profit organizations that procure, warehouse and distribute food to member social service agencies.

**Grocery Industry Foundation... Together (G.I.F.T.)**
Provides funding to various Ontario charities dedicated to assisting children facing physical, intellectual or economical challenges.

**Heart and Stroke Foundation of Canada**
Dedicated to improving the health of Canadians by preventing and reducing disability and death from heart disease and stroke through research, health promotion and advocacy.

**ROM Foundation**
Contributions fund galleries, curatorial research, and programs for children and ensure long term stability of the Royal Ontario Museum.

**United Way – Centraide (Across Canada)**
Committed to improving lives and building community by engaging individuals and mobilizing collective action.

THE W. GARFIELD WESTON FOUNDATION

**The W. Garfield Weston Foundation is a Canadian charitable foundation associated with the Company. Its grants are directed primarily to specific organizations in the fields of education and environment. These include the Canadian Merit Scholarship Foundation, the Children First: School Choice Trust, the Royal Ontario Museum and the Weston Family Innovation Centre at the Ontario Science Centre. From coast to coast, the Foundation also works with the Nature Conservancy of Canada to protect critical habitat.**

**Loblaw Companies Limited and its subsidiaries are committed to responsible corporate citizenship. This includes providing a safe workplace for employees, contributing to its local communities, respecting the environment, and promoting health and food safety, while offering products that provide meaningful choices to consumers.**

These commitments are instilled throughout the organization and are overseen by the Environmental, Health and Safety Committee of the Board of Directors (the "Board") of the Company, and by the full Board itself. The Board reviews and monitors policies, procedures, practices and compliance in these fields.

Initiatives in these areas are undertaken through any combination of four approaches: by the Company itself, in conjunction with other industry members, as part of industry-government partnerships, and in direct cooperation with governments.

### Respecting the Environment in a Sustainable Way

The commitment to the environment is demonstrated through measures in such areas as environmental awareness and management, energy efficiency, waste management and packaging.

Environmental Awareness Management Measures in this area are driven by an Environmental Management System designed to achieve the structured integration of environmental programs into the Company's operations. This system also focuses on ensuring the control of high-risk activities, the management of hazardous wastes, and the control and reduction of ozone-depleting substances. Environmental risk assessments and audits of ongoing and newly acquired or established operations are conducted on a regular basis by in-house environmental staff as well as by external parties. In addition, employees receive education and training that enable them to recognize and minimize environmental risks and to respond to any incidents that might occur.

Energy Efficiency Ongoing efforts are directed towards improving energy efficiency throughout Loblaw, including cooperating with federal and provincial agencies. The areas in which these efficiencies are pursued include the lighting used inside and outside stores, energy-efficient refrigeration, the use of energy in corporate facilities, and the fuels used in the Company's transportation and other operations. In September 2005, Loblaw opened its new, energy efficient head office and Store Support Centre in Brampton, Ontario. Furthermore, Loblaw has established partnerships and commitments with federal and provincial agencies to achieve energy conservation at the retail store level in a realistic and focused manner, including the use of innovative refrigeration system technology.

Waste Management and Packaging Waste management programs follow a three-stage process – source reduction, diversion to re-use or recycling and, finally, disposal. Loblaw is a long-standing supporter of, and financial contributor to, such industry-sponsored programs as Corporations Supporting Recycling and the Composting Council of Canada. This commitment is evident throughout the Company's operations. In-store photo labs recycle disposable cameras, processing fluids and even film cuttings. Post-consumer recycled material is used in private label packaging to the greatest extent possible without compromising the safety or quality of the product. Packaging of control label products is labelled as appropriate with the symbols that help customers identify materials that can be recycled through local municipal programs. As well, customers are offered a choice in grocery checkout packaging, including conventional plastic shopping bags, re-usable plastic bags, recyclable corrugated containers and re-usable bins. Also, this commitment extends to the administration, support and corporate offices of the Company, where waste minimization and recycling activities are actively employed. These programs promote the diversion of plastics, metals, paper, corrugate and organics from landfill.

### Promoting Health and Food Safety

The commitment to health promotion and food safety is reflected in the Company's participation in standard-setting initiatives, in its operations, in its dealings with suppliers, and in the information provided to customers.

The Company supports national food initiatives designed to promote health and food safety. It works to ensure that products meet or exceed the food safety requirements of the Canadian Food Inspection Agency. It also participates in national joint industry-government initiatives in the development of food safety programs for different parts of the food supply system. Suppliers are informed of the standards to which they must adhere and are expected to observe them. Manufacturing and food handling procedures, employee education and training programs, compliance systems and independent audits are among the measures used to promote food safety within the Company's stores and other operations. Through packaging and labelling of control label products, customers are informed of ingredients and whether certain products may have come in contact with one or more allergens. This allows consumers to make more fully informed purchasing decisions.

### Offering Products that Provide Meaningful Choices

The Company provides a wide range of product offerings to meet an equally wide range of consumer preferences. This includes the provision of alternative food products that provide customers with meaningful choices.

The environmentally responsible collection of *President's Choice GREEN* products and the hundreds of *President's Choice Organics* products have been developed to satisfy customers' environmental or health preferences. The organic products are third-party certified as organic, are in packages containing recycled materials, and are priced to be competitive with similar national brands. The *Natural Value* department in many stores is a one-stop source for health food needs, offering a selection of healthy and nutritious alternative foods, vitamins and herbal products.

The focus on healthy and nutritious food products is further demonstrated by two recent product initiatives under the *President's Choice* label. The line of *PC Mini Chefs* products has been designed to fit into a healthy eating plan for young children consistent with the federal government's "Nutrition Recommendations for Canadians". These products have been approved by a team consisting of prominent nutrition researchers and registered dieticians. The *PC Blue Menu* line of products offers adults a variety of alternatives lower in fat, calories and sodium, and higher in fibre.

## The Board of Directors (the "Board") and management of the Company believe that sound corporate governance practices will contribute to the effective management of the Company and its achievement of strategic and operational plans, goals and objectives.

The Company seeks to attain high standards of corporate governance and when appropriate adopts "best practices" in developing its approach to corporate governance. The Company's approach to corporate governance is consistent with National Policy 58-201 – Corporate Governance Guidelines (the "Guidelines"). The Governance, Employee Development, Nominating and Compensation Committee ("Governance Committee") regularly reviews its corporate governance practices and considers any changes necessary to maintain the Company's high standards of corporate governance.

#### Director Independence

The Board is comprised of a majority of independent directors. The Governance Committee has reviewed each director's factual circumstances and relationships with the Company to determine whether he or she is independent within the meaning of the Guidelines. The Guidelines provide that a director is independent if he or she has no material relationship with the Company or its affiliates that would reasonably be expected to interfere with the director's independent judgment.

#### Board Leadership

Mr. W. Galen Weston is Chairman of the Board. Mr. Weston has a significant common interest with other shareholders with respect to value creation, the well being of the Company, and the performance of its publicly listed securities. The Board has established a position description for the Chairman of the Board. The Board has also appointed an independent director, Anthony S. Fell, to serve as lead director. The lead director provides leadership to the Board and particularly to the independent directors. He ensures that the Board operates independently of management and that directors have an independent leadership contact. As part of his responsibilities, the lead director meets periodically with the other directors to obtain insight as to areas where the Board and its Committees can operate more effectively and to ensure the Board is able to discharge its responsibilities independently of management. The Board has developed a position description for the lead director.

#### Board Responsibilities and Duties

The Board, directly and through its Committees, supervises the management of the business and affairs of the Company with the goal of enhancing long-term shareholder value. The Board reviews the Company's direction, assigns responsibility to management for achievement of that direction, develops and approves major policy decisions, delegates to management the authority and responsibility in day-to-day affairs and reviews management's performance and effectiveness. The Board's expectations of management are communicated to management directly and through Committees of the Board.

The Board approves the Company's corporate goals and objectives, operating budgets and strategies, which take into account the opportunities and risks of the business. Members of the Board attend an annual all-day strategy session with management to discuss and review the Company's strategic plans and opportunities. In addition, management's strengths and weaknesses are discussed. Through the Audit Committee, the Board oversees the Company's risk management framework and assesses and evaluates the integrity of the Company's internal controls and management information systems. Through the Governance Committee, the Board oversees succession planning and compensation for senior management as well as Board nominees.

Individual directors may, with the approval of the lead director, retain an outside advisor at the expense of the Company.

The Board requires that management seek directors' review and approval of:

- strategic corporate direction and corporate performance objectives;
- multi-year and annual business, capital and operating plans and budgets;
- material capital expenditures, acquisitions, divestitures and restructurings; and
- investment outside of the ordinary course of business.

These matters are in addition to those matters which are required by law to receive Board consideration and approval.

The Board regularly receives reports on the operating results of the Company, as well as timely reports on various matters, including insurance, pensions, corporate governance, health and safety and treasury matters.

#### Ethical Business Conduct

The Company's Code of Business Conduct (the "Code"), sets out the Company's long-standing commitment of requiring adherence to high standards of ethical conduct and business practices. The Code is reviewed annually to ensure it is current and reflects best practices in the area of ethical business conduct. Directors, officers and employees of the Company are required to comply with the Code and must acknowledge their commitment to abide by the Code on a periodic basis. The Code is available on the Company's website, www.loblaw.ca.

The Code also deals with conflicts of interest. Should an officer, director or employee have a conflict of interest with respect to any matter, that individual is required to bring the conflict to the attention of the Ethics and Conduct Committee and, if a director has a conflict with respect to any matter, he or she may not participate in any discussion or vote on the conflict matter. The Code also addresses such issues as the protection of confidential information and the protection and proper use of the Company's assets.

The Company has established an Ethics and Conduct Committee which reviews all material breaches of the Code. The Ethics and Conduct Committee also oversees implementation of the Code, educating employees regarding the Code and reviews the Code annually to determine if it requires revision.

The Company encourages the reporting of unethical behaviour and has established an Ethics Response Line, a toll-free number that any employee or director may use to report conduct which he or she feels violates the Code or otherwise constitutes fraud or unethical conduct. A fraud reporting protocol has also been implemented to ensure that fraud is reported to senior management in a timely manner. In addition, the Audit Committee has endorsed procedures for the receipt, retention and handling of complaints regarding accounting, internal control or auditing matters. These procedures are available at www.loblaw.ca.

The Company has adopted a Vendor Code of Conduct that sets out the Company's expectations of its vendor community with respect to ethical conduct and social responsibilities. The Vendor Code deals with such matters as labour practices, respect for the environment and compliance with various laws.

### Board Committees

There are five committees of the Board: Audit; Governance, Employee Development, Nominating and Compensation; Pension and Benefits; Environmental, Health and Safety and Executive.

The Audit Committee is comprised solely of independent directors. All Committees are comprised solely of non-management directors, in each case, with a majority of members being independent directors except for the Executive Committee. The Board believes that the composition of its committees other than the Executive Committee allows them to operate independently from management such that shareholders' interests are protected.

Each Committee has a formal mandate and a position description for the Chair established by the Board. Both the mandate and position description are reviewed annually. Copies of the Committees' mandates are available on the Company's website, www.loblaw.ca.

The following is a brief summary of some of the responsibilities of each Committee.

#### Audit Committee

All members of the Audit Committee must be independent and financially literate as required under applicable rules. The Audit Committee is also responsible for supporting the Board in overseeing the integrity of the Company's financial reporting and internal controls over financial reporting, disclosure controls, internal audit function and its compliance with legal and regulatory requirements. The Audit Committee's responsibilities include:

- recommending the appointment of the external auditor;
- reviewing the arrangements for and scope of the audit by the external auditor;
- reviewing the independence of the external auditor;
- reviewing and approving the Company's hiring policies regarding partners and professional employees of the present and former external auditor of the Company;
- considering and evaluating with management the adequacy and effectiveness of internal controls over financial reporting and disclosure controls and procedures and reviewing any proposed corrective actions;
- reviewing and monitoring the Company's policies relating to ethics and conflicts of interests;
- overseeing procedures for the receipt, retention and follow up of complaints regarding the Company's accounting, internal controls and auditing matters and the confidential anonymous submission by employees of concerns regarding such matters;
- reviewing and monitoring the internal audit function of the Company;
- reviewing the integrity of the Company's management and information systems;
- reviewing and approving the audit fees paid to the external auditor and pre-approval of non-audit related fees to the external auditor;
- discussing and reviewing with management and the external auditor the Company's annual and interim consolidated financial statements, key reporting matters and Management's Discussion and Analysis and Annual Information Form;
- reviewing disclosure containing financial information based on the Company's financial statements; and
- reviewing with management the principal risks of the Company's business and the systems and processes implemented to manage these risks.

#### Governance, Employee Development, Nominating and Compensation Committee

The Governance Committee is responsible for overseeing the compensation of directors and executive officers. The Governance Committee is also responsible for developing and maintaining governance practices consistent with high standards of corporate governance. As part of its mandate, the Governance Committee identifies and recommends candidates for nomination to the Board as directors, monitors the orientation program for new directors and maintains a process for assessing the performance of the Board and its Committees as well as the performance of individual directors and discharging the Board's responsibilities relating to compensation and succession planning for the Company's senior employees. The Governance Committee's specific responsibilities include:

- identifying candidates for membership on the Board and evaluating the independence of the directors;
- assisting in directors' orientation and assessing their performance on an on-going basis;
- shaping the Company's approach to corporate governance and recommending to the Board corporate governance principles to be followed by the Company;
- discharging the Board's responsibilities relating to compensation and succession planning for the Company's senior employees; and
- determining the process for the compensation of directors and executive officers.

The Board appointed the Chairman of the Governance Committee, who is an independent director, to serve as lead director.

#### Pension and Benefits Committee

The Pension and Benefits Committee is responsible for:

- reviewing the performance of the Company's and its subsidiaries' pension plans and pension funds;
- reviewing and recommending managers for the fund's portfolio;
- reviewing the performance of pension fund managers;
- reviewing and approving the assumptions used, the funded status and amendments to the Company's and its subsidiaries' pension plans; and
- receiving reports regarding level, types and costs of the Company's employee benefit plans.

#### Environmental, Health and Safety Committee

The Environmental, Health and Safety Committee is responsible for reviewing and monitoring environmental, food safety and workplace health and safety policies, procedures, practices and compliance.

#### Executive Committee

The Executive Committee possesses all of the powers of the Board except the power to declare common dividends and certain other powers specifically reserved by applicable law to the Board. The Executive Committee acts only when it is not practicable for the full Board to meet.

### Other Corporate Governance Matters

Disclosure Policy The Board has reviewed and adopted a corporate Disclosure Policy to deal with the timely dissemination of all material information. A copy of the Disclosure Policy is available on the Company's website, www.loblaw.ca. The Disclosure Policy, which is reviewed annually, establishes consistent guidance for determining what information is material and how it is to be disclosed to avoid selective disclosure and to ensure wide dissemination. The Board, directly and through its Committees, reviews and approves the contents of major disclosure documents, including unaudited interim and audited annual consolidated financial statements, Management's Discussion and Analysis, the Annual Information Form, and the Proxy Circular. The Company seeks to communicate to its shareholders through these documents as well as by means of news releases, its website and investor relations meetings.

Disclosure Committee A Disclosure Committee comprised of senior management of the Company oversees the Company's disclosure process as outlined in the Disclosure Policy. The Disclosure Committee's mandate includes ensuring that effective disclosure controls and procedures are in place to allow the Company to satisfy all of its continuous disclosure obligations including certification requirements. The Disclosure Committee is also responsible for ensuring that the policies and procedures contained in the Company's Disclosure Policy are in compliance with regulatory requirements.

## Directors

**W. Galen Weston,** O.C., B.A., LL.D.[1*]
Chairman, Loblaw Companies Limited; Chairman and President, George Weston Limited; Chairman, Holt, Renfrew & Co., Limited, Brown Thomas Group Limited, Selfridges & Co. Ltd.; President, The W. Garfield Weston Foundation; Director, Associated British Foods plc; Member, Advisory Board, Columbia University.

**Paul M. Beeston,** C.M., B.A., F.C.A.[2,5]
Former President and Chief Executive Officer, Major League Baseball; Former President, Toronto Blue Jays Baseball Team; Director, President's Choice Bank.

**Gordon A.M. Currie,** B.A., LL.B.
Executive Vice President, Secretary and General Counsel, George Weston Limited; Former Senior Vice President and General Counsel, Centrica North America; Former Partner, Blake, Cassels & Graydon LLP.

**Camilla H. Dalglish,** B.A.[5]
Director, The W. Garfield Weston Foundation, The Nature Conservancy of Canada; Former President, The Civic Garden Centre.

**Anthony S. Fell,** O.C.[3*,4]
Chairman, RBC Capital Markets Inc.; Former Chairman and Chief Executive Officer, RBC Dominion Securities; Former Deputy Chairman, Royal Bank of Canada; Chairman, Munich Reinsurance Group of Companies; Director, CAE Inc., BCE Inc.; Chairman of the Board of Trustees, University Health Network.

**Anthony R. Graham** [1,3,4]
President and Director, Wittington Investments, Limited; President and Chief Executive Officer, Sumarria Inc.; Former Vice Chairman, National Bank Financial; Chairman and Director, President's Choice Bank, Graymont Ltd.; Director, George Weston Limited, Holt, Renfrew & Co., Limited, Brown Thomas Group Limited, Power Corporation of Canada, Power Financial Corporation, Provigo Inc., Selfridges & Co. Ltd.

**John A. Lederer,** B.A.[1]
President, Loblaw Companies Limited; Former Executive Vice President, Loblaw Companies Limited; Director, Food Marketing Institute; Founder, *President's Choice* Children's Charity.

**Nancy H.O. Lockhart** [5]
Chief Administrative Officer, Frum Development Group; Former Vice President, Shoppers Drug Mart Corporation; Former Chair of the Board of Trustees, Ontario Science Centre; Former President, Canadian Club; Former Chair, Canadian Film Centre.

**Pierre Michaud**, C.M.[5*]
Chairman and Director, Provigo Inc.; Vice Chairman, Laurentian Bank of Canada; Director, Bombardier Recreational Products Inc., Gaz Métro Inc., Old Port of Montreal Corporation Inc.

**Thomas C. O'Neill,** B. COMM., F.C.A.[2]
Retired Chairman and former Chief Executive Officer, PricewaterhouseCoopers Consulting; Director, President's Choice Bank, Nexen Inc., BCE Inc., OTPP (Ontario Teachers Pension Plan), St. Michael's Hospital, Adecco S.A.; Vice Chairman, Board of Governors, Queen's University.

**G. Joseph Reddington,** B.A., J.D.[3]
Retired Chairman, Director and Chief Executive Officer, Breuners Home Furnishings Corporation; Former Chairman and Chief Executive Officer, The Signature Group; Former President and Chief Executive Officer, Sears Canada; Director, Ansett Worldwide.

**T. Iain Ronald,** M.B.A., B. LAW., F.C.A.[2*,4*]
Chairman, TransAlta Power Ltd., TransAlta Cogeneration Ltd., BFI Canada Inc.; Former Vice Chairman, Canadian Imperial Bank of Commerce; Director, President's Choice Bank, Holt, Renfrew & Co., Limited, Leon's Furniture Limited, Strongco Inc., Allied Properties REIT.

**Joseph H. Wright,** B.A.[2,3,4]
Managing Partner, Barnagain Capital; Former President and Chief Executive Officer, Swiss Bank Corporation (Canada); Chairman and Trustee, BFI Canada Income Fund; Chairman, Hollinger Inc.; Director, President's Choice Bank.

1. Executive Committee
2. Audit Committee
3. Governance, Employee Development, Nominating and Compensation Committee
4. Pension and Benefits Committee
5. Environmental, Health and Safety Committee

* Chairman of the Committee

## Officers
(includes age and years of service)

**W. Galen Weston,** O.C. (65 and 34 years)
Chairman of the Board

**John A. Lederer** (50 and 29 years)
President

**David K. Bragg** (57 and 22 years)
Executive Vice President

**David R. Jeffs** (48 and 27 years)
Executive Vice President

**Richard P. Mavrinac** (53 and 23 years)
Executive Vice President

**Peter McMahon** (effective February 2006)
Executive Vice President

**Paul D. Ormsby** (54 and 23 years)
Executive Vice President

**Stephen A. Smith** (48 and 20 years)
Executive Vice President

**Robert A. Balcom** (44 and 12 years)
Senior Vice President, Secretary and General Counsel

**Roy R. Conliffe** (55 and 24 years)
Senior Vice President, Labour Relations

**Louise M. Lacchin** (48 and 22 years)
Senior Vice President, Finance

**Franca Smith** (42 and 17 years)
Senior Vice President, Financial Control

**Galen G. Weston** (33 and 8 years)
Senior Vice President, Corporate Development

**Geoffrey H. Wilson** (50 and 19 years)
Senior Vice President, Investor Relations and Public Affairs

**Manny DiFilippo** (46 and 14 years)
Vice President, Risk Management and Strategic Initiatives

**David G. Gore** (35 and 4 years)
Vice President, Legal Counsel, Compliance and Regulatory Affairs, Privacy and Ethics Officer

**J. Bradley Holland** (42 and 12 years)
Vice President, Taxation

**Michael N. Kimber** (50 and 21 years)
Vice President, Legal Counsel

**Joyce C. Lee** (34 and 9 years)
Vice President, Financial Reporting

**Lucy J. Paglione** (46 and 22 years)
Vice President, Pension and Benefits

**Mark A. Rodrigues** (48 and 19 years)
Vice President, Internal Control Compliance

**George D. Seslija** (50 and 26 years)
Vice President, Real Estate Development

**Lisa R. Swartzman** (35 and 12 years)
Vice President, Treasurer

**Ann Weir** (43 and 12 years)
Vice President, Internal Audit Services and Systems Audit

**Laurel MacKay-Lee** (36 and 6 years)
Controller, Financial Projects

**Irene Pinheiro** (38 and 13 years)
Controller, Financial Analysis

**Marian M. Burrows** (51 and 27 years)
Assistant Secretary

**Swavek A. Czapinski** (31 and 7 years)
Assistant Treasurer

**M. Darryl Hanstead** (31 and 7 years)
Assistant Treasurer

**Walter H. Kraus** (43 and 17 years)
Senior Director, Environmental Affairs

**National Head Office and Store Support Centre**
Loblaw Companies Limited
1 President's Choice Circle
Brampton, Canada
L6Y 5S5
Tel: (905) 459-2500
Fax: (905) 861-2206
Internet: www.loblaw.ca

**Registered Office**
22 St. Clair Avenue East
Toronto, Canada
M4T 2S7
Tel: (416) 922-8500
Fax: (416) 922-7791

**Stock Exchange Listing and Symbol**
The Company's common shares are listed on the Toronto Stock Exchange and trade under the symbol "L".

**Common Shares**
63% of the Company's common shares are owned beneficially by W. Galen Weston and George Weston Limited.

At year end 2005 there were 274,054,814 common shares outstanding, 5,124 registered common shareholders and 100,737,979 common shares available for public trading.

The average daily trading volume of the Company's common shares for 2005 was 322,169.

**Common Dividend Policy**
It is the Company's policy to maintain a dividend payment equal to approximately 20% to 25% of the prior year's adjusted basic net earnings per common share.[1]

**Common Dividend Dates**
The declaration and payment of quarterly dividends are made subject to approval by the Board of Directors. The anticipated record and payment dates for 2006 are:

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

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

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

**Registrar and Transfer Agent**
Computershare Investor Services Inc.
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**Independent Auditors**
KPMG LLP
Chartered Accountants
Toronto, Canada

**Annual Meeting**
Loblaw Companies Limited Annual Meeting of Shareholders will be held on Thursday, May 4, 2006 at 11:00 a.m. at the Metro Toronto Convention Centre, Constitution Hall, Toronto, Canada.

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

**Investor Relations**
Shareholders, security analysts and investment professionals should direct their requests to Geoffrey H. Wilson, Senior Vice President, Investor Relations and Public Affairs at the Company's National Head Office or by e-mail at investor@loblaw.ca

Additional financial information has been filed electronically with various securities regulators in Canada through the System for Electronic Document Analysis and Retrieval (SEDAR) and with the Office of the Superintendent of Financial Institutions (OSFI) as the primary regulator for the Company's subsidiary, President's Choice Bank. The Company holds an analyst call shortly following the release of its quarterly results. These calls are archived in the Investor Zone section of the Company's website.

Ce rapport est disponible en français.

This Annual Summary was printed in Canada on Cougar Opaque, manufactured totally chlorine-free with 10% post-consumer fibre, at a mill independently certified as meeting the procurement provisions of the Sustainable Forestry Initiative® (SFI) standard.

(1) See Non-GAAP Financial Measures on page 33 of the 2005 Financial Report.

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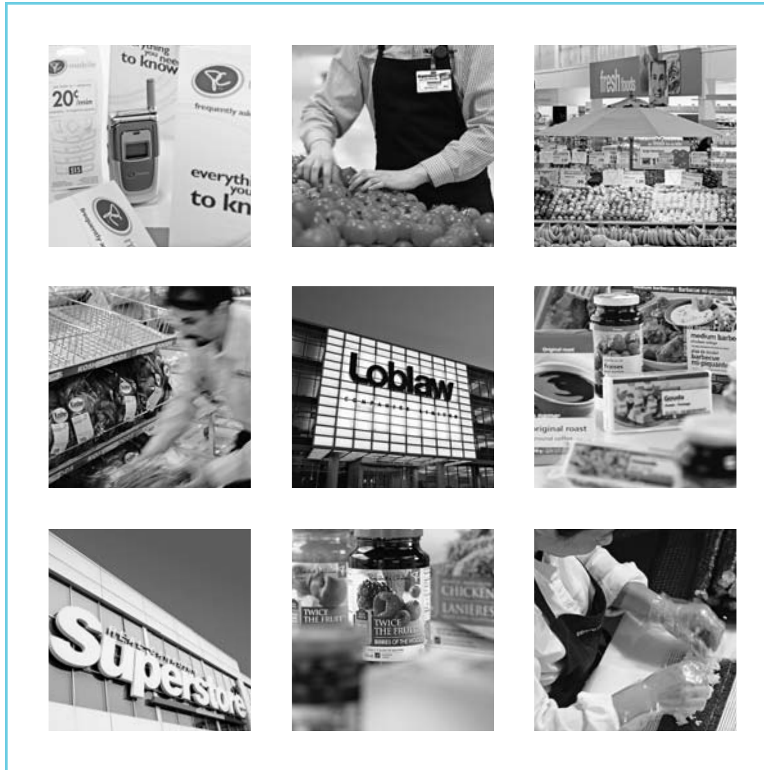
COMPANIES LIMITED

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COMPANIES LIMITED

**Loblaw Companies Limited** 2005 Financial Report

## Financial Highlights[1]

| For the years ended December 31, 2005 and January 1, 2005 ($ millions except where otherwise indicated) | 2005 (52 weeks) | 2004 (52 weeks) |
|---|---|---|
| **Operating Results** | | |
| Sales | **$ 27,801** | $ 26,209 |
| Sales excluding impact of variable interest entities[2] | **27,423** | 26,209 |
| Adjusted EBITDA[2] | **2,132** | 2,125 |
| Operating income | **1,401** | 1,652 |
| Adjusted operating income[2] | **1,600** | 1,652 |
| Interest expense | **252** | 239 |
| Net earnings | **746** | 968 |
| **Cash Flow** | | |
| Cash flows from operating activities | **1,489** | 1,443 |
| Capital investment | **1,156** | 1,258 |
| **Per Common Share** ($) | | |
| Basic net earnings | **2.72** | 3.53 |
| Adjusted basic net earnings[2] | **3.35** | 3.48 |
| Dividend rate at year end | **.84** | .76 |
| Cash flows from operating activities | **5.43** | 5.26 |
| Book value | **21.48** | 19.74 |
| Market price at year end | **56.37** | 72.02 |
| **Financial Ratios** | | |
| Adjusted EBITDA margin[2] | **7.8%** | 8.1% |
| Operating margin | **5.0%** | 6.3% |
| Adjusted operating margin[2] | **5.8%** | 6.3% |
| Return on average total assets[2] | **11.2%** | 14.2% |
| Return on average shareholders' equity | **13.2%** | 19.2% |
| Interest coverage | **5.6:1** | 6.9:1 |
| Net debt[2] to equity | **.66:1** | .71:1 |
| **Operating Statistics** | | |
| Retail square footage (in millions) | **48.5** | 45.7 |
| Average corporate store size (square feet) | **56,100** | 53,600 |
| Corporate stores sales per average square foot ($) | **579** | 592 |
| Same-store sales growth | **0.2%** | 1.5% |
| Number of corporate stores | **670** | 658 |
| Number of franchised stores | **402** | 400 |

(1) For financial definitions and ratios refer to the Glossary of Terms on page 68.
(2) See Non-GAAP Financial Measures on page 33.

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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 37 to 65 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. As a result of implementing Accounting Guideline 15, *"Consolidation of Variable Interest Entities"*, ("AcG 15") effective January 2, 2005, these consolidated financial statements include the accounts of Loblaw Companies Limited and its subsidiaries and variable interest entities ("VIEs") that the Company is required to consolidate. A more comprehensive discussion regarding the implementation of AcG 15 is included in the section Accounting Standards below. A glossary of terms used throughout this Financial Report can be found on page 68. The information in this MD&A is current to March 7, 2006, unless otherwise noted.

## 1. Forward-Looking Statements

This Annual Report, including this MD&A, contains forward-looking statements which reflect management's expectations regarding the Company's objectives, plans, goals, strategies, future growth, results of operations, performance and business prospects and opportunities. These forward-looking statements include expected sales and earnings prospects for 2006. Forward-looking statements are typically identified by words or phrases such as "anticipates", "expects", "believes", "estimates", "intends" and other similar expressions.

These forward-looking statements are not guarantees, but only predictions. Although the Company believes that these statements are based on information and assumptions which are current, reasonable and complete, these statements are necessarily subject to a number of factors that could cause actual results to vary significantly from the estimates, projections and intentions. Such differences may be caused by factors which include, but are not limited to, changes in consumer spending and preferences, heightened competition including new competitors and expansion of current competitors, the ability to realize anticipated cost savings, including those resulting from restructuring and other cost reduction initiatives, the ability to execute restructuring plans effectively, the Company's relationship with its employees, results of labour negotiations including the terms of future collective bargaining agreements, changes to the regulatory environment in which the Company operates now or in the future, changes in the Company's tax liabilities, either through changes in tax laws or future assessments, performance of third-party service providers, public health events, the ability of the Company to attract and retain key executives and supply and quality control issues with vendors. The Company cautions that this list of factors is not exhaustive. These factors and other risks and uncertainties are discussed in the Company's materials filed with the Canadian securities regulatory authorities from time to time, including in the Risks and Risk Management section of this MD&A.

The assumptions applied in making the forward-looking statements contained in this Annual Report, including this MD&A include the following: economic conditions in 2006 do not materially change from those expected, patterns of consumer spending are reasonably consistent with historical trends, no new significant competitors enter our market nor does any existing competitor significantly increase its presence, anticipated cost savings from restructuring activities are realized as planned, continuing future restructuring activities are effectively executed, there are no material work stoppages in 2006 and the performance of third-party service providers is in accordance with expectations in the upcoming year.

Potential investors and other readers are urged to consider these factors carefully in evaluating these forward-looking statements and are cautioned not to place undue reliance on them. The forward-looking statements included in this Annual Report, including this MD&A are made only as of the filing date of this Annual Report and the Company does not undertake to publicly update these forward-looking statements to reflect new information, future events or otherwise. In light of these risks, uncertainties and assumptions, the forward-looking events contained in these forward-looking statements may or may not occur. The Company cannot assure that projected results or events will be achieved.

## 2. Overview

Loblaw, a subsidiary of George Weston Limited, is Canada's largest food distributor and a leading provider of general merchandise, drugstore, and financial products and services. Through its various operating banners, it is committed to providing Canadians across the country with a one-stop destination in meeting their food and everyday household needs. For over 45 years, the Company has supplied the Canadian market with innovative products and services through corporate, franchised and associated stores. Corporate owned store banners include *Atlantic Superstore, Dominion* (in Newfoundland and Labrador), *Extra Foods, Loblaws, Maxi, Maxi* & *Cie, Provigo, The Real Canadian Superstore* and *Zehrs Markets* and a number of wholesale outlets operating as *Cash* & *Carry, Presto* and *The Real Canadian Wholesale Club*. The Company's franchised and associated stores operate under the trade names *Atlantic SaveEasy, Fortinos, Lucky Dollar Foods, no frills, Shop Easy Foods, SuperValu, Valu-mart* and *Your Independent Grocer*. The store network is supported by 26 Company owned and 2 third-party warehouse facilities located across Canada.

The Company also offers a strong control label program, including the *President's Choice* and *no name* brands. In addition, the Company makes available to consumers *President's Choice Financial* services and products, including the *President's Choice Financial* MasterCard®, and *PC Financial* auto, home, travel and pet insurance, *PC Mobile* phone service, as well as a loyalty program known as *PC* points.

The Company competes in the retail industry in Canada, which is a changing and competitive market. Consumer needs drive industry changes, which are impacted by changing demographic and economic trends such as changes in disposable income, increasing ethnic diversity, nutritional awareness and time availability. Over the past several years, consumers have demanded more choice, value and convenience.

The Company competes with non-traditional competitors as well as traditional supermarkets. Recent industry changes have been characterized by the expansion of non-traditional competitors, such as mass merchandisers, warehouse clubs, limited assortment stores, discount stores, convenience stores, drugstores and specialty stores, which continue to increase their offerings of products typically associated with traditional supermarkets. Over the past several years, there has been an increase in the number of retail outlets that traditionally exclusively featured food, general merchandise or drugstore items, that now offer a selection of these items, resulting in what is commonly referred to in the industry as "channel blurring". This evolution of the retail landscape presents a number of issues for traditional grocers: the need to re-position conventional supermarkets to either expand or, conversely, better focus their offerings; the reality of lower prices offered by discount models and the obvious need to reduce operating and labour costs in order to maintain earnings in light of lower prices and increased competition.

## 3. Vision and Strategies

Loblaw's vision has been, and continues to be, centred on three main principles: growth, innovation and flexibility. While accepting prudent operating risks, Loblaw seeks long term, stable growth supported by a strong balance sheet, with the goal of providing sustainable superior returns to its shareholders through a combination of common share price appreciation and dividends. It encourages innovation based on the belief that providing consumers with new products and convenient services at competitive prices and exciting shopping environments is critical to its success. Loblaw strives for flexibility in its operations in order to grow its market share across the country.

On a long term basis, Loblaw's goal is to be known for:
- offering the highest quality fresh foods;
- a compelling value proposition and food assortment;
- leading in the development of unique, high quality control label products and services;
- a powerful and compelling general merchandise and drugstore offering;
- delivering sustainable growth through distinct but integrated approaches to the marketplace; and
- providing a great place to work and grow.

In support of its vision, the Company employs various operating and financial strategies. These strategies guide the Company over the long term and represent a philosophy for the way in which it conducts its business.

The Company's long term operating strategies are:

- using the cash flow generated in the business to invest in its future;
- owning its real estate, where possible, to maximize flexibility for product and business opportunities in the future;
- using a multi-format approach to maximize market share over the longer term;
- focusing on food but serving the consumer's everyday household needs;
- creating customer loyalty and enhancing price competitiveness through a superior control label program;
- implementing and executing plans and programs flawlessly; and
- constantly striving to improve the Company's value proposition.

The Company's long term financial strategies are:

- maintaining a strong balance sheet;
- minimizing the risks and costs of its operating and financing activities; and
- maintaining liquidity and access to capital markets.

The Company's Board of Directors (the "Board") and senior management meet annually to review the strategic imperatives. These strategic imperatives, which generally span a three to five year time frame, target specific issues in response to changes in consumer needs and the competitive retail landscape.

The table below summarizes the Company's strategic imperatives and the activities undertaken in 2005 to progress these imperatives.

| Strategic Imperative | Progress in 2005 |
|---|---|
| Continue to focus on food | • New products and programs were introduced in the produce, meat, bakery, seafood, deli and other areas<br>• Centralized food merchandising teams were established to realize opportunities of scale and develop common practices<br>• Increased number of *President's Choice* and *no name* food offerings<br>• Published first Healthy Insider's Report featuring *PC Blue Menu*, *PC Mini Chefs* and additional *PC Organics* products |
| Continue to drive general merchandise and drugstore programs as a vital and integral component of the business | • Established a national and integrated organizational structure located at the Store Support Centre in Brampton, Ontario<br>• Focused general merchandise offering on conveying qualities of product innovation, great value and differentiation in the marketplace<br>• Increased number of products and services including the introduction of the *PC* Bath and Body line of products<br>• Developed the *Joe Fresh Style* apparel for adults which was introduced in early 2006 |
| Leverage the equity of the *President's Choice* brand across all product lines while ensuring consistent quality is maintained | • Launched the *PC Mobile* line of prepaid cellular phone services and related accessories<br>• Continued to grow the *President's Choice Financial* MasterCard® and *PC Financial* insurance programs<br>• Launch of the first *PC* Home *Insider's Report* |
| Intensify leadership programs with a focus on store operations, increasing the frequency of sessions and taking a more interactive, collaborative approach to training | • Store Managers' Council completed first full year of operation<br>• Conducted off-site leadership sessions for store personnel<br>• Developed common approach to leadership coaching, program execution and business development at the store level |
| Execute on imperatives as a cost effective and fully integrated operation | • Continued development of four distinct store formats: superstores, hard discount stores, conventional stores and warehouse clubs<br>• Continued discussions with organized labour to explore competitive opportunities<br>• Work continued on the conversion to one national systems platform across a number of functions<br>• Simplified distribution network by closing several smaller facilities and transferring various functions to larger, more cost-effective centres<br>• Focused on simplification of business operations including the examination of the flow of goods from vendors to store shelves |

Management has identified specific critical success factors which are key enablers of the long term strategies. These critical success factors involve systems and technology, logistics, food safety, working capital management and labour partnerships. Targets have been set across the Company that will enable management to assess progress made on each imperative as well as the effectiveness of implementation. 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 superior returns to its shareholders.

### 4. Key Performance Indicators

The Company continuously reviews and monitors its activities and performance indicators, which it believes are important to measuring the success of the implementation of its operating and financial strategies. Some of the Company's key performance indicators are set out below:

Key Performance Indicators

| | **2005 (52 weeks)** | 2004 (52 weeks) |
|---|---|---|
| Sales growth[2] | **6.1%** | 3.9% |
| Sales growth excluding impact of VIEs[1] | **4.6%** | 3.9% |
| Basic net earnings per common share growth | **(22.9)%** | 15.0% |
| Adjusted basic net earnings per common share[1] growth | **(3.7)%** | 12.3% |
| Net debt[1] to equity ratio | **.66:1** | .71:1 |
| Return on average shareholders' equity | **13.2%** | 19.2% |

(1) See Non-GAAP Financial Measures on page 33.
(2) Sales growth in 2004 calculated on a 53 week year base in 2003. The extra week in 2003 had a negative impact of approximately 2% on the 2004 sales growth shown in the table above.

Other performance indicators include, but are not limited to: same-store sales growth, operating and administrative cost management, development of new control label products and market share.

### 5. Financial Performance

Basic net earnings per common share for 2005 were $2.72, a 23% reduction when compared to $3.53 last year. Basic net earnings per common share were negatively impacted in 2005 by the following:

- 22 cents per common share for the net effect of stock-based compensation and the associated equity forwards;
- 20 cents per common share related to restructuring and other charges;
- 10 cents per common share related to the estimate of Goods and Services Tax ("GST") and provincial sales taxes ("PST") charges;
- 7 cents per common share related to the estimated impact of direct costs associated with supply chain disruptions;
- 1 cent per common share related to the adjustment to future income tax balances due to the changes in statutory income tax rates in certain provinces; and
- 3 cents per common share related to the consolidation of variable interest entities.

After adjusting for the above noted items, adjusted basic net earnings per common share[1] were $3.35 for the year. These results compare to adjusted basic net earnings per common share[1] of $3.48 in 2004, which were adjusted for the successful resolution of certain income tax matters from a previous year of $14 million. The net effect of stock-based compensation and the associated equity forwards did not have an impact on basic net earnings per common share in 2004.

Results for 2005 were adversely affected by the short term costs associated with one of the largest transformations in the Company's history. The need for this transformative process was driven by the Company's assessment of a fast-changing retail environment marked by increased consumer choice, low-cost global retailers, and the addition of an increasingly unsustainable amount of industry square footage.

Based on this assessment, the Company developed a comprehensive strategy designed to fortify its competitive position and to maintain its leadership role in meeting the food and everyday household needs of Canadian consumers. In pursuit of this strategy, the Company

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

implemented a number of transformative changes to its organization during 2005.

These changes included the restructuring of its supply chain network and the reorganizations involving its merchandising, procurement and operations groups, the establishment of a new national head office and Store Support Centre in Brampton, Ontario, which opened in the third quarter of 2005, and the relocation of general merchandise operations from Calgary, Alberta to the new office. A charge of 20 cents per common share was recorded in 2005 consisting of employee termination benefits resulting from planned involuntary terminations, site closing costs and fixed asset impairment and accelerated depreciation charges associated with these activities.

The Company encountered challenges during the execution of planned changes to its systems, supply chain and general merchandise areas including certain supply chain systems conversions which were initiated as part of the creation of a national information technology platform and the startup of a new third-party owned and operated general merchandise warehouse and distribution centre for eastern Canada. These challenges disrupted the flow of inventory to the Company's stores and caused the Company to incur additional operating costs. Additional incremental direct costs incurred in the handling, storage and movement of inventory resulting from these disruptions amounted to approximately 7 cents per common share for the year.

Also in 2005, a charge was recorded relating to an audit and proposed assessment by the Canada Revenue Agency relative to GST on certain products sold during prior fiscal periods 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. Accordingly, a charge of 10 cents per common share was recorded to reflect the best estimate of such potential tax liabilities of which management is currently aware.

Further charges in 2005 related to the net effect of stock-based compensation and the associated equity forwards, the adjustment to future income tax balances due to the changes in statutory income tax rates in certain provinces and to the consolidation of variable interest entities, also contributed to the reduction in basic net earnings per common share by 22 cents, 1 cent and 3 cents per common share, respectively.

### 5.1 Results of Operations

Sales and Sales Growth Excluding Impact of VIEs[1]

| ($ millions except where otherwise indicated) | 2005 (52 weeks) | 2004 (52 weeks) |
|---|---|---|
| Total sales | **$ 27,801** | $ 26,209 |
| Less: Sales attributable to the consolidation of VIEs pursuant to AcG 15 | **378** | |
| Sales excluding impact of VIEs[1] | **$ 27,423** | $ 26,209 |
| Total sales growth[2] | **6.1%** | 3.9% |
| Less: Positive impact on sales growth attributable to the consolidation of VIEs pursuant to AcG 15 | **1.5%** | |
| Sales growth excluding impact of VIEs[1] | **4.6%** | 3.9% |

(1) See Non-GAAP Financial Measures on page 33.
(2) Sales growth in 2004 calculated on a 53 week year base in 2003. The extra week in 2003 had a negative impact of approximately 2% on the 2004 sales growth shown in the table above.

**Sales** Full year sales in 2005 increased 6.1% to $27.8 billion from $26.2 billion last year, including 1.5% or $378 million in sales relating to the consolidation of certain independent franchisees as required by AcG 15. Excluding the impact of the VIEs, 2005 sales increased 4.6% or $1.2 billion over last year.

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

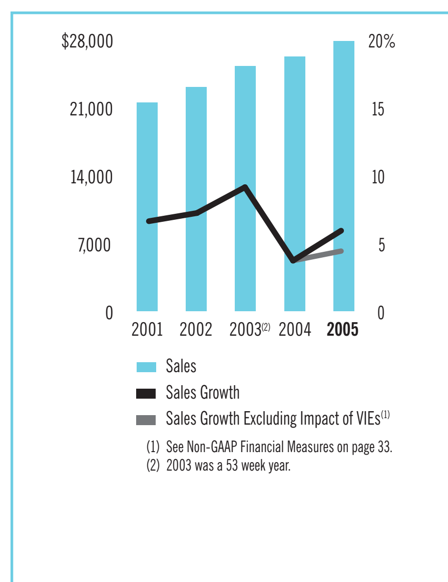
- as described earlier, certain initiatives resulted in supply chain disruptions and a drop in service levels and in-stock positions causing an estimated reduction in expected sales growth of approximately 0.5% to 0.7% versus last year;
- retail sales growth in general merchandise and drugstore categories continued to exceed that of food in all regions except in western Canada; general merchandise and drugstore sales in western Canada were most profoundly impacted by the supply chain disruptions;
- *The Real Canadian Superstore* program was positively received in Ontario and has enjoyed significant sales growth;
- strong gas bar sales were partially offset by a decline in tobacco sales;

- same-store sales growth of approximately 0.2%;
- national food price inflation as measured by "The Consumer Price Index for Food Purchased from Stores" ("CPI") was approximately 2% for the year, with variances by region; the Company's calculation of food price inflation, which considers Company-specific product mix and pricing strategy, was reasonably consistent with that of CPI;
- an increase in net retail square footage of 2.8 million square feet or 6.1% due to the opening of 69 new corporate and franchise stores and the closure of 57 stores including stores which have undergone conversions and major expansions;
- sales per corporate store increased to $32 million in 2005 from $31 million in 2004 reflecting the introduction of larger stores which are expected to become ultimately more productive; and
- sales per average square foot of corporate stores of $579 in 2005 decreased from $592 in 2004 as a result of increases in net retail square footage which outpaced the increase in sales.

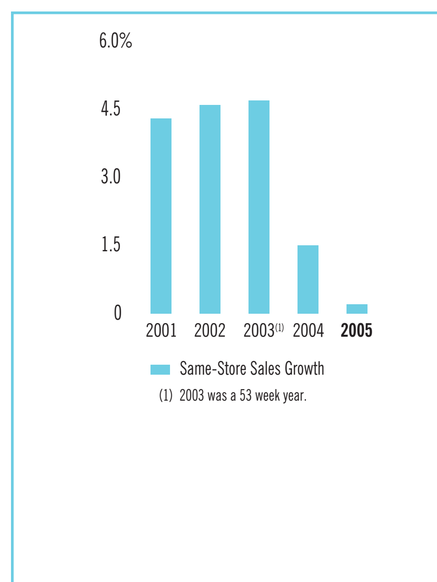
Sales of control label products for 2005 amounted to $5.9 billion compared to $5.6 billion in 2004. Control label penetration, which is measured as control label retail sales as a percentage of total retail sales, was 22.4% for 2005, and approximately equal to that of 2004. The Company introduced approximately 2,000 new control label products in 2005, including 1,600 new general merchandise products. The Company's control label program, which includes *President's Choice, PC, President's Choice Organics, PC Blue Menu, PC Mini Chefs, no name, Club Pack, GREEN, EXACT, Teddy's Choice* and *Life@Home*, provides additional sales growth potential.

Loblaw expects that the following initiatives, coupled with continued investment in pricing, promotions and advertising where appropriate, will generate continued sales growth over the next few years:
- capital investment in its store network including the planned opening, expansion or renovation of approximately 123 corporate and franchise stores across Canada in 2006;
- additional emphasis on food offerings of great quality and value;
- expansion of general merchandise offerings, including the launch of *Joe Fresh Style* apparel for adults in early 2006, and continued improvement in the execution of its general merchandise and drugstore programs; and
- continued focus on control label products including the development of new products in strategic categories, increased marketing and shortened time to market.

**Sales and Sales Growth**
($ millions)




**Same-Store Sales Growth**



Operating Income, Adjusted Operating Income, Adjusted EBITDA and Margins[1]

| ($ millions except where otherwise indicated) | **2005 (52 weeks)** | 2004 (52 weeks) | Change |
|---|---|---|---|
| Operating income | **$ 1,401** | $ 1,652 | (15.2)% |
| Adjusted operating income[1] | **$ 1,600** | $ 1,652 | (3.1)% |
| Operating margin | **5.0%** | 6.3% | |
| Adjusted operating margin[1] | **5.8%** | 6.3% | |
| Adjusted EBITDA[1] | **$ 2,132** | $ 2,125 | 0.3% |
| Adjusted EBITDA margin[1] | **7.8%** | 8.1% | |

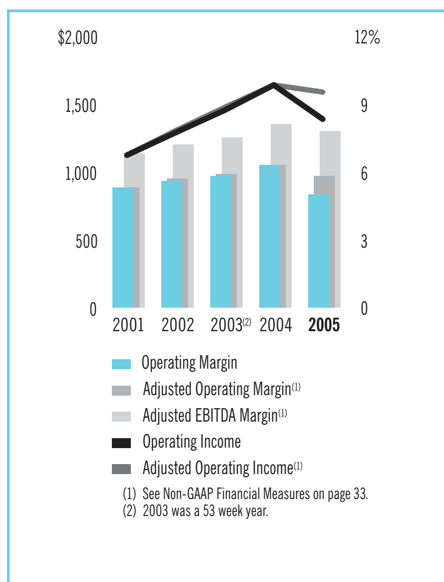
(1) See Non-GAAP Financial Measures on page 33.

**Operating Income** Operating income for 2005 decreased $251 million, or 15.2%, to $1.4 billion. Operating margin declined to 5.0% in 2005 from 6.3% in 2004. Adjusted EBITDA[1] increased marginally in 2005. Adjusted EBITDA margin[1] was 7.8% in 2005 compared to 8.1% in 2004. In 2005, operating income was adversely impacted by the factors described below.

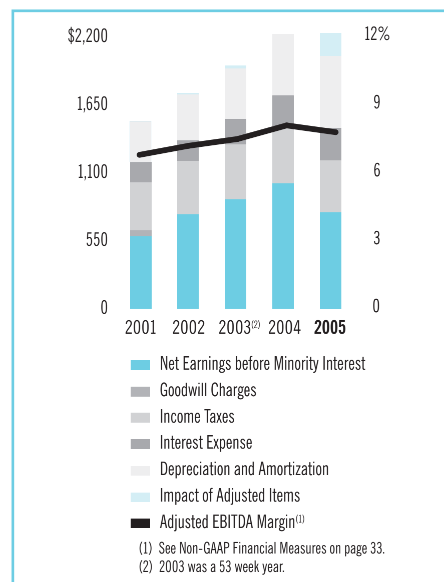
During the first quarter of 2005, after completion of a detailed assessment of its supply chain network, management of the Company approved a comprehensive plan to restructure its supply chain operations nationally. This plan, which is anticipated to be fully implemented by the end of 2007 or early 2008, is expected to reduce future operating costs, provide a smoother flow of products and better service levels to stores and further enable the Company to achieve its targeted operating efficiencies. The plan involves the closure of six distribution centres and the relocation of certain activities to new distribution centres. Costs accrued thus far relate primarily to employee termination benefits resulting from planned involuntary terminations. Further costs related to fixed asset impairment and accelerated depreciation and site closure costs as well as additional employee costs will be recognized as appropriate criteria are met. Total costs are expected to approximate $90 million of which $62 million was recognized in 2005.

In addition to the restructuring of its supply chain network, the Company also reorganized its merchandising, procurement and operations groups, established a new national head office and Store Support Centre in Brampton, Ontario, which opened in the third quarter of 2005, and relocated its general merchandise operations from Calgary, Alberta to the new office. Of the total estimated $25 million cost associated with these initiatives, $24 million was recognized in 2005 resulting in total restructuring and other charges of $86 million in 2005.

**Operating Income and Margins**
($ millions)




**Analysis of Adjusted EBITDA and Margin[1]**
($ millions)




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

| ($ millions) | Costs Recognized in 2005 (52 weeks) | Total Expected Costs |
|---|---|---|
| Supply chain network | **$ 62** | $ 90 |
| Office move and reorganization of the operation support functions | **24** | 25 |
| Total restructuring and other charges | **$ 86** | $ 115 |

In 2005, operations were also disrupted by certain systems conversions and the startup of a new third-party owned and operated general merchandise warehouse and distribution centre serving eastern Canada.

As part of the plan to consolidate the Company's supply chain operations nationally and to implement a national information technology platform, a number of warehouse systems conversions in western Canada commenced late in the second quarter of 2005 and were scheduled to be completed by year end 2005. Implementation challenges arising from these initiatives were encountered, particularly during the conversion of the Calgary, Alberta general merchandise distribution centre. Service levels, a measure of distribution centre operating efficiency, fell below normal running rates, resulting in recurring out-of-stock positions at retail. This resulted in lost sales and the associated operating income. Given the challenges encountered in the Calgary general merchandise distribution centre, all other planned system conversions for 2005 were delayed and resumed in early 2006.

In Ontario, the general merchandise warehouse and distribution activities were transitioned to a new facility owned and operated by a third party. Complexities were experienced during the start-up phase and as a result, service levels were below expectations in the second half of the year. This resulted in some out-of-stock positions in Ontario and a delay in the transition of volume into the third-party facility from existing Company distribution centres, which in turn, placed additional pressure on existing Company distribution centres. Productivity declined in certain Company distribution centres during 2005 as a result of the announced restructuring.

Higher direct and indirect operating costs resulting from the supply chain disruptions were significant during the last two quarters of 2005. While it was possible to quantify the direct costs at approximately $30 million for the year, the indirect cost of lost sales, poor service levels and resultant higher operating costs was difficult to quantify.

During the third quarter of 2005, the Company also recorded a charge relating to an audit and proposed assessment by the Canada Revenue Agency relating to GST on certain products sold between 2000 and 2002 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 up to the end of 2004. Accordingly, a charge of $40 million was recorded in operating income to reflect management's best estimate of such potential tax liabilities of which management is currently aware. Approximately $15 million of this amount was settled during the fourth quarter of 2005. 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. An internal review of the procedures and controls surrounding the process of charging and remitting these taxes has been substantially completed and recommendations are in the process of being implemented to avoid the recurrence of similar charges subsequent to the periods currently accounted for.

An incremental charge of $43 million over last year was also recorded in operating income in 2005 for the net effect of stock-based compensation and the associated equity forwards.

After adjusting for the above-noted items, adjusted operating income(1) was $1.6 billion in 2005 compared to $1.7 billion in 2004. Adjusted operating margin(1) was 5.8% in 2005 compared to 6.3% in 2004.

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

Inventory shrink in the general merchandise categories was higher than normal throughout 2005 and showed some progress back to more normal levels in the fourth quarter. Improved buying synergies and product mix offset this increase in shrink, resulting in gross margin in 2005 that was approximately equal to that of 2004. Softening sales from product supply issues and deliberate delays in program activity in 2005 resulted in lost leverage on the fixed components of operating and administrative expenses.

The Company expects to see improvement in adjusted operating income(1) on a year-over-year basis during the second half of 2006. The emphasis in the early part of 2006 will be on improving service levels, particularly in the general merchandise and drugstore areas, and ensuring that product is available at the store level to support merchandising programs. The Company expects some lowering of prices in certain formats to encourage more customer traffic and build sales.

**Interest Expense** Interest expense consists primarily of interest on short and long term debt, the amortization of deferred financing costs net of interest on financial derivative instruments, interest income earned on short term investments and interest capitalized to fixed assets. In 2005, total interest expense increased $13 million, or 5.4%, to $252 million from $239 million in 2004.

In 2006, interest expense is expected to be relatively consistent with that of 2005.

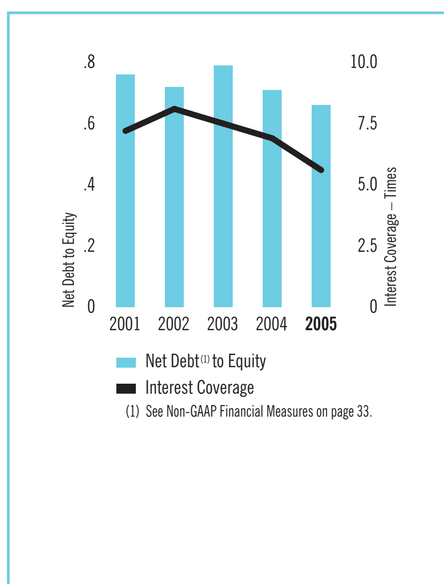
Interest on long term debt in 2005 was consistent with last year's level, at $290 million. The 2005 weighted average fixed interest rate on long term debt (excluding capital lease obligations) was 6.7% (2004 – 6.8%) and the weighted average term to maturity was 17 years (2004 – 17 years).

Interest on financial derivative instruments includes the net positive effect of the Company's interest rate swaps, cross currency basis swaps and equity forwards, and amounted to income of $6 million in 2005 (2004 – $30 million). The decrease in net interest income was due mainly to the maturity of interest rate swaps during the year and an increase in United States short term interest rates.

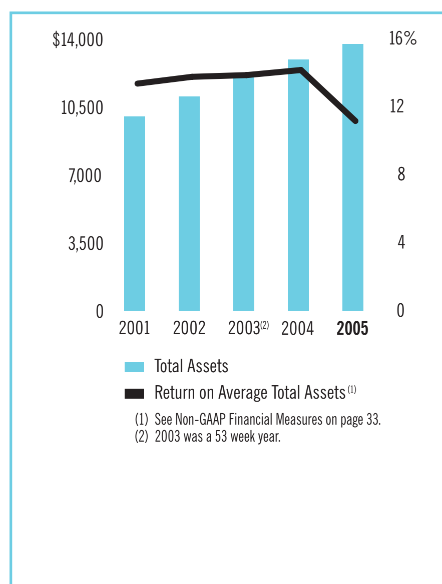
Net short term interest income of $11 million was realized in 2005 (2004 – nil). This increase in income resulted primarily from higher interest rates on United States dollar denominated cash, cash equivalents and short term investments partially offset by an increase in Canadian short term interest rates.

During 2005, $21 million (2004 – $21 million) of interest incurred on debt related to real estate properties under development was capitalized to fixed assets.

**Net Debt(1) to Equity and Interest Coverage**




**Total Assets and Return on Average Total Assets(1)**
($ millions)






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

Analysis of Long Term Financing Costs

| ($ millions except where otherwise indicated) | 2005 (52 weeks) | 2004 (52 weeks) |
|---|---|---|
| Total long term debt at year end (including portion due within one year) | **$ 4,355** | $ 4,151 |
| Interest on long term debt | **$ 290** | $ 290 |
| Weighted average fixed interest rate on long term debt (excluding capital lease obligations) | **6.7%** | 6.8% |

**Income Taxes** The effective income tax rate in 2005 increased to 34.8% from 31.5% in 2004, mainly as a result of the change in the income tax impact related to stock-based compensation and the associated equity forwards and the successful resolution in 2004 of certain income tax matters from a previous year.

The effective income tax rate for 2006 is expected to be approximately 33%, however, this rate may change with variances in the proportion of taxable income across different tax jurisdictions or if there is any change in tax legislation.

**Net Earnings** In 2005, net earnings decreased $222 million, or 22.9%, to $746 million from $968 million in 2004 and basic net earnings per common share decreased 81 cents, or 22.9%, to $2.72 from $3.53 in 2004 due to the factors described in the preceding sections.

### 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 2005 net debt[1] to equity ratio was .66:1 compared to the 2004 ratio of .71:1.

Pursuant to the requirements of AcG 15, the consolidated balance sheet as at December 31, 2005 includes $126 million of loans payable of VIEs consolidated by the Company, $23 million of which is due within one year. The loans payable represent financing obtained by eligible independent franchisees through a structure involving independent trusts to facilitate the purchase of the majority of their inventory and fixed assets, consisting mainly of fixturing and equipment. These loans payable, which have an average term to maturity of 7 years, are due and payable on demand under certain predetermined circumstances and are secured through a general security agreement made by the independent franchisees in favour of the independent funding trust. Interest is charged on a floating rate basis and prepayment of the loans may be made without penalty. The independent funding trust within the structure finances its activities through the issuance of short term asset-backed notes to third-party investors.

As disclosed in Note 19 to the consolidated financial statements for the year ended December 31, 2005, a standby letter of credit has been provided by a major Canadian bank for the benefit of the independent funding trust equal to approximately 10% of the total principal amount of the loans outstanding at any point in time. The Company has agreed to reimburse the issuing bank for any amount drawn on the standby letter of credit. In the event of a default by an independent franchisee, the independent funding trust may assign the loan to the Company and draw upon the standby letter of credit. No amount has ever been drawn on the standby letter of credit.

Cash flows from operating activities cover a large portion of the Company's funding requirements and in 2005, exceeded the capital investment program of $1.2 billion. In 2005, funding requirements resulted primarily from the capital investment program and dividends paid on the Company's common shares.

In 2005, shareholders' equity increased $472 million, or 8.7%, to $5.9 billion. The 2006 net debt to equity ratio is expected to improve slightly as retained earnings growth is expected to exceed debt financing requirements. The interest coverage ratio declined to 5.6 times in 2005 compared to 6.9 times in 2004, as a result of the decline in operating income as outlined previously.

At year end, the working capital position improved over the prior year. The 2005 return on average total assets[1] was 11.2% compared to 14.2% in 2004. The 2005 return on average shareholders' equity was 13.2% compared to the 2004 return of 19.2%. Both 2005 returns were negatively impacted by the incremental costs and charges incurred in 2005 as outlined previously. The five year average return on shareholders' equity was 17.3% (2004 – 18.2%).

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

**Common Share Dividends** The Company's dividend policy is to maintain a dividend payment equal to approximately 20% to 25% of the prior year's adjusted basic net earnings per common share, giving consideration to the year end cash position, future cash flow requirements and investment opportunities. During 2005, the Board declared quarterly dividends of 21 cents per common share. The annualized dividend per common share of 84 cents is equal to 24.1% of the 2004 adjusted basic net earnings per common share[1], which is consistent with the Company's dividend policy. Subsequent to year end, the Board declared a quarterly dividend of 21 cents per common share, payable April 1, 2006.

**Outstanding Share Capital** The Company's outstanding share capital is comprised of common shares. An unlimited number of common shares is authorized and 274,054,814 common shares were outstanding at year end. Further information on the Company's outstanding share capital is provided in Note 16 to the consolidated financial statements.

## 6. Liquidity and Capital Resources

### 6.1 Cash Flows

Major Cash Flow Components

| ($ millions) | 2005 (52 weeks) | 2004 (52 weeks) | Change |
|---|---|---|---|
| Cash flows from (used in): | | | |
| Operating activities | $ 1,489 | $ 1,443 | $ 46 |
| Investing activities | $ (903) | $ (1,177) | $ 274 |
| Financing activities | $ (208) | $ (290) | $ 82 |

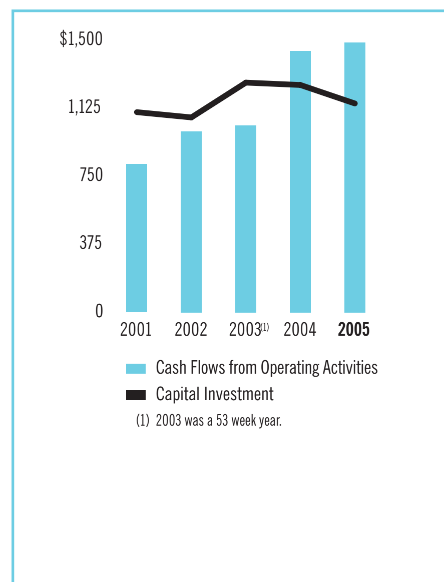
**Cash Flows from Operating Activities** 2005 cash flows from operating activities increased to $1.5 billion from $1.4 billion in 2004. The 2006 cash flows from operating activities are expected to increase at a rate consistent with net earnings growth and are expected to fund a large portion of the anticipated 2006 funding requirements, including planned capital investment activity.

**Cash Flows used in Investing Activities** 2005 cash flows used in investing activities were $903 million compared to $1.2 billion in 2004. During 2005, proceeds were received from the sale of a portfolio of third-party long term loans receivable as described in the Related Party Transactions section of this MD&A. In addition, the shortening term to maturity profile of the Company's short term investments portfolio resulted in a shift from short term investments to cash and cash equivalents.

Capital investment amounted to $1.2 billion (2004 – $1.3 billion), reflecting a continuing commitment to maintain and renew the asset base and invest for growth. Approximately 82% (2004 – 83%) of the capital investment was for new stores, renovations or expansions. The continued capital investment activity benefited all regions in varying degrees and strengthened the existing store base. Some of the new, larger stores replaced older, smaller, less efficient stores that did not offer the broad range of products and services demanded by today's consumer. The remaining 18% (2004 – 17%) of the capital investment was for the warehouse and distribution network, information systems and other infrastructure required to support store growth.

The 2005 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 6.1% over 2004. During 2005, 69 (2004 – 86) new corporate and franchised stores were opened and 77 (2004 – 82) underwent renovation or minor expansion. The 69 new stores, net

**Cash Flows from Operating Activities and Capital Investment** ($ millions)




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

of 57 (2004 – 71) store closures, added 2.8 million square feet of retail space (2004 – 3.4 million). The 2005 average corporate store size increased 4.7% to 56,100 square feet (2004 – 53,600) and the average franchised store size increased 4.2% to 27,100 square feet (2004 – 26,000).

Capital investment is estimated at $1 billion for 2006. At year end, the Company had committed approximately $264 million (2004 – $354 million) with respect to capital investment projects and the purchase of real property. In 2006, the Company plans to open, expand or renovate more than 123 corporate and franchised stores throughout Canada in a geographic investment pattern similar to that of last year. This is expected to result in a net increase of approximately 1.8 million square feet, which should generate additional sales growth.

The Company also generated $109 million (2004 – $110 million) from fixed asset sales.

Capital Investment and Store Activity

| | 2005 (52 weeks) | 2004 (52 weeks) | Change |
|---|---|---|---|
| Capital investment ($ millions) | $ 1,156 | $ 1,258 | |
| Retail square footage (in millions) | 48.5 | 45.7 | 6.1% |
| Average store size (sq. ft.) | | | |
| Corporate | 56,100 | 53,600 | 4.7% |
| Franchised | 27,100 | 26,000 | 4.2% |

**Cash Flows used in Financing Activities** Cash flows used in financing activities decreased to $208 million in 2005 compared to $290 million in 2004 mainly due to the relative change in commercial paper when compared to the same period last year.

During the first quarter of 2005, Loblaw issued $300 million of 5.90% Medium Term Notes ("MTN") due 2036, under its 2003 Base Shelf Prospectus, to refinance the $100 million of 6.35% Provigo Inc. Debenture that matured in the fourth quarter of 2004 and the $200 million of 6.95% MTN that matured in the first quarter of 2005. During the second quarter of 2005, the Company's 2003 Base Shelf Prospectus expired and a new base shelf prospectus allowing the issue of up to $1 billion of aggregate MTN was filed. Net change in VIE long term debt issued and retired during 2005 was not material. In 2006, the $125 million of 8.70% Provigo Inc. Debenture will mature.

The Company intends to renew its Normal Course Issuer Bid ("NCIB") to purchase on the Toronto Stock Exchange or enter into equity forwards to purchase up to 5% of its common shares outstanding. During 2005, the Company purchased for cancellation 226,100 (2004 – 576,100) of its common shares for $16 million (2004 – $35 million), pursuant to its NCIB.

### 6.2 Sources of Liquidity

The Company can obtain its short term financing through a combination of cash generated from operating activities, cash, cash equivalents, short term investments, bank indebtedness and its commercial paper program. The Company's cash, cash equivalents and short term investments, as well as $845 million in uncommitted operating lines of credit extended by several banks, support its $1.2 billion commercial paper program. The Company's commercial paper borrowings generally mature less than three months from the date of issuance although the terms can be up to 364 days.

Securitization of credit card receivables provides President's Choice Bank ("PC Bank"), a wholly owned subsidiary of the Company, with an additional source of funds for the operation of its business. Under PC Bank's securitization program, a portion of the total interest in the credit card receivables is sold to an independent trust. PC Bank securitized $225 million of credit card receivables during 2005 (2004 – $227 million). In 2006, PC Bank finalized the restructuring of its securitization program which was undertaken in part to accommodate growth in the credit card program. Information on PC Bank's credit card receivables and securitization is provided in Notes 8 and 19 to the consolidated financial statements and in the Off-Balance Sheet Arrangements section of this MD&A.

The Company obtains its long term financing through its MTN program. The Company plans to refinance existing long term debt as it matures.

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 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 $276 million (2004 – $264 million) against which the Company had $316 million (2004 – $311 million) in credit facilities available to draw on.

The Company has the following sources from which it can fund its 2006 cash requirements: cash flows generated from operating activities, cash, cash equivalents, short term investments, commercial paper program, MTN program and additional credit card receivable securitizations from future growth in the PC Bank credit card operations.

In 2006, the Company anticipates no difficulty in obtaining external financing in view of its current credit ratings, its past experience in the capital markets and general market conditions.

The Company's credit ratings are outlined in the table below:

Credit Ratings (Canadian Standards)

| | Dominion Bond Rating Service | Standard & Poor's |
|---|---|---|
| Commercial paper | R-1 (low) | A-1 (mid) |
| Medium term notes | A (high) | A |
| Other notes and debentures | A (high) | A |

The rating organizations listed above base their credit ratings on quantitative and qualitative considerations. In January 2006, Dominion Bond Rating Service and Standard & Poor's changed their outlook on the trend of the Company's long term debt from "stable" to "negative".

These credit ratings are intended to give an indication of the risk that the Company will not fulfill its obligations in a timely manner.

### 6.3 Contractual Obligations

The following illustrates certain of the Company's significant contractual obligations and discusses other obligations as at December 31, 2005:

Summary of Contractual Obligations

| | Payments due by year | | | | | | |
|---|---|---|---|---|---|---|---|
| ($ millions) | 2006 | 2007 | 2008 | 2009 | 2010 | Thereafter | Total |
| Long term debt | $ 161 | $ 24 | $ 406 | $ 140 | $ 314 | $ 3,310 | $ 4,355 |
| Operating leases(1) | 192 | 184 | 166 | 146 | 126 | 823 | 1,637 |
| Contracts for purchases of real property and capital investment projects(2) | 255 | | 9 | | | | 264 |
| Purchase obligations(3) | 693 | 811 | 758 | 717 | 656 | 1,320 | 4,955 |
| Total contractual obligations | $ 1,301 | $ 1,019 | $ 1,339 | $ 1,003 | $ 1,096 | $ 5,453 | $ 11,211 |

(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. 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. These obligations also include commitments with respect to capital investment projects, such as the construction, expansion and renovation of buildings.

(3) These include material contractual obligations 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. While estimates of anticipated financial commitments were made for the purpose of this disclosure, the amount of actual payments may vary.

The purchase obligations presented in the above table do not include purchase orders issued in the ordinary course of business for goods which are meant for resale, nor do they include any contracts which may be terminated on relatively short notice with insignificant cost or liability to the Company. Also excluded are purchase obligations related to commodities or commodity-like goods for which a market for resale exists. The Company believes such excluded contracts do not have a material impact on its liquidity.

At year end, the Company had other long term liabilities which included accrued benefit plan liability, future income taxes liability and stock-based compensation liability. These long term liabilities have not been included in the table above 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;
- 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 they exercise those stock options; and
- future payments of restricted share units depend on market price of the Company's common shares.

**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 $143 million (2004 – $104 million);
- guarantees;
- the securitization of a portion of PC Bank's credit card receivables through independent trusts;
- a standby letter of credit to an independent funding trust which provides loans to the Company's franchisees for their purchase of inventory and fixed assets; and
- financial derivative instruments in the form of interest rate swaps.

**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 and in relation to third-party financing made available to the Company's 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 19 to the consolidated financial statements.

**Securitization of Credit Card Receivables** The Company, through its wholly owned subsidiary PC Bank, securitizes credit card receivables through an independent trust administered by a major Canadian bank. In these securitizations, PC Bank sells a portion of its credit card receivables to the trust in exchange for cash. The trust funds these purchases by issuing debt securities in the form of asset-backed commercial paper 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 trust and PC Bank have been, and are expected to continue to be, accounted for as sales as contemplated by Canadian GAAP, specifically Accounting Guideline ("AcG") 12, *"Transfers of Receivables"*. As PC Bank does not control or exercise any measure of influence over the trust, the financial results of the trust have not been included in the Company's consolidated financial statements.

When the Company sells credit card receivables to the trust, it no longer has access to the receivables but continues to maintain credit card customer account relationships and servicing obligations. The Company does not receive a servicing fee from the trust for its servicing obligations. When a sale occurs, PC Bank retains a subordinated interest consisting of rights to future cash flows after obligations to the investors in the trust have been met which is considered to be a retained interest. The trust's recourse to PC Bank's assets is limited to PC Bank's retained interests and is further supported through a standby letter of credit provided by a major Canadian bank for 9% (2004 – 15%) of the securitized amount. This standby letter 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 bank for any amount drawn on the standby letter of credit. The carrying value of the retained interests is periodically reviewed and when a decline in value is identified that is other than temporary, the carrying value is written down to fair value.

As at December 31, 2005, the total amount of securitized credit card receivables outstanding which PC Bank continues to service was $1 billion (2004 – $785 million) and the associated retained interests amounted to $5 million (2004 – $12 million). The standby letter of credit supporting these securitized receivables amounted to approximately $91 million (2004 – $118 million). During 2005, PC Bank received income of $106 million (2004 – $83 million) in securitization revenue from the independent trust 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 8 and 19 to the consolidated financial statements.

In October 2005, Eagle Credit Card Trust ("Eagle"), an independent trust, was established for the purpose of issuing notes backed by credit card receivables originated and serviced by PC Bank. Subsequent to year end, Eagle issued $500 million, five year notes at a weighted average rate of 4.5%, due 2011, to finance the purchase of credit card receivables, previously securitized by PC Bank, from an independent trust. PC Bank will continue to service the credit card receivables on behalf of Eagle but will not receive any fee for its servicing obligations and has a retained interest in the securitized receivables represented by the right to future cash flows after obligations to investors have been met. In accordance with Canadian GAAP, the financial statements of Eagle will not be consolidated with those of the Company.

**Independent Funding Trust** Franchisees of the Company may obtain financing through a structure, involving independent trusts, that was created to provide loans to the franchisees to facilitate their purchase of inventory and fixed assets, consisting mainly of fixturing and equipment. These trusts are administered by a major Canadian bank. The independent funding trust within the structure finances its activities through the issuance of short term asset-backed notes to third-party investors. The total amount of loans issued to the Company's franchisees outstanding as of December 31, 2005 was $420 million (2004 – $394 million) including $126 million of loans payable of VIEs consolidated by the Company in 2005. 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 for approximately 10% of the principal amount of the loans outstanding at any point in time, or $42 million (2004 – $42 million) as of December 31, 2005. This credit enhancement allows the independent funding trust to provide favourable financing terms to the Company's franchisees. In the event that a 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 may 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. No amount has ever been drawn on the standby letter of credit. The Company is confident it would be able to fully recover from the franchisee any amounts it had reimbursed to the issuing bank. Neither the independent funding trust nor the Company can voluntarily terminate the agreement prior to December 2009, and only upon six months' prior notice following that date. Automatic termination of the agreement can only occur if specific, pre-determined events occur and are not remedied within the time periods required. If the arrangement is terminated, the franchisees would be required to replace the loans provided by the independent funding trust with alternative financing. The Company is under no contractual obligation to provide funding to franchisees under such circumstances. In accordance with Canadian GAAP, the financial statements of the independent funding trust are not consolidated with those of the Company.

**Financial Derivative Instruments** The Company uses off-balance sheet financial derivative instruments to manage its exposure to changes in interest rates. For a detailed description of the Company's off-balance sheet financial derivative instruments and the related accounting policies, see Notes 1 and 18 to the consolidated financial statements.

## 7. Selected Consolidated Annual Information

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 two year period.

Selected Consolidated Annual Information

| ($ millions except where otherwise indicated) | **2005 (52 weeks)** | 2004 (52 weeks) | 2003 (53 weeks) |
|---|---|---|---|
| Sales | **$ 27,801** | $ 26,209 | $ 25,220 |
| Sales excluding impact of VIEs[1] | **27,423** | 26,209 | 25,220 |
| Net earnings | **746** | 968 | 845 |
| Net earnings per common share ($) | | | |
| Basic | **2.72** | 3.53 | 3.07 |
| Adjusted basic[1] | **3.35** | 3.48 | 3.10 |
| Diluted | **2.71** | 3.51 | 3.05 |
| Total assets[2] | **13,761** | 12,949 | 12,113 |
| Long term debt (excluding amount due within one year) | **4,194** | 3,935 | 3,956 |
| Dividends declared per common share ($) | **.84** | .76 | .60 |

(1) See Non-GAAP financial measures on page 33.
(2) Certain prior years' information was reclassified to conform with the current year's presentation.

Sales in 2005 increased 6.1% to $27.8 billion from $26.2 billion in 2004. Excluding the impact of VIEs sales were $27.4 billion or 4.6% higher than 2004. Sales growth of 3.9% for the full year 2004 includes a 2% negative impact from the 53rd week in 2003. Same-store sales increased 0.2% in 2005 and 1.5% in 2004 on an equivalent 52 week basis. National food price inflation as measured by CPI was approximately 2% for 2005 compared to 1% to 2% in 2004. The Company's calculation of food price inflation, which considers Company specific product mix and pricing strategy was reasonably consistent with that of CPI. Sales growth in 2005 was adversely affected by supply chain disruptions by approximately 0.5% to 0.7% over 2004.

Sales were also influenced by a number of other factors, including changes in net retail square footage, expansion into new services and/or departments and the activities of competitors. Over the past two years, an average of $1.2 billion annually in capital was invested, resulting in an increase in net retail square footage of approximately 6.2 million square feet or 14.7%.

Corporate store sales per average square foot declined from $605 in 2003 (a 53 week year) to $579 in 2005.

The amount of new net retail square footage and the timing of the store openings and closures within any given year may vary. The increase in weighted average net retail square footage was 7.5% in 2005 and 6.4% in 2004.

The rollout of *The Real Canadian Superstore* in Ontario, Canada also had an impact on same-store sales in that region by replacing mature, well performing stores that were previously included in same-store sales, and by creating pricing pressure on other Company stores located within the respective trading areas. In pursuit of improving its value proposition, Loblaw has established price leadership in specific markets by adopting everyday low pricing strategies. Consistent with its strategy of focusing on food but serving the consumer's everyday household needs, the Company has expanded its general merchandise and drugstore offerings over this period and the retail sales growth realized in those categories continued to surpass retail sales growth of food. Competitor activity varied by market. During the past two years, unprecedented levels of retail square footage, mainly associated with food offerings, have been introduced into certain markets, resulting in pressure on prices and customer retention.

Full year 2005 net earnings decreased $222 million or 22.9% and basic net earnings per common share decreased 81 cents or 22.9% over 2004. This decline included a decrease of 15.2% in operating income and a 5.4% increase in interest expense. The effective income tax rate increased to 34.8% in 2005 from 31.5% in 2004.

In 2004, net earnings increased $123 million or 14.6% and basic net earnings per common share increased 46 cents or 15.0% over 2003. The improvement was due to an increase in operating income of 12.6% over 2003 partially offset by a 21.9% increase in interest expense. The effective income tax rate declined to 31.5% in 2004 from 33.5% in 2003.

Operating income for the full year 2005 was lower than in 2004 as a result of ongoing transformative changes and certain other charges outlined previously. Over the two year period, net interest expense increased, primarily due to the increased weighted average borrowing levels required to support the Company's

funding requirements. The 2005 increase in the effective income tax rate was mainly as a result of the impact related to the net effect of stock-based compensation and the associated equity forwards. The 2004 effective income tax rate was positively impacted by the successful resolution of certain income tax matters from a previous year of $14 million.

Adjusted basic net earnings per common share[1] decreased 3.7% to $3.35 in 2005 from $3.48 in 2004 and increased 12.3% to $3.48 in 2004 from $3.10 in 2003.

Total assets of the Company continued to increase. Fixed assets have grown as a result of the capital investment program. Inventory growth resulted from an investment in general merchandise. Inventory turns of general merchandise categories are lower than those of food categories, resulting in higher aggregate levels of investment in general merchandise inventories as that business developed. A substantial portion of credit card receivables is sold to an independent trust and the unsecuritized balance net of the allowance for credit losses increased by $94 million since 2003. Cash flows from operating activities have covered a large portion of the funding requirements for the Company. For each of 2005 and 2004, total long term debt issued net of the amounts retired was approximately $100 million. The amount of fixed rate debt issued in any given year is intended to continue to preserve the Company's liquidity needs. In addition, long term debt increased in 2005 as a result of consolidating $126 million of VIE long term debt ($23 million of which is due within one year) pursuant to AcG 15.

Dividends declared per common share have been consistent with the Company's policy of maintaining a dividend payment equal to approximately 20% to 25% of the prior year's adjusted basic net earnings per common share.

During the two year period ended December 31, 2005, the Company implemented several new accounting standards issued by the Canadian Institute of Chartered Accountants ("CICA"). The new accounting standards implemented in 2005 and the resulting impact on the financial position and results of operations are outlined in the Accounting Standards section of this MD&A. The following standards were implemented in 2004:

- Section 3063, *"Impairment of Long-lived Assets"*;
- AcG 13, *"Hedging Relationships"*;
- Section 3110, *"Asset Retirement Obligations"*;
- Emerging Issues Committee ("EIC") Abstract 144, *"Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor"* and
- Section 3461, *"Employee Future Benefits"* (for enhanced disclosure).

## 8. Quarterly Results of Operations

### 8.1 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. 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 and is reported in Canadian dollars.

Summary of Quarterly Results[1]
(unaudited)

| ($ millions except where otherwise indicated) | 2005 First Quarter | 2005 Second Quarter | 2005 Third Quarter | 2005 Fourth Quarter | 2005 Total (audited) | 2004 First Quarter | 2004 Second Quarter | 2004 Third Quarter | 2004 Fourth Quarter | 2004 Total (audited) |
|---|---|---|---|---|---|---|---|---|---|---|
| Sales | **$ 6,124** | **$ 6,436** | **$ 8,653** | **$ 6,588** | **$ 27,801** | $ 5,677 | $ 6,069 | $ 8,134 | $ 6,329 | $ 26,209 |
| Net earnings | **$ 142** | **$ 211** | **$ 192** | **$ 201** | **$ 746** | $ 176 | $ 197 | $ 258 | $ 337 | $ 968 |
| Net earnings per common share | | | | | | | | | | |
| Basic ($) | **$ .52** | **$ .77** | **$ .70** | **$ .73** | **$ 2.72** | $ .64 | $ .72 | $ .94 | $ 1.23 | $ 3.53 |
| Diluted ($) | **$ .52** | **$ .76** | **$ .70** | **$ .73** | **$ 2.71** | $ .64 | $ .71 | $ .94 | $ 1.22 | $ 3.51 |

(1) During 2005, the Company implemented AcG 15 retroactively without restatement as described in the "Accounting Standards" section of this MD&A. The implementation of Emerging Issues Committee Abstract 144, *"Accounting by a Customer (Including a Reseller) for Certain Consideration received from a Vendor"* ("EIC 144"), in the third quarter of 2004 on a retroactive basis with restatement did not result in a material change in the quarterly net earnings.



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

Sales growth in 2005 was impacted by various factors. Sales from VIEs consolidated by the Company in 2005 accounted for quarterly sales growth of between 1.2% and 1.7% when compared to the respective quarters in 2004. Sales growth during the last two quarters of 2005 continued to be negatively impacted by supply chain disruptions which started earlier in the year. Net retail square footage increased by 2.8 million square feet in 2005 and was somewhat weighted over the last two quarters. Same-store sales growth declined during the year from 2.4% in the first quarter to a decline of approximately 0.7% in the fourth quarter. Overall national food price inflation, as measured by CPI, during 2005 was approximately 2%, trending downwards in the last quarter of the year.

Fluctuations in quarterly net earnings in 2005 reflect the impact of restructuring and other charges resulting from the ongoing transformative changes. Quarter-to-quarter variability was also caused by the following:

- Fluctuations in stock-based compensation net of the impact of the associated equity forwards as a result of changes in the market price of the Company's common shares;
- $30 million of direct costs in 2005 related to the handling, storage and movement of inventory from supply chain disruptions, of which $20 million was incurred in the third quarter and an additional $10 million was incurred in the fourth quarter;
- $40 million in GST and PST related charges recorded in the third quarter of 2005; and
- Higher than normal inventory shrink in the general merchandise categories throughout 2005 with some progress back to more normal levels in the fourth quarter.

Interest expense increased in the third and fourth quarters of 2005 over 2004 primarily due to the maturity of a portion of the interest rate swaps.

The change in the quarterly effective income tax rate for 2005 over 2004 was primarily due to the change in the proportion of taxable income across different tax jurisdictions, the income tax impact related to stock-based compensation and the associated equity forwards and a reversal of $14 million due to the successful resolution in the first quarter of 2004 of certain income tax matters from a previous year.

During 2005 and 2004 the Company purchased common shares for cancellation pursuant to its NCIB. The weighted average number of common shares outstanding has not been significantly impacted by these purchases.

### 8.2 Fourth Quarter Results

The following is a summary of selected consolidated information for the fourth quarter of 2005 extracted from the Company's preliminary unaudited 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 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) | **2005 (12 weeks)** | 2004 (12 weeks) |
|---|---|---|
| Sales | **$ 6,588** | $ 6,329 |
| Sales excluding impact of VIEs(1) | **6,501** | 6,329 |
| Operating income | **394** | 530 |
| Adjusted operating income(1) | **441** | 522 |
| Interest expense | **61** | 56 |
| Income taxes | **132** | 137 |
| Net earnings | **201** | 337 |
| Net earnings per common share ($) | | |
| Basic | **.73** | 1.23 |
| Adjusted basic(1) | **.94** | 1.17 |
| Diluted | **.73** | 1.22 |
| Cash flows from (used in): | | |
| Operating activities | **830** | 894 |
| Investing activities | **(456)** | (430) |
| Financing activities | **(333)** | (489) |
| Dividends declared per common share ($) | **.21** | .19 |

(1) See Non-GAAP financial measures on page 33.

Sales for the fourth quarter of 2005 increased 4.1% or $259 million to $6.6 billion from $6.3 billion reported in the fourth quarter of 2004, including an increase of 1.4% or $87 million related to the consolidation of certain independent franchisees.

Sales and Sales Growth Excluding Impact of VIEs[1]

| ($ millions except where otherwise indicated) | **2005 (12 weeks)** | 2004 (12 weeks) |
|---|---|---|
| Total sales | **$ 6,588** | $ 6,329 |
| Less: Sales attributable to the consolidation of VIEs pursuant to AcG 15 | **87** | |
| Sales excluding impact of VIEs[1] | **$ 6,501** | $ 6,329 |
| Total sales growth[2] | **4.1%** | (0.7)% |
| Less: Positive impact on sales growth attributable to the consolidation of VIEs pursuant to AcG 15 | **1.4%** | |
| Sales growth excluding impact of VIEs[1] | **2.7%** | (0.7)% |

(1) See Non-GAAP Financial Measures on page 33.
(2) Sales growth in 2004 calculated on a 13 week base in 2003. The extra week in 2003 had a negative impact of approximately 7.5% on the 2004 sales growth shown in the table above.

Sales in the fourth quarter continued to be negatively impacted by the supply chain disruptions which started earlier in 2005. Some improved stability had been realized in the latter part of the quarter but significant improvements are not expected to be felt until mid-2006. *The Real Canadian Superstore* program has been positively received in Ontario and has enjoyed growth in both absolute and same-store sales.

Fourth quarter same-store sales in 2005 declined approximately 0.7% when compared to the same period last year. Expected sales growth was also negatively impacted by approximately 0.9% to 1.2% for the quarter due to supply chain disruptions and a drop in service levels. During the quarter, 17 new corporate and franchised stores were opened and 9 stores were closed, resulting in a net increase of 0.8 million square feet of retail square footage. The Company's calculation of food price inflation was reasonably consistent with the national food price inflation as measured by CPI of approximately 1% for the quarter.

Operating income for the fourth quarter of 2005 decreased $136 million or 25.7% from the fourth quarter of 2004 to $394 million. Operating margin declined to 6.0% from 8.4% in the comparable period of 2004. Fourth quarter operating income in 2005 included a $6 million charge for restructuring and other charges and incremental direct costs of approximately $10 million related to supply chain disruptions. A charge of $27 million related to stock-based compensation net of the impact of the associated equity forwards was also recorded in the fourth quarter and compared to $8 million income in 2004. These items in addition to the negative $4 million VIE impact, accounted for a decline in operating margin of approximately 0.8 of a percentage point for the quarter.

The effective income tax rate for the fourth quarter of 2005 increased to 39.6% from 28.9% in 2004 mainly as a result of the change in the income tax impact related to stock-based compensation and the associated equity forwards.

Net earnings for the quarter were at $201 million, $136 million or 40.4% below the same period last year. Basic net earnings per common share decreased 50 cents, or 40.7%, to 73 cents in 2005 from $1.23 in 2004. Adjusted basic net earnings per common share[1] decreased 23 cents or 19.7% to 94 cents in 2005 from $1.17 in 2004.

Fourth quarter cash flows from operating activities were $830 million in 2005 compared to $894 million in 2004. The decrease was mainly a result of lower net earnings before minority interest. Fourth quarter cash flows used in investing activities were $456 million in 2005 compared to $430 million in 2004.

Fourth quarter cash flows used in financing activities were $333 million in 2005 compared to $489 million in 2004, decreasing mainly due to the repayment of the Company's $100 million 6.35% Provigo Inc. Debenture as it matured during the fourth quarter of 2004.

Further discussion and analysis of the fourth quarter results was provided in the Company's 2005 Fourth Quarter News Release which is available online at www.sedar.com.

### 9. Disclosure Controls and Procedures

Based on an evaluation of the Company's disclosure controls and procedures, the Company's President and Executive Vice President have concluded that these controls and procedures were effective as of December 31, 2005.

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

## 10. Risks and Risk Management

### 10.1 Operating Risks and Risk Management

In the normal course of business, the Company is exposed to operating risks that have the potential to negatively affect its financial performance. The Company has operating and risk management strategies and insurance programs which help to minimize these operating risks.

**Industry** The retail industry in Canada is a changing and competitive market. Consumer needs drive industry changes, which are impacted by changing demographic and economic trends such as changes in disposable income, increasing ethnic diversity, nutritional awareness and time availability. Over the past several years, consumers have demanded more choice, value and convenience. If the Company is ineffective in responding to these demands, its financial performance could be negatively impacted.

The Company monitors its market share and the market in which it operates, and will adjust its operating strategies, which include, but are not limited to, 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 significant competitive advantage because it enhances customer loyalty by offering superior value and provides some protection against national brand pricing strategies.

**Competitive Environment** The Company faces increasing competition from many types of non-traditional competitors, such as mass merchandisers, warehouse clubs, drugstores, limited assortment stores, discount stores, convenience stores and specialty stores, all of which continue to increase their offerings of products typically associated with traditional supermarkets. In order to compete effectively and efficiently, the Company is developing and operating new departments and services that complement the traditional supermarket layout, as well as enhancing its product and service offerings. The Company is also subject to competitive pressures from new entrants into the marketplace and from the potential consolidation of existing competitors. These competitors may have extensive resources which will allow them to compete effectively with the Company in the long term. In order to remain competitive by having an optimal cost structure, the Company continuously evaluates and implements various cost saving initiatives. The Company may not always achieve the expected cost savings and other benefits of these initiatives, which could negatively impact the Company's financial performance.

The Company continuously evaluates the markets it operates in and will enter new markets and review acquisitions when opportunities arise and will also exit a particular market and reallocate assets elsewhere when there is a strategic advantage to doing so. The Company pursues a strategy of enhancing profitability on a market-by-market basis using a multi-format approach. By operating across Canada through corporate stores, franchised stores and associated stores and by servicing independent accounts, the Company strategically minimizes and balances its exposure to industry and competitive risks.

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, lessening of 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.

**Food Safety and Public Health** The Company is subject to potential liabilities connected with its business operations, including potential exposures 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.

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 ensure that potentially harmful products are removed from inventories immediately. Food safety related

liability exposures are insured by the Company's insurance program. In addition, the Company has food safety policies and programs which address safe food handling and preparation standards. The Company endeavours to employ best practices for the storage and distribution of food products and is intensifying the campaign for consumer awareness of safe food handling and consumption.

In the event of a significant public health crisis, such as a flu or other type of pandemic, it is possible that significant numbers of customers may choose to limit their activities outside of their home, including shopping trips, thereby negatively impacting the Company's sales. Furthermore, it may not be possible to adequately staff all the Company's stores during such an event. The Company is in the process of preparing a plan for its approach to such an event.

**Labour** A significant portion of the Company's workforce is unionized. Renegotiating collective agreements might 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. Significant labour negotiations took place across the Company in 2005 as 54 collective agreements expired and another 61 collective agreements were successfully negotiated which represented a combination of agreements expiring in 2005, those carried over from prior years, and those negotiated early. In 2006, 79 collective agreements affecting approximately 41,354 employees will expire, with the single largest agreement covering approximately 14,300 employees. The Company will also continue to negotiate the 35 collective agreements carried over from 2003, 2004 and 2005 and anticipates no labour disruption with respect to these negotiations. The Company has good relations with its employees and unions and, although it is possible, does not anticipate any unusual difficulties in renegotiating these agreements.

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

**Employee Future Benefit Contributions** While the Company's registered funded defined benefit pension plans are currently adequately funded and returns on pension plan assets are in line with expectations, there is no assurance that this will continue. An extended period of depressed capital markets and low interest rates could require the Company to make contributions to its registered funded defined benefit pension plans in excess of those currently contemplated, which in turn could have a negative effect on its financial performance.

During 2005, the Company contributed $59 million (2004 – $40 million) to its registered funded defined benefit pension plans. During 2006, the Company expects to contribute approximately $61 million to these plans. In 2006, the Company also expects to make a contribution of $16 million to the long term disability plan in addition to contributions 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.

In addition to the Company-sponsored pension plans, the Company participates in various multi-employer pension plans, providing pension benefits in which approximately 40% (2004 – 41%) of employees of the Company and of its 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. Pension cost for these plans is recognized as contributions are paid. The Financial Services Commission of Ontario has recently issued a report concerning one of these multi-employer pension plans. The report deals with alleged breaches of the Ontario pension and benefits legislation in connection with certain of the investments of the plan under review and its governance practices.

**Third-Party Service Providers** Certain aspects of the Company's business are significantly affected by third parties. While 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.

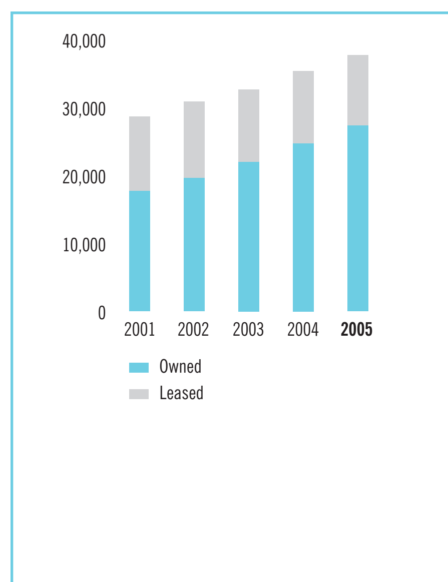
A large portion of the Company's case-ready meat products are produced by a third party which operates facilities dedicated to Loblaw.

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 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 credit and fraud for the *President's Choice Financial* MasterCard®. In order 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 provides its Board with regular reports on vendor management and risk assessment. *PC Financial* home and auto insurance products are provided by companies within the Aviva Canada group, the Canadian subsidiary of a major international property and casualty insurance provider.

**Corporate Stores Owned vs. Leased**
(thousands of sq. ft.)




**Real Estate** The availability and conditions affecting the acquisition and development of real estate properties may impact the Company's ability to execute its planned real estate program on schedule and therefore, its ability to achieve its sales targets. Real estate development plans may be contingent on successful negotiation of labour agreements with respect to same-site expansion or redevelopment. As the Company expands its general merchandise offering, on-time execution of the real estate program becomes increasingly important due to significantly longer lead times required for ordering this merchandise. Delays in execution could lead to inventory management issues. 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 allowing the Company to introduce new departments and services that could be precluded under operating leases. At year end 2005, the Company owned 72% (2004 – 70%) of its corporate store square footage.

**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. As the Company expands the breadth of its general merchandise offering, it may increase the number of seasonal products offered and its operations may therefore be subject to more seasonal fluctuations.

**Leadership Development and Employee Retention** Effective leadership is essential to sustaining the growth and success of the Company. The Company continues to focus on the development of leaders at all levels and across all regions by executing tailored leadership development programs that provide the knowledge and skills necessary to drive positive change and ensure

effective execution. The degree to which the Company is effective in developing its leaders and retaining key employees could affect its ability to execute its strategies, efficiently run its operations and meet its goals for financial performance.

A new office facility and Store Support Centre in Brampton, Ontario opened in the third quarter of 2005 combining several administrative and operating offices from across southern Ontario and the general merchandise operations from Calgary, Alberta. In addition, internal reorganizations involving the merchandising, procurement and operations groups took effect. These initiatives may result in further short term employee turnover and disruption as certain employees may assume new roles and responsibilities.

**Utility and Fuel Prices** The Company is a significant consumer of electricity, other utilities and fuel. Unanticipated cost increases in these items could negatively affect the Company's financial performance.

**Insurance** The Company limits its exposure to risk 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 which provides the appropriate level of retained and insured risks. 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 to manage the risk it retains.

**Environmental, Health and Safety** The Company has environmental, health and workplace safety programs in place and has established policies and procedures aimed at ensuring compliance with applicable legislative requirements. To this end, the Company employs 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. Environmental protection requirements do not and are not expected to have an adverse effect on the Company's financial performance.

The Environmental, Health and Safety Committee of the Board receives regular reporting from management addressing current and potential future issues, identifying new legislative concerns and related communication efforts.

**Ethical Business Conduct** Any failure of the Company to adhere to its policies, the law or ethical business practices could significantly affect its reputation and brands and could therefore, negatively impact the Company's financial performance. The Company has adopted a Code of Business Conduct which employees of the Company are required to acknowledge and agree to on a regular basis. The Company has established 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.

**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 its 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, regulations and policies may subject it to civil or regulatory actions or proceedings, including fines, assessments, injunctions, recalls or seizures, which may have an adverse effect on the Company's financial results.

There can be no assurance that the tax laws and regulations in the jurisdictions 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.

**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

In the normal course of business, the Company is exposed to financial risks that have the potential to negatively affect its financial performance including financial risks related to changes in foreign currency exchange rates, interest rates and the market price of the Company's common shares. These risks and the actions taken to minimize them are discussed below. The Company is also exposed to credit risk on certain of its financial instruments.

**Financial Derivative Instruments** The Company uses over-the-counter financial derivative instruments, specifically cross currency basis swaps, interest rate swaps and equity forwards, to minimize the risks and costs associated with its financing activities and its stock-based compensation plans. The Company maintains treasury centres that operate under policies and guidelines approved by the Board covering funding, investing, equity, foreign currency exchange and interest rate management. The Company's policies and guidelines prevent it from using any financial derivative instrument for trading or speculative purposes. See Notes 1 and 18 to the consolidated financial statements for additional information on the Company's financial derivative instruments.

**Foreign Currency Exchange Rate** The Company enters into cross currency basis swaps to manage its current and anticipated exposure to fluctuations in foreign currency exchange rates. The Company's cross currency basis swaps are transactions in which floating interest payments and principal in United States dollars are exchanged against the receipt of floating interest payments and principal in Canadian dollars. These cross currency basis swaps limit the Company's exposure against foreign currency exchange rate fluctuations on a portion of its United States dollar denominated assets, principally cash, cash equivalents and short term investments.

**Interest Rate** The Company enters into interest rate swaps to manage its current and anticipated exposure to fluctuations in interest rates and market liquidity. Interest rate swaps are transactions in which the Company exchanges interest flows with a counterparty on a specified notional amount for a predetermined period based on agreed upon fixed and floating interest rates. Notional amounts are not exchanged. The Company monitors market conditions and the impact of interest rate fluctuations on its fixed and floating interest rate exposure mix on an ongoing basis.

**Common Share Market Price** The Company enters into equity forwards to manage its current and anticipated exposure to fluctuations in its stock-based compensation cost as a result of changes in the market price of its common shares. These equity forwards change in value as the market price of the underlying common shares changes, which results in a partial offset to fluctuations in the Company's stock-based compensation costs. The partial offset between the Company's stock-based compensation costs and the equity forwards exists as long as the market price of the Company's common shares exceeds the exercise price of employee stock options. As disclosed in Note 17 to the consolidated financial statements, 2,254,639 stock options had exercise prices which were greater than the market price of the Company's common shares at year end.

**Counterparty** Over-the-counter financial derivative instruments are subject to counterparty risk. Counterparty risk arises from the possibility that market changes may affect a counterparty's position unfavourably and that the counterparty defaults on its obligations to the Company. 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, principal amounts on cross currency basis swaps and equity forwards are each netted by agreement and there is no exposure to loss of the original notional principal amounts on the interest rate swaps and equity forwards.

**Credit** The Company's exposure to credit risk relates to the Company's cash equivalents and short term investments, PC Bank's credit card receivables and accounts receivable from franchisees, associates and independent accounts.

Credit risk associated with the Company's cash equivalents and short term investments results from the possibility that a counterparty may default on the repayment of a security. This risk is mitigated by the established 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 issuers.

PC Bank manages the *President's Choice Financial* MasterCard®. PC Bank grants credit to its customers on *President's Choice Financial* MasterCard® with the intention of increasing the loyalty of those customers and the Company's profitability. Credit risk results from the potential for loss due to those customers defaulting on their payment obligations. In order to minimize the associated credit risk, PC Bank employs stringent credit scoring techniques, actively monitors the credit card portfolio and reviews techniques and technology that can improve the effectiveness of its collection process. In addition, these receivables are dispersed among a large, diversified group of credit card customers.

The Company also has accounts receivable from its franchisees, associates and independent accounts, mainly as a result of sales to these customers. The Company actively monitors the balances on an ongoing basis and collects funds from its franchisees on a frequent basis in accordance with terms specified in the applicable agreements.

## 11. Related Party Transactions

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

Related party transactions between the Company and Weston include:
- inventory purchases,
- cost sharing agreements,
- real estate leases,
- borrowings/lendings,
- income tax matters, and
- management agreements.

During 2005, Glenhuron Bank Limited ("Glenhuron"), a wholly owned subsidiary of the Company, sold a portfolio of third-party long term loans receivable to a wholly owned subsidiary of George Weston Limited. Originally, the loans in this portfolio were acquired from third-party financial institutions in 2001. This transaction was undertaken by Glenhuron as part of its overall ongoing management of its investment portfolio.

The amount of the cash consideration of U.S.$106 million was based on a fair market value of the loan portfolio and was approximately equal to carrying value. An independent review of the valuation analysis has been obtained by the Company to ensure that Glenhuron's methodology used in arriving at fair market value was reasonable. As at the date of sale, the current portion of this loan portfolio of U.S.$13 million was included in accounts receivable and the long term portion of U.S.$93 million was included in other assets.

Glenhuron has entered into an agreement with the George Weston Limited subsidiary for the administration of the loan portfolio.

For a detailed description of the Company's related party transactions, see Note 20 to the consolidated financial statements.

## 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 Valuation of Inventories**
Certain retail store inventories are stated at the lower of cost and estimated net realizable value less normal gross profit margin. Significant 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 a category or department 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 may 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.

**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 2005 net cost for defined benefit pension and other benefit plans were 6.25% and 6.1%, respectively, on a weighted average basis, compared to 6.25% and 6.0%, respectively, in 2004. Certain defined benefit pension and other benefit plans affected by the plan to restructure the supply chain operations nationally, were remeasured as at March 31, 2005. For these plans, costs subsequent to April 1, 2005 were determined using a discount rate of 5.75%, resulting in a nominal impact to net earnings and curtailment gains which were offset against unamortized net actuarial losses for these plans. Additional defined benefit pension costs also resulted from the restructuring plan and were recorded in restructuring and other charges in the consolidated statement of earnings. The discount rates used to determine the net 2006 defined benefit pension and other benefit plans costs decreased to 5.25% and 5.2%, respectively and as a result, the Company expects an increase in these costs in 2006.

The expected long term rate of return on plan assets is based on historical returns, on the asset mix and on the active management of defined benefit pension plan assets. The Company's defined benefit pension plan assets had a 10 year annualized return of 9.3% as at the 2005 measurement date. The actual annual returns within this 10 year period varied with market conditions. Consistent with 2005, the Company has assumed an 8.0% expected long term rate of return on plan assets in calculating its defined benefit pension plans cost for 2006.

The expected growth rate in health care costs for 2005 was based on external data and the Company's historical trends. Higher initial growth rates were used in 2006, when compared to 2005.

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. Differences between actual experience and the assumptions and changes in the assumptions may result in changes to the accrued benefit plan asset and liability presented in the consolidated balance sheet and the defined benefit pension and other benefit plans cost recognized in the consolidated statement of earnings.

In accordance with Canadian GAAP, the difference between actual results and assumptions are accumulated in net actuarial gain or loss. The magnitude of any immediate impact to the Company's operating income is mitigated by the fact that the excess net accumulated actuarial gain or loss over 10% of the greater of the accrued benefit plan obligation or the fair value of the plan assets at the beginning of the year is amortized over the expected average remaining service period of the active employees. As at September 30, 2005, the unamortized net actuarial loss was $271 million (2004 – $137 million) for defined benefit pension plans and $128 million (2004 – $70 million) for other benefit plans.

Additional information regarding the Company's pension and other benefit plans, including a sensitivity analysis for changes in key assumptions, is provided in Note 13 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 loss would be recognized to the extent that, at the reporting unit level, the carrying value of goodwill exceeds the implied fair value. Any goodwill impairment will result in a reduction in the carrying value of goodwill on the consolidated balance sheet and in the recognition of a non-cash impairment charge in operating income in the consolidated statement of earnings.

The Company determines the fair value of its reporting units 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 may 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 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 and the timing of reversal of temporary differences and possible audits of tax filings by the regulatory authorities. Management believes it has adequately provided for income taxes based on current available information.

Changes or differences in these 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 ("GST") and Provincial Sales Taxes ("PST")**
During the third quarter of 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 between 2000 and 2002 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 up to the end of 2004. Accordingly, a charge of $40 million was recorded in operating income in the third quarter to reflect management's best estimate of all such potential tax liabilities of which management is currently aware. Approximately $15 million of this amount was settled during the fourth quarter of 2005. 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.

## 13. Accounting Standards

### 13.1 Accounting Standards Implemented in 2005

Effective January 2, 2005, the Company implemented the following accounting standards issued by the CICA:

- Accounting Guideline 15, *"Consolidation of Variable Interest Entities"*, issued by the CICA in June 2003 and amended in September 2004 requires the consolidation of certain entities that are subject to control on a basis other than through ownership of a majority of voting interests.

  AcG 15 defines a variable interest entity as an entity that either does not have sufficient equity at risk to finance its activities without subordinated financial support or where the holders of the equity at risk lack the characteristics of a controlling financial interest. AcG 15 requires the primary beneficiary to consolidate VIEs.

  AcG 15 considers an entity to be the primary beneficiary of a VIE if it holds variable interests that expose it to a majority of the VIE's expected losses or that entitle it to receive a majority of the VIE's expected residual returns or both.

  Prior to AcG 15, the Company consolidated all entities that it controlled through ownership of a majority of voting interests. Effective January 2, 2005, the Company implemented AcG 15, retroactively without restatement of prior periods and as a result, the Company consolidates entities in which it has control through ownership of a majority of the voting interests as well as all VIEs for which it is the primary beneficiary.

  Upon implementation of AcG 15, the Company identified the following significant VIEs:

  **Independent Franchisees** The Company enters into various forms of franchise agreements that generally require the independent franchisee to purchase inventory from the Company and pay certain fees in exchange for services provided by the Company and for the right to use certain trademarks and licences owned by the Company. Independent franchisees generally lease the land and building from the Company, and when eligible, may obtain financing through a structure involving independent trusts to facilitate the purchase of the majority of their inventory and fixed assets, consisting mainly of fixturing and equipment. These trusts are administered by a major Canadian bank. Under the terms of certain franchise agreements, the Company may also lease equipment to independent franchisees. Independent franchisees may also obtain financing through operating lines of credit with traditional financial institutions or through issuing preferred shares or notes payable to the Company. The Company monitors the financial condition of its independent franchisees and provides for estimated losses or write-downs on its accounts and notes receivable or investments when appropriate. Upon implementation of AcG 15, the Company determined that 121 of its independent franchisee stores met the criteria for VIEs that require consolidation by the Company pursuant to AcG 15.

**Warehouse and Distribution Agreement** The Company has entered into a warehousing and distribution agreement with a third party to provide to the Company distribution and warehousing services from a dedicated facility. The Company has no equity interest in this third party; however, the terms of the agreement with the third party are such that the Company has determined that the third party meets the criteria for a VIE that requires consolidation by the Company. As a result of the fee structure agreed to with this third party, the impact of the consolidation of this warehouse and distribution entity was not material.

Accordingly, the Company has included the results of these independent franchisees and this third-party entity that provides distribution and warehousing services in its consolidated financial statements effective January 2, 2005.

Details of the amounts recorded upon implementation and the effect on the opening consolidated balance sheet as at January 2, 2005 are summarized below and include the impact of both the independent franchisees and the warehouse and distribution entity:

Condensed Consolidated Balance Sheet as at January 2, 2005

| ($ millions) | Condensed consolidated balance sheet as at January 2, 2005 before AcG 15 impact | Impact of the implementation of AcG 15 | Condensed consolidated balance sheet as at January 2, 2005 after AcG 15 impact |
|---|---|---|---|
| Cash and cash equivalents | $ 549 | $ 20 | $ 569 |
| Short term investments | 275 | | 275 |
| Accounts receivable | 665 | (73) | 592 |
| Inventories | 1,821 | 78 | 1,899 |
| Other current assets | 113 | 4 | 117 |
| Total current assets | 3,423 | 29 | 3,452 |
| Fixed assets | 7,113 | 136 | 7,249 |
| Goodwill | 1,621 | 3 | 1,624 |
| Other assets | 792 | (51) | 741 |
| Total assets | $ 12,949 | $ 117 | $ 13,066 |
| Total current liabilities | $ 3,133 | $ 48 | $ 3,181 |
| Long term debt | 3,935 | 96 | 4,031 |
| Other liabilities | 467 | (8) | 459 |
| Minority interest | | 10 | 10 |
| Total liabilities | 7,535 | 146 | 7,681 |
| Common share capital | 1,192 | | 1,192 |
| Retained earnings | 4,222 | (29) | 4,193 |
| Total liabilities and shareholders' equity | $ 12,949 | $ 117 | $ 13,066 |

The impact of AcG 15 on the opening consolidated balance sheet can be further explained as follows:

- An after-tax, one-time charge of $29 million (net of income taxes of $12 million) was recorded upon implementation and resulted mainly from delaying the recognition of vendor monies to when the related inventories of the independent franchisees are sold to their customers, the excess of the independent franchisees' accumulated losses over the allowance for doubtful accounts previously recorded by the Company and the reversal of initial franchise fees initially recognized upon the sale of franchises to third parties.
- Accounts receivable due from the independent franchisees and the investment in preferred shares of the independent franchisees were eliminated upon consolidation; cash and cash equivalents, inventories and fixed assets financed by long term debt (a portion of which is due within one year) were recorded.

- An increase in fixed assets and total current liabilities in respect of the warehouse and distribution entity.
- Minority interest representing the common stakeholder's equity in the respective VIEs.

As at December 31, 2005, 123 of the Company's independent franchise stores met the criteria for a VIE and were consolidated pursuant to AcG 15.

The impact from the consolidation of these VIEs on the consolidated balance sheet as at December 31, 2005 was not significantly different than the impact on the opening consolidated balance sheet as outlined above. The impact on the consolidated statement of earnings for the year ended December 31, 2005 was predominantly an increase in sales as quantified in the table "Sales and Sales Growth Excluding Impact of VIEs" included on page 6. The impact on basic net earnings per common share for 2005 was a decline of approximately 3 cents.

The consolidation of these VIEs by the Company does not result in any change to its tax, legal or credit risks nor does it result in the Company assuming any obligations of these third parties.

**Independent Trust** The Company has also identified that it holds a variable interest, by way of a standby letter of credit, in an independent trust which is used to securitize credit card receivables for PC Bank. In these securitizations, PC Bank sells a portion of its credit card receivables to the independent trust in exchange for cash. Although this independent trust has been identified as a VIE, it was determined that the Company is not the primary beneficiary and therefore this VIE is not subject to consolidation by the Company. The Company's maximum exposure to loss as a result of its involvement with this independent trust is disclosed in the Off-Balance Sheet Arrangements section of this MD&A and in Notes 8 and 19 to the consolidated financial statements.

- EIC Abstract 150, *"Determining Whether an Arrangement Contains a Lease"*, ("EIC 150") addresses arrangements comprising a transaction or a series of transactions that do not take the legal form of a lease but convey a right to use a tangible asset in return for a payment or a series of payments. EIC 150 provides guidance for determining whether these types of arrangements contain a lease within the scope of Section 3065, *"Leases"*, and should be accounted for accordingly. The assessment should be based on whether the fulfillment of the arrangement is dependent on the use of specific tangible assets and whether the arrangement conveys the right to control the use of the tangible assets. This assessment should be made at inception of the arrangement and only reassessed if certain conditions are met. EIC 150 is effective for arrangements entered into or modified as of the beginning of 2005 and did not have any impact during 2005. The Company will continue to monitor whether EIC 150 is applicable to transactions undertaken by the Company.
- EIC Abstract 154, *"Accounting for Pre-Existing Relationships Between the Parties of a Business Combination"*, ("EIC 154") issued on May 31, 2005, requires that a business combination between parties that have a pre-existing relationship be evaluated to determine if a settlement of a pre-existing contract has occurred which would require separate accounting from the business combination. The settlement of the pre-existing contract should be measured at the settlement amount as defined within the standard. In addition, EIC 154 requires that certain reacquired rights, including the rights to the acquirer's trade name under a franchise agreement, be recognized as an intangible asset separate from goodwill.

  The Company has determined that acquisitions by the Company of franchised, associated and independent stores are within the scope of EIC 154. The adoption of EIC 154 by the Company on a prospective basis did not have a material impact on net earnings.

**13.2 Future Accounting Standards**

The Company closely monitors new accounting standards to assess the impact, if any, on its consolidated financial statements. In 2006, the Company will be reviewing the implications of the following standards and implementing the recommendations as required:

- In 2005, the Accounting Standards Board finalized its strategic plan for financial reporting in Canada whereby Canadian GAAP will converge with International Financial Reporting Standards over a five-year period. After this transitional period, Canadian GAAP will cease to exist as a separate, distinct basis of financial reporting. The Company will continue to monitor the changes resulting from this transition.

- EIC 156, *"Accounting for Consideration by a Vendor to a Customer (Including a Reseller of the Vendor's Products)"*, issued in September 2005 addresses cash consideration, including a sales incentive, given by a vendor to a customer. This consideration is presumed to be a reduction of the selling price of the vendor's products and should therefore be classified as a reduction of sales in the vendor's income statement. These recommendations are effective for all interim and annual financial statements for fiscal years beginning on or after January 1, 2006. The Company is currently assessing the impact of these recommendations and will implement them in the first quarter of 2006.
- Section 3855, *"Financial Instruments – Recognition and Measurement"*, Section 3865, *"Hedges"* and Section 1530, *"Comprehensive Income"* issued in January 2005:
- Section 3855, *"Financial Instruments – Recognition and Measurement"*, establishes standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. All financial instruments must be classified into a defined category, namely, held-to-maturity investments, held for trading, loans and receivables, available-for-sale financial assets, and other liabilities. This classification will determine how each instrument is measured and how gains and losses are recognized. In addition, the recommendations define derivatives to include non-financial derivatives and embedded derivatives which meet certain criteria. All such derivatives must be classified as held for trading and therefore recorded at fair value unless they are designated in a hedging relationship.
- Section 3865, *"Hedges"*, replaces AcG 13, *"Hedging Relationships"* and the guidance formerly in Section 1650, *"Foreign Currency Translation"*. The recommendations of this section are optional and are only required if the entity is applying hedge accounting. This section establishes standards for the accounting treatment of qualifying hedge relationships and the necessary disclosures.
- Section 1530, *"Comprehensive Income"*, introduces a statement of comprehensive income which will be included in the full set of interim and annual financial statements. Comprehensive income will represent the change in equity during a period from transactions and other events and circumstances from non-owner sources and will include all changes in equity other than those resulting from investments by owners and distributions to owners.

  These standards are effective for interim and annual financial statements for fiscal years beginning on or after October 1, 2006. The Company is currently assessing the impact of these recommendations and will implement them in the first quarter of 2007 prospectively.

**14. Outlook**

Loblaw continues to expect that the negative impact of its transformative process will be absorbed by the end of the second quarter of 2006. This includes an anticipated decline in adjusted basic net earnings per common share[1] in the first quarter of 2006 compared to the same period in 2005. This decline is expected to be consistent with the relative decline in adjusted basic net earnings per common share[1], experienced in the fourth quarter of 2005. The Company expects that adjusted basic net earnings per common share[1] performance will improve during the second half of 2006.

The Company remains confident that its strategic plan is appropriate given the increased competitive landscape. It believes that the transformation will provide the benefits of being a national organization while operating locally in each community. Loblaw expects these initiatives will better position the Company to meet the food and everyday household needs of Canadian consumers, and make the Company more aligned, streamlined and efficient so that it can continue to offer customers the best value in the form of lower prices and better service.

Loblaw confirms its previously announced anticipated sales and earnings performance for the 2006 fiscal year. It anticipates that sales growth, excluding variable interest entities, will be in the range of 3% to 6%, while growth in adjusted basic net earnings per common share[1] will be in the range of 4% to 7%, as it enters 2006 with confidence in its strategy.

This outlook should be read in conjunction with the Forward-Looking Statements section of this MD&A on page 2.



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

## 15. Non-GAAP Financial Measures

The Company reports its financial results in accordance with Canadian GAAP. However, the Company has included certain non-GAAP financial measures and ratios which it believes provide useful information to both management and readers of this Annual Report, including this Financial Report, in measuring the financial performance and financial condition of the Company for the reasons set out 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. For the following tables, the annual non-GAAP financial measures for the years 2005 through to 2001, are for the 52 or 53 weeks ended or as at December 31, 2005; January 1, 2005; January 3, 2004; December 28, 2002 and December 29, 2001, respectively.

**Sales and Sales Growth Excluding Impact of VIEs** These financial measures exclude the impact of the increase in sales from the consolidation by the Company of the independent franchisees which resulted from the implementation of AcG 15 retroactively without restatement effective January 2, 2005. These sales are excluded because they affect the comparability of the financial results and could potentially distort the analysis of trends. A reconciliation of the financial measures to the Canadian GAAP financial measures is included in the "Sales and Sales Growth Excluding Impact of VIEs" tables on pages 6 and 20 of this MD&A.

**Adjusted Operating Income and Margin** The following table reconciles adjusted operating income to Canadian GAAP operating income reported in the consolidated statements of earnings for the twelve week periods ended December 31, 2005 and January 1, 2005 and the years ended as previously indicated. Items listed in the reconciliation below are excluded because the Company believes this allows for a more effective analysis of the operating performance of the Company. In addition, they affect the comparability of the financial results and could potentially distort the analysis of trends. The exclusion of these items does not imply they are non-recurring. Adjusted operating income and margin are useful to management in assessing the Company's performance and in making decisions regarding the ongoing operations of its business.

| ($ millions) | **2005 (12 weeks)** | 2004 (12 weeks) | **2005 (52 weeks)** | 2004 (52 weeks) | 2003 (53 weeks) | 2002 (52 weeks) | 2001 (52 weeks) |
|---|---|---|---|---|---|---|---|
| Operating income | **$ 394** | $ 530 | **$ 1,401** | $ 1,652 | $ 1,467 | $ 1,303 | $ 1,136 |
| Add (deduct) impact of the following: | | | | | | | |
| Net effect of stock-based compensation and the associated equity forwards | **27** | (8) | **43** | | (4) | 14 | |
| Restructuring and other charges | **6** | | **86** | | | | |
| Goods and Services Tax and provincial sales taxes | | | **40** | | | | |
| Direct costs associated with supply chain disruptions | **10** | | **30** | | | | |
| Variable interest entities | **4** | | | | | | |
| *The Real Canadian Superstore* labour arrangement | | | | | 25 | | |
| Adjusted operating income | **$ 441** | $ 522 | **$ 1,600** | $ 1,652 | $ 1,488 | $ 1,317 | $ 1,136 |

Adjusted operating margin is calculated as adjusted operating income divided by sales excluding the impact of VIEs.

**Adjusted EBITDA and Margin** The following table reconciles adjusted earnings before interest, income taxes, depreciation and amortization ("EBITDA") to adjusted operating income which is reconciled to Canadian GAAP measures reported in the consolidated statements of earnings, in the table above, for the twelve week periods ended December 31, 2005 and January 1, 2005 and the years ended as previously indicated. Adjusted 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.

| ($ millions) | **2005 (12 weeks)** | 2004 (12 weeks) | **2005 (52 weeks)** | 2004 (52 weeks) | 2003 (53 weeks) | 2002 (52 weeks) | 2001 (52 weeks) |
|---|---|---|---|---|---|---|---|
| Adjusted operating income | **$ 441** | $ 522 | **$ 1,600** | $ 1,652 | $ 1,488 | $ 1,317 | $ 1,136 |
| Add (deduct) impact of the following: | | | | | | | |
| Depreciation and amortization | **140** | 117 | **558** | 473 | 393 | 354 | 315 |
| VIE depreciation and amortization | **(8)** | | **(26)** | | | | |
| Adjusted EBITDA | **$ 573** | $ 639 | **$ 2,132** | $ 2,125 | $ 1,881 | $ 1,671 | $ 1,451 |

Adjusted EBITDA margin is calculated as adjusted EBITDA divided by sales excluding the impact of VIEs.

**Adjusted Basic Net Earnings per Common Share** The following table reconciles adjusted basic net earnings per common share to Canadian GAAP basic net earnings per common share measures reported in the consolidated statements of earnings for the twelve week periods ended December 31, 2005 and January 1, 2005 and the years ended as previously indicated. Items listed in the reconciliation below are excluded because the Company believes this allows for a more effective analysis of the operating performance of the Company. In addition, they affect the comparability of the financial results and could potentially distort the analysis of trends. The exclusion of these items does not imply they are non-recurring. Adjusted basic net earnings per common share is useful to management in assessing the Company's performance and in making decisions regarding the ongoing operations of its business.

| | **2005 (12 weeks)** | 2004 (12 weeks) | **2005 (52 weeks)** | 2004 (52 weeks) | 2003 (53 weeks) | 2002 (52 weeks) | 2001 (52 weeks) |
|---|---|---|---|---|---|---|---|
| Basic net earnings per common share[(1)] | **$ .73** | $ 1.23 | **$ 2.72** | $ 3.53 | $ 3.07 | $ 2.64 | $ 2.20 |
| Add (deduct) impact of the following: | | | | | | | |
| Net effect of stock-based compensation and the associated equity forwards | **.15** | (.06) | **.22** | | (.06) | .04 | |
| Restructuring and other charges | **.01** | | **.20** | | | | |
| Goods and Services Tax and provincial sales taxes | | | **.10** | | | | |
| Direct costs associated with supply chain disruptions | **.02** | | **.07** | | | | |
| Changes in statutory income tax rates in certain provinces | **.01** | | **.01** | | .03 | | |
| Variable interest entities | **.02** | | **.03** | | | | |
| Resolution of certain income tax matters | | | | (.05) | | | |
| *The Real Canadian Superstore* labour arrangement | | | | | .06 | | |
| Adjusted basic net earnings per common share | **$ .94** | $ 1.17 | **$ 3.35** | $ 3.48 | $ 3.10 | $ 2.68 | $ 2.20 |

(1) 2001 basic net earnings per common share is before goodwill charges.

**Net Debt** The following table reconciles net debt used in the net debt to equity ratio to Canadian GAAP measures reported in the consolidated balance sheets as at the years ended as previously indicated. The Company calculates net debt as the sum of long term debt and short term debt less cash, cash equivalents and short term investments. The net debt to equity ratio is useful in assessing the amount of leverage employed.

| ($ millions) | **2005** | 2004 | 2003 | 2002 | 2001 |
|---|---|---|---|---|---|
| Bank indebtedness | **$ 30** | $ 28 | $ 38 | | $ 95 |
| Commercial paper | **436** | 473 | 603 | $ 533 | 191 |
| Long term debt due within one year | **161** | 216 | 106 | 106 | 81 |
| Long term debt | **4,194** | 3,935 | 3,956 | 3,420 | 3,333 |
| Less: Cash and cash equivalents | **916** | 549 | 618 | 823 | 575 |
| Short term investments | **4** | 275 | 378 | 304 | 426 |
| Net debt | **$ 3,901** | $ 3,828 | $ 3,707 | $ 2,932 | $ 2,699 |

**Total Assets** The following table reconciles total assets used in the return on average total assets to Canadian GAAP measures reported in the consolidated balance sheets as at the years ended as previously indicated. 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 and short term investments from the total assets used in the ratio.

| ($ millions) | **2005** | 2004 | 2003 | 2002 | 2001 |
|---|---|---|---|---|---|
| Total assets[(1)] | **$ 13,761** | $ 12,949 | $ 12,113 | $ 11,047 | $ 10,025 |
| Less: Cash and cash equivalents | **916** | 549 | 618 | 823 | 575 |
| Short term investments | **4** | 275 | 378 | 304 | 426 |
| Total assets | **$ 12,841** | $ 12,125 | $ 11,117 | $ 9,920 | $ 9,024 |

(1) Certain prior years' information was reclassified to conform with the current year's presentation.

## 16. Additional Information

Additional information 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, President's Choice Bank.

March 7, 2006
Toronto, Canada

# Financial Results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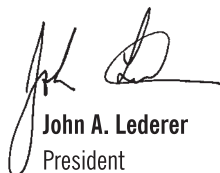
## Management's Statement of Responsibility for Financial Reporting

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

To provide reasonable assurance that assets are safeguarded and that relevant and reliable financial information is produced, management maintains a system of internal controls reinforced by the Company's Code of Business Conduct. Internal auditors, who are employees of the Company, review and evaluate internal controls on management's behalf, coordinating this work with the independent auditors. KPMG LLP, whose report follows, were appointed as independent auditors by a vote of the Company's shareholders to audit the consolidated financial statements.

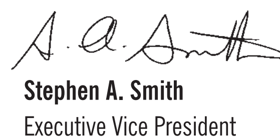
The Board of Directors, acting through an Audit Committee comprised solely of directors who are independent of the Company, is responsible for determining that management fulfills its responsibilities in the preparation of the consolidated financial statements and the financial control of operations.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

Toronto, Canada
March 7, 2006



**John A. Lederer**
President

**Richard P. Mavrinac**
Executive Vice President



**Stephen A. Smith**
Executive Vice President

## Independent Auditors' Report

To the Shareholders of Loblaw Companies Limited:
We have audited the consolidated balance sheets of Loblaw Companies Limited as at December 31, 2005 and January 1, 2005 and the consolidated statements of earnings, retained earnings and cash flow for the 52 week years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2005 and January 1, 2005 and the results of its operations and its cash flow for the years then ended in accordance with Canadian generally accepted accounting principles.

Toronto, Canada
March 7, 2006

Chartered Accountants

## Consolidated Statements of Earnings

| For the years ended December 31, 2005 and January 1, 2005<br>($ millions except where otherwise indicated) | 2005<br>(52 weeks) | 2004<br>(52 weeks) |
|---|---|---|
| **Sales** | **$ 27,801** | $ 26,209 |
| **Operating Expenses** | | |
| Cost of sales, selling and administrative expenses | **25,716** | 24,084 |
| Depreciation and amortization | **558** | 473 |
| Restructuring and other charges (note 3) | **86** | |
| Goods and Services Tax and provincial sales taxes (note 4) | **40** | |
| | **26,400** | 24,557 |
| **Operating Income** | **1,401** | 1,652 |
| Interest Expense (note 5) | **252** | 239 |
| **Earnings before Income Taxes** | **1,149** | 1,413 |
| Income Taxes (note 9) | **400** | 445 |
| **Net Earnings before Minority Interest** | **749** | 968 |
| Minority Interest | **3** | |
| **Net Earnings** | **$ 746** | $ 968 |
| **Net Earnings per Common Share** ($) (note 6) | | |
| Basic | **$ 2.72** | $ 3.53 |
| Diluted | **$ 2.71** | $ 3.51 |

See accompanying notes to the consolidated financial statements.

## Consolidated Statements of Retained Earnings

| For the years ended December 31, 2005 and January 1, 2005<br>($ millions except where otherwise indicated) | 2005<br>(52 weeks) | 2004<br>(52 weeks) |
|---|---|---|
| **Retained Earnings, Beginning of Year as Previously Reported** | **$ 4,222** | $ 3,496 |
| Impact of implementing new accounting standard (note 2) | **(29)** | |
| **Retained Earnings, Beginning of Year Restated** | **4,193** | 3,496 |
| Net earnings | **746** | 968 |
| Premium on common shares purchased for cancellation (note 16) | **(15)** | (33) |
| Dividends declared per common share – 84¢ (2004 – 76¢) | **(230)** | (209) |
| **Retained Earnings, End of Year** | **$ 4,694** | $ 4,222 |

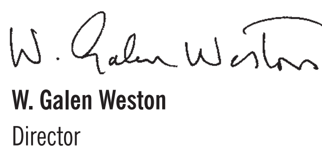
See accompanying notes to the consolidated financial statements.

## Consolidated Balance Sheets

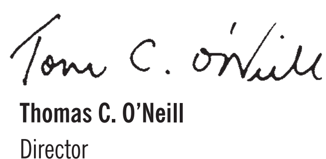
| As at December 31, 2005 and January 1, 2005<br>($ millions) | 2005 | 2004 |
|---|---|---|
| **Assets** | | |
| Current Assets | | |
| Cash and cash equivalents (note 7) | $ 916 | $ 549 |
| Short term investments (note 7) | 4 | 275 |
| Accounts receivable (note 8) | 656 | 665 |
| Inventories | 2,020 | 1,821 |
| Income taxes | 3 | |
| Future income taxes (note 9) | 72 | 81 |
| Prepaid expenses and other assets | 30 | 32 |
| Total Current Assets | 3,701 | 3,423 |
| Fixed Assets (note 10) | 7,785 | 7,113 |
| Goodwill (note 11) | 1,587 | 1,621 |
| Other Assets (note 12) | 688 | 792 |
| **Total Assets** | $ 13,761 | $ 12,949 |
| **Liabilities** | | |
| Current Liabilities | | |
| Bank indebtedness | $ 30 | $ 28 |
| Commercial paper | 436 | 473 |
| Accounts payable and accrued liabilities | 2,535 | 2,307 |
| Income taxes | | 109 |
| Long term debt due within one year (note 14) | 161 | 216 |
| Total Current Liabilities | 3,162 | 3,133 |
| Long Term Debt (note 14) | 4,194 | 3,935 |
| Future Income Taxes (note 9) | 237 | 184 |
| Other Liabilities (note 15) | 271 | 283 |
| Minority Interest | 11 | |
| **Total Liabilities** | 7,875 | 7,535 |
| **Shareholders' Equity** | | |
| Common Share Capital (note 16) | 1,192 | 1,192 |
| Retained Earnings | 4,694 | 4,222 |
| **Total Shareholders' Equity** | 5,886 | 5,414 |
| **Total Liabilities and Shareholders' Equity** | $ 13,761 | $ 12,949 |

See accompanying notes to the consolidated financial statements.

Approved on Behalf of the Board



**W. Galen Weston**
Director



**Thomas C. O'Neill**
Director

## Consolidated Cash Flow Statements

| For the years ended December 31, 2005 and January 1, 2005 ($ millions) | 2005 (52 weeks) | 2004 (52 weeks) |
|---|---|---|
| **Operating Activities** | | |
| Net earnings before minority interest | **$ 749** | $ 968 |
| Depreciation and amortization | **558** | 473 |
| Restructuring and other charges (note 3) | **86** | |
| Goods and Services Tax and provincial sales taxes (note 4) | **40** | |
| Future income taxes | **90** | 67 |
| Change in non-cash working capital | **(51)** | (99) |
| Other | **17** | 34 |
| **Cash Flows from Operating Activities** | **1,489** | 1,443 |
| **Investing Activities** | | |
| Fixed asset purchases | **(1,156)** | (1,258) |
| Short term investments | **271** | 83 |
| Proceeds from fixed asset sales | **109** | 110 |
| Credit card receivables, after securitization (note 8) | **(84)** | (34) |
| Franchise investments and other receivables | **53** | (26) |
| Other | **(96)** | (52) |
| **Cash Flows used in Investing Activities** | **(903)** | (1,177) |
| **Financing Activities** | | |
| Bank indebtedness | **(17)** | (11) |
| Commercial paper | **(37)** | (130) |
| Long term debt (note 14) | | |
| Issued | **333** | 200 |
| Retired | **(240)** | (103) |
| Common share capital | | |
| Issued (notes 16 and 17) | **1** | |
| Retired (note 16) | **(16)** | (35) |
| Dividends | **(230)** | (209) |
| Other | **(2)** | (2) |
| **Cash Flows used in Financing Activities** | **(208)** | (290) |
| Effect of foreign currency exchange rate changes on cash and cash equivalents (note 7) | **(31)** | (45) |
| Initial impact of variable interest entities (note 2) | **20** | |
| Change in Cash and Cash Equivalents | **367** | (69) |
| Cash and Cash Equivalents, Beginning of Year | **549** | 618 |
| **Cash and Cash Equivalents, End of Year** | **$ 916** | $ 549 |

See accompanying notes to the consolidated financial statements.

For the years ended December 31, 2005 and January 1, 2005
($ millions except where otherwise indicated)

### Note 1. Summary of Significant Accounting Policies

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

**Basis of Consolidation** The consolidated financial statements include the accounts of Loblaw Companies Limited and its subsidiaries, collectively referred to as the "Company" or "Loblaw". The Company's interest in the voting share capital of its subsidiaries is 100%. Effective January 2, 2005, the Company was required, pursuant to Accounting Guideline 15, "*Consolidation of Variable Interest Entities*", ("AcG 15") issued by the Canadian Institute of Chartered Accountants ("CICA"), to consolidate certain variable interest entities ("VIEs") that are subject to control on a basis other than through ownership of a majority of voting interest.

Additional disclosure regarding the implementation of AcG 15 is provided in Note 2.

**Fiscal Year** The fiscal year of the Company ends on the Saturday closest to December 31. As a result, the Company's fiscal year is usually 52 weeks in duration but includes a 53rd week every 5 to 6 years. The years ended December 31, 2005 and January 1, 2005 each contained 52 weeks.

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

**Earnings per Share ("EPS")** Basic EPS is calculated by dividing the net earnings available to common shareholders by the weighted average number of common shares outstanding during the year. Diluted EPS is calculated using the treasury stock method, which assumes that all outstanding stock options with an exercise price below the average market price are exercised and the assumed proceeds are used to purchase the Company's common shares at the average market price during the year.

**Cash, Cash Equivalents and Bank Indebtedness** Cash balances which the Company has the ability and intent to offset are used to reduce reported bank indebtedness. Cash equivalents are highly liquid investments with a maturity of 90 days or less.

**Short Term Investments** Short term investments are carried at the lower of cost or quoted market value and consist primarily of United States government securities, commercial paper and bank deposits.

**Credit Card Receivables** The Company, through President's Choice Bank ("PC Bank"), a wholly owned subsidiary of the Company, has credit card receivables that are stated net of an allowance for credit losses. Credit card receivables, if contractually past due, are not classified as impaired but are fully written off the earlier of when payments are contractually 180 days in arrears or when the likelihood of collection is considered remote. Interest income on credit card receivables is recorded on an accrual basis and is recognized in operating income.

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

**Securitization** PC Bank securitizes credit card receivables through the sale of a portion of the total interest in these receivables to an independent trust and does not exercise any control over the trust's management, administration or assets. When PC Bank sells credit card receivables in a securitization transaction, it has a retained interest in the securitized receivables represented by the right to future cash flows after obligations to investors have been met. Although PC Bank remains responsible for servicing all credit card receivables, it does not receive additional compensation for servicing those credit card receivables sold to the trust. Any gain or loss on the sale of these receivables depends, in part, on the previous carrying amount of receivables involved in the securitization, allocated between the receivables sold and the retained interest, based on their relative fair values at the date of securitization. The fair values are determined using a financial model. Any gain or loss on a sale is recognized in operating income at the time of the securitization. The carrying value of retained interests is periodically reviewed and when a decline in value is identified that is other than temporary, the carrying value is written down to fair value.

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

**Inventories** Retail store inventories are stated at the lower of cost and estimated net realizable value less normal gross profit margin. Wholesale and seasonal general merchandise inventories are stated at the lower of cost and estimated net realizable value. Cost is determined substantially using the first-in, first-out method.

**Fixed Assets** Fixed assets are recorded at cost including capitalized interest. Depreciation commences when the assets are put into use and is recognized on a straight-line basis to depreciate the cost of these assets over their estimated useful lives. Estimated useful lives range from 20 to 40 years for buildings, 10 years for building improvements and from 3 to 10 years for equipment and fixtures. Leasehold improvements are depreciated over the lesser of their estimated useful lives and the term of the lease, plus renewal options when applicable, to a maximum of 10 years.

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

**Deferred Charges** Debt issue costs associated with long term debt are deferred and amortized on a straight-line basis over the term of the debt. Other deferred charges are amortized over the related assets' estimated useful lives, to a maximum of 15 years.

**Goodwill** Goodwill represents the excess of the purchase price of a business acquired over the fair value of the underlying net assets acquired at the date of acquisition. Goodwill is not amortized and its carrying value is tested at least annually for impairment. Any impairment in the carrying value of goodwill is recognized in operating income.

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

The Company formally identifies, designates and documents the relationships between hedging instruments and hedged items including cross currency basis swaps and interest rate swaps as cash flow hedges against its exposure to fluctuations in the foreign currency exchange rate and variable interest rates on a portion of its United States dollar denominated assets, principally cash equivalents and short term investments; and interest rate swaps as a cash flow hedge of the variable interest rate exposure on commercial paper. Effectiveness tests are performed to evaluate hedge effectiveness at inception and on an ongoing basis, both retrospectively and prospectively.

Realized and unrealized foreign currency exchange rate adjustments on cross currency basis swaps are offset by realized and unrealized foreign currency exchange rate adjustments on a portion of the Company's United States dollar denominated assets and are recognized in operating income. The cumulative unrealized foreign currency exchange rate receivable or payable is recorded in other assets or other liabilities, respectively. The exchange of interest payments on the cross currency basis swaps and interest rate swaps is recognized on an accrual basis in interest expense. Unrealized gains or losses on the interest rate swaps designated within an effective hedging relationship are not recognized.

Financial derivative instruments not designated within an effective hedging relationship are measured at fair value with changes in fair value recorded in interest expense.

During 2005, an electricity forward contract expired which had been designated as a cash flow hedge of price volatility of the Company's electricity costs in Ontario, Canada. Prior to its expiry, gains and losses on this electricity forward contract were recognized in operating income as actual electricity costs were recognized.

Equity forwards are used to manage exposure to fluctuations in the Company's stock-based compensation cost because they change in value as the market price of the underlying common shares changes. The market price adjustments on the equity forwards are recognized in operating income as gains or losses and the cumulative unrealized gains or losses are recorded in other assets or other liabilities, respectively. Interest on the equity forwards is recognized on an accrual basis in interest expense.

**Foreign Currency Translation** Assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the foreign currency exchange rate in effect at the balance sheet date. Exchange gains or losses arising from the translation of these balances denominated in foreign currencies are recognized in operating income. Revenues and expenses denominated in foreign currencies are translated into Canadian dollars at the average foreign currency exchange rate for the year.

**Income Taxes** The asset and liability method of accounting is used for income taxes. Under the asset and liability method, future income tax assets and liabilities are recognized for the future income tax consequences attributable to temporary differences between the financial statement carrying values of existing assets and liabilities and their respective income tax bases. Future income tax assets and liabilities are measured using enacted or substantively enacted income tax rates expected to apply to taxable income in the years in which those temporary differences are

expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in income tax rates is recognized in income tax expense when enacted or substantively enacted. Future income tax assets are evaluated and a valuation allowance, if required, is recorded against any future income tax asset if it is more likely than not that the asset will not be realized.

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

The cost of plan amendments and the excess unamortized net actuarial gain or loss over 10% of the greater of the accrued benefit plan obligation or the fair value of the benefit plan assets at the beginning of the year are amortized over the expected average remaining service period of the active employees. The expected average remaining service period of the active employees covered by the defined benefit pension plans ranges from 6 to 17 years with a weighted average of 13 years. The expected average remaining service period of the employees covered by the other benefit plans ranges from 7 to 13 years with a weighted average of 11 years.

The cost of pension benefits for defined contribution pension plans and multi-employer pension plans are expensed as contributions are paid.

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

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

The Company accounts for stock options issued prior to December 30, 2001 that will be settled by issuing common shares as capital transactions. Consideration paid by employees on the exercise of this type of stock option is credited to common share capital. This type of option was last issued in 2001 and represents approximately 2.9% of all options outstanding at year end.

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

**Employee Share Ownership Plan** The Company maintains an Employee Share Ownership Plan which allows employees to acquire the Company's common shares through regular payroll deductions of up to 5% of their gross regular earnings. The Company contributes an additional 25% (2004 – 15%) of each employee's contribution to the plan, which is recognized in operating income as a compensation cost when the contribution is made.

**Deferred Share Units** Members of the Company's Board of Directors may elect annually to receive all or a portion of their annual retainer(s) and fees in the form of deferred share units, which are accounted for using the intrinsic value method. Under the intrinsic value method, the deferred share unit compensation liability is the amount by which the market price of the common shares exceeds the initial value of the deferred share unit. The year-over-year change in the deferred share units liability is recognized in operating income as a compensation cost.

**Use of Estimates and Assumptions** The preparation of the consolidated 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. These estimates and assumptions are based on management's historical experience, best knowledge of current events and conditions and activities that may be undertaken in the future. Actual results could differ from these estimates.

Certain estimates, such as those related to valuation of inventories, goodwill, income taxes, Goods and Services Tax and provincial sales taxes and employee future benefits, depend upon subjective or complex judgments about matters that may be uncertain, and changes in those estimates could materially impact the consolidated financial statements.

**Comparative Information** Certain prior year's information was reclassified to conform with the current year's presentation.

### Note 2. Variable Interest Entities

Effective January 2, 2005, the Company implemented AcG 15, retroactively without restatement of prior periods and as a result, the Company consolidates entities in which it has control through ownership of a majority of the voting interests as well as all VIEs for which it is the primary beneficiary.

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

Upon implementation of AcG 15, the Company identified the following significant VIEs:

**Independent Franchisees** The Company enters into various forms of franchise agreements that generally require the independent franchisee to purchase inventory from the Company and pay certain fees in exchange for services provided by the Company and for the right to use certain trademarks and licences owned by the Company. Independent franchisees generally lease the land and building from the Company, and when eligible, may obtain financing through a structure involving independent trusts to facilitate the purchase of the majority of their inventory and fixed assets, consisting mainly of fixturing and equipment. These trusts are administered by a major Canadian bank. Under the terms of certain franchise agreements, the Company may also lease equipment to independent franchisees. Independent franchisees may also obtain financing through operating lines of credit with traditional financial institutions or through issuing preferred shares or notes payable to the Company. The Company monitors the financial condition of its independent franchisees and provides for estimated losses or write-downs on its accounts and notes receivable or investments when appropriate. Upon implementation of AcG 15, the Company determined that 121 of its independent franchisee stores met the criteria for VIEs that require consolidation by the Company pursuant to AcG 15.

**Warehouse and Distribution Agreement** The Company has entered into a warehousing and distribution agreement with a third party to provide to the Company distribution and warehousing services from a dedicated facility. The Company has no equity interest in this third party; however, the terms of the agreement with the third party are such that the Company has determined that the third party meets the criteria for a VIE that requires consolidation by the Company. As a result of the fee structure agreed to with this third party, the impact of the consolidation of the warehouse and distribution entity was not material.

Accordingly, the Company has included the results of these independent franchisees and this third-party entity that provides distribution and warehousing services in its consolidated financial statements effective January 2, 2005.

Details of the amounts recorded upon implementation and the effect on the opening consolidated balance sheet as at January 2, 2005 are summarized below and include the impact of both the independent franchisees and the warehouse and distribution entity:

Condensed Consolidated Balance Sheet as at January 2, 2005

| | Condensed consolidated balance sheet before AcG 15 impact | Impact of the implementation of AcG 15 | Condensed consolidated balance sheet after AcG 15 impact |
|---|---|---|---|
| Cash and cash equivalents | $ 549 | $ 20 | $ 569 |
| Short term investments | 275 | | 275 |
| Accounts receivable | 665 | (73) | 592 |
| Inventories | 1,821 | 78 | 1,899 |
| Other current assets | 113 | 4 | 117 |
| Total current assets | 3,423 | 29 | 3,452 |
| Fixed assets | 7,113 | 136 | 7,249 |
| Goodwill | 1,621 | 3 | 1,624 |
| Other assets | 792 | (51) | 741 |
| Total assets | $ 12,949 | $ 117 | $ 13,066 |
| Total current liabilities | $ 3,133 | $ 48 | $ 3,181 |
| Long term debt | 3,935 | 96 | 4,031 |
| Other liabilities | 467 | (8) | 459 |
| Minority interest | | 10 | 10 |
| Total liabilities | 7,535 | 146 | 7,681 |
| Common share capital | 1,192 | | 1,192 |
| Retained earnings | 4,222 | (29) | 4,193 |
| Total liabilities and shareholders' equity | $ 12,949 | $ 117 | $ 13,066 |

The impact of AcG 15 on the opening consolidated balance sheet can be further explained as follows:

- An after-tax, one-time charge of $29 (net of income taxes of $12) was recorded upon implementation and resulted mainly from delaying the recognition of vendor monies to when the related inventories of the independent franchisees are sold to their customers, the excess of the independent franchisees' accumulated losses over the allowance for doubtful accounts previously recorded by the Company and the reversal of initial franchise fees initially recognized upon the sale of franchises to third parties.

- Accounts receivable due from the independent franchisees and the investment in preferred shares of the independent franchisees were eliminated upon consolidation; cash and cash equivalents, inventories and fixed assets financed by long term debt (a portion of which is due within one year) were recorded.
- An increase in fixed assets and total current liabilities in respect of the warehouse and distribution entity.
- Minority interest representing the common stakeholder's equity in the respective VIEs.

As at December 31, 2005, 123 of the Company's independent franchise stores met the criteria for a VIE and were consolidated pursuant to AcG 15.

The impact from the consolidation of these VIEs on the consolidated balance sheet as at December 31, 2005 was not significantly different than the impact on the opening consolidated balance sheet as outlined above. The impact on the consolidated statement of earnings for the year ended December 31, 2005 was predominantly an increase in sales of 1.5%. The impact on basic net earnings per common share for 2005 was a decline of approximately 3 cents.

The consolidation of these VIEs by the Company does not result in any change to its tax, legal or credit risks nor does it result in the Company assuming any obligations of these third parties.

**Independent Trust** The Company has also identified that it holds a variable interest, by way of a standby letter of credit, in an independent trust which is used to securitize credit card receivables for PC Bank. In these securitizations, PC Bank sells a portion of its credit card receivables to the independent trust in exchange for cash. Although this independent trust has been identified as a VIE, it was determined that the Company is not the primary beneficiary and therefore this VIE is not subject to consolidation by the Company. The Company's maximum exposure to loss as a result of its involvement with this independent trust is disclosed in Notes 8 and 19.

### Note 3. Restructuring and Other Charges

During 2005, after completion of a detailed assessment of its supply chain network, management of the Company approved a comprehensive plan to restructure its supply chain operations nationally. This plan is expected to reduce future operating costs, provide a smoother flow of products and better service levels to stores and further enable the Company to achieve its targeted operating efficiencies. The plan involves the closure of six distribution centres and the relocation of certain activities to new distribution centres. The transfer of the distribution activities of general merchandise to a new facility owned and operated by a third party in Pickering, Ontario was substantially completed by the end of 2005. In addition, a new distribution centre dedicated to food distribution is expected to open in late 2007 or early 2008 in Ajax, Ontario. As a result of these initiatives, it is expected that approximately 1,400 positions will be affected within the supply chain network. The restructuring plan is expected to be completed by late 2007 or early 2008 and the total restructuring cost under this plan is estimated to be approximately $90. Of the $90 total estimated cost, approximately $57 is attributable to employee termination benefits which include severance and additional pension costs resulting from the termination of employees, $13 to fixed asset impairment and accelerated depreciation of assets relating to this restructuring activity and $20 to site closing and other costs directly attributable to the restructuring plan. In 2005, the Company recognized $62 of restructuring costs resulting from this plan.

In addition, the Company consolidated several administrative and operating offices from across southern Ontario into a new national head office and Store Support Centre in Brampton, Ontario and reorganized the merchandising, procurement and operations groups which included the transfer of the general merchandise operations from Calgary, Alberta to the new office. The charge recognized in 2005 was $24. These restructuring activities were substantially completed by the end of 2005.

The following table provides a summary of the costs recognized and cash payments made in 2005, as well as the corresponding net liability as at December 31, 2005:

| | Employee Termination Benefits | Site Closing Costs and Other | Total Net Liability | Fixed Asset Impairment and Accelerated Depreciation | Total |
|---|---|---|---|---|---|
| Costs recognized in 2005: | | | | | |
| Supply chain network | $ 45 | $ 6 | $ 51 | $ 11 | $ 62 |
| Office move and reorganization of the operation support functions | 6 | 15 | 21 | 3 | 24 |
| | $ 51 | $ 21 | $ 72 | $ 14 | $ 86 |
| Cash payments during 2005: | | | | | |
| Supply chain network | $ 7 | $ 6 | $ 13 | | |
| Office move and reorganization of the operation support functions | 3 | 15 | 18 | | |
| | $ 10 | $ 21 | $ 31 | | |
| Net liability as at December 31, 2005 | $ 41 | $ – | $ 41 | | |
| Recorded in the consolidated balance sheet as follows: | | | | | |
| Other assets(1) (note 13) | $ 9 | | $ 9 | | |
| Accounts payable and accrued liabilities | 7 | | 7 | | |
| Other liabilities (note 15) | 25 | | 25 | | |
| Net liability as at December 31, 2005 | $ 41 | | $ 41 | | |

(1) Represents defined benefit pension plan costs applied to other assets.

### Note 4. Goods and Services Tax ("GST") and Provincial Sales Taxes ("PST")

During 2005, a charge was recorded relating to an audit and proposed assessment by the Canada Revenue Agency relative to GST on certain products sold between 2000 and 2002 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 up to the end of 2004. Accordingly, a charge of $40 was recorded in operating income in the third quarter to reflect management's best estimate of such potential tax liabilities of which management is currently aware. Approximately $15 of this amount was settled during the fourth quarter. 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.

#### Note 5. Interest Expense

| | 2005 | 2004 |
|---|---|---|
| Interest on long term debt | $ 290 | $ 290 |
| Interest on financial derivative instruments | (6) | (30) |
| Net short term interest | (11) | |
| Capitalized to fixed assets | (21) | (21) |
| Interest expense | $ 252 | $ 239 |

Net interest paid in 2005 was $263 (2004 – $254).

#### Note 6. Basic and Diluted Net Earnings per Common Share

| | 2005 | 2004 |
|---|---|---|
| Net earnings | $ 746 | $ 968 |
| Weighted average common shares outstanding (in millions) | 274.2 | 274.3 |
| Dilutive effect of stock-based compensation (in millions) | 0.8 | 1.6 |
| Diluted weighted average common shares outstanding (in millions) | 275.0 | 275.9 |
| Basic net earnings per common share ($) | $ 2.72 | $ 3.53 |
| Dilutive effect of stock-based compensation per common share ($) | (0.01) | (0.02) |
| Diluted net earnings per common share ($) | $ 2.71 | $ 3.51 |

At the end of 2005, there were 2,254,639 stock options outstanding with a weighted average exercise price of $69.578 per common share that were not recognized in the computation of diluted net earnings per common share because the exercise prices of the options were greater than the average market price of the common shares for 2005.

#### Note 7. Cash, Cash Equivalents and Short Term Investments

At year end, the Company had $837 (2004 – $819) in cash, cash equivalents and short term investments held by Glenhuron Bank Limited ("Glenhuron"), a wholly owned subsidiary of the Company in Barbados. The $27 (2004 – $14) of income from cash, cash equivalents and short term investments was recognized in net short term interest.

The Company recognized an unrealized foreign currency exchange rate loss of $31 (2004 – $65) as a result of translating its United States dollar denominated cash, cash equivalents and short term investments, of which $31 (2004 – $45) related to cash and cash equivalents. The resulting loss on cash, cash equivalents and short term investments is offset in operating income by the unrealized foreign currency exchange rate gain on the cross currency basis swaps. A cumulative unrealized foreign currency exchange rate receivable of $168 (2004 – $155) relating to these swaps is recorded in other assets on the balance sheet.

#### Note 8. Credit Card Receivables

The Company, through PC Bank, securitizes credit card receivables through the sale of a portion of the total interest in these receivables to an independent trust and does not exercise any control over the trust's management, administration or assets. When PC Bank sells credit card receivables in a securitization transaction, it has a retained interest in the securitized receivables represented by the right to future cash flows after obligations to investors have been met. Although PC Bank remains responsible for servicing all credit card receivables, it does not receive additional compensation for servicing those credit card receivables sold to the trust.

During 2005, $225 (2004 – $227) of credit card receivables were securitized, through the sale of a portion of the total interest in these receivables to an independent trust yielding a nominal net loss (2004 – nominal net gain) on the initial sale inclusive of a $1 (2004 – $1) servicing liability. Servicing liabilities expensed during the year were $13 (2004 – $11) and the fair value at year end of recognized servicing liabilities was $8 (2004 – $7). The trust's recourse to PC Bank's assets is limited to PC Bank's retained interests and is further supported by the Company through a standby letter of credit for 9% (2004 – 15%) of the securitized amount.

| | **2005** | 2004 |
|---|---|---|
| Credit card receivables | **$ 1,257** | $ 950 |
| Amount securitized | **(1,010)** | (785) |
| Net credit card receivables | **$ 247** | $ 165 |
| Net credit loss experience | **$ 5** | $ 4 |

The net credit loss experience of $5 (2004 – $4) includes $33 (2004 – $23) of credit losses on the total portfolio of credit card receivables net of credit losses of $28 (2004 – $19) relating to securitized credit card receivables. The following table outlines the key economic assumptions used in measuring the retained interests at the date of securitization for securitizations completed in 2005. The table also displays the sensitivity of the current fair value of retained interests to an immediate 10% and 20% adverse change in the 2005 key economic assumptions. The sensitivity analysis provided in the table is hypothetical and should be used with caution. The sensitivities of each key assumption have been calculated independently of any changes in other key assumptions. Actual experience may result in changes in a number of key assumptions simultaneously. Changes in one factor may result in changes in another, which could amplify or reduce the impact of such assumptions.

| | | **Change in Assumptions** | |
|---|---|---|---|
| | **2005** | **10%** | **20%** |
| Carrying value of retained interests | **$ 5** | | |
| Payment rate (monthly) | **46.0%** | | |
| Weighted average life (years) | **0.6** | | |
| Expected credit losses (annual) | **3.0%** | **$ (0.5)** | **$ (1.0)** |
| Discount rate applied to residual cash flows (annual) | **14.0%** | **$ (1.6)** | **$ (3.1)** |

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

| | **2005** | 2004 |
|---|---|---|
| Proceeds from new securitizations | **$ 225** | $ 227 |
| Net cash flows received on retained interests | **$ 106** | $ 83 |

In October 2005, Eagle Credit Card Trust ("Eagle"), an independent trust, was established for the purpose of issuing notes backed by credit card receivables originated and serviced by PC Bank. Subsequent to year end, Eagle issued $500, five year notes at a weighted average rate of 4.5%, due 2011, to finance the purchase of credit card receivables previously securitized by PC Bank, from an independent trust. PC Bank will continue to service the credit card receivables on behalf of Eagle, but will not receive any fee for its servicing obligations and has a retained interest in the securitized receivables represented by the right to future cash flows after obligations to investors have been met. In accordance with Canadian GAAP, the financial statements of Eagle will not be consolidated with those of the Company.

**Note 9. Income Taxes**

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

| | 2005 | 2004 |
|---|---|---|
| Weighted average basic Canadian federal and provincial statutory income tax rate | **34.4%** | 34.9% |
| Net increase (decrease) resulting from: | | |
| Earnings in jurisdictions taxed at rates different from the Canadian statutory income tax rates | **0.5** | (2.0) |
| Non-taxable amounts | **(0.7)** | (0.7) |
| Large corporation tax | **0.5** | 0.7 |
| Impact of statutory income tax rate changes on future income tax balances | **0.3** | |
| Impact of successful resolution of certain income tax matters from a previous year and other | **(0.2)** | (1.4) |
| Effective income tax rate | **34.8%** | 31.5% |

Net income taxes paid in 2005 were $387 (2004 – $400).

Future income tax balances were adjusted for statutory income tax rate changes in certain provinces, in 2005, resulting in a $3 charge to future income tax expense. In 2004, the Company recognized a $14 reduction to the income tax expense as a result of the successful resolution of certain income tax matters from a previous year.

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

| | 2005 | 2004 |
|---|---|---|
| Accounts payable and accrued liabilities | **$ 55** | $ 56 |
| Other liabilities | **86** | 90 |
| Fixed assets | **(278)** | (222) |
| Other assets | **(64)** | (55) |
| Other | **36** | 28 |
| Net future income tax liabilities | **$ (165)** | $ (103) |

| | 2005 | 2004 |
|---|---|---|
| Recorded in the consolidated balance sheets as follows: | | |
| Current future income tax assets | **$ 72** | $ 81 |
| Non-current future income tax liabilities | **(237)** | (184) |
| Net future income tax liabilities | **$ (165)** | $ (103) |

**Note 10. Fixed Assets**

| | 2005 | | | 2004 | | |
|---|---|---|---|---|---|---|
| | **Cost** | **Accumulated Depreciation** | **Net Book Value** | Cost | Accumulated Depreciation | Net Book Value |
| Properties held for development | **$ 442** | | **$ 442** | $ 378 | | $ 378 |
| Properties under development | **231** | | **231** | 290 | | 290 |
| Land | **1,629** | | **1,629** | 1,530 | | 1,530 |
| Buildings | **4,579** | **$ 835** | **3,744** | 4,040 | $ 731 | 3,309 |
| Equipment and fixtures | **3,589** | **2,207** | **1,382** | 3,057 | 1,835 | 1,222 |
| Building and leasehold improvements | **647** | **290** | **357** | 656 | 276 | 380 |
| | **11,117** | **3,332** | **7,785** | 9,951 | 2,842 | 7,109 |
| Capital leases – buildings and equipment | **95** | **95** | **–** | 95 | 91 | 4 |
| | **$ 11,212** | **$ 3,427** | **$ 7,785** | $ 10,046 | $ 2,933 | $ 7,113 |

Fixed asset impairment and accelerated depreciation charges of $7 (2004 – $22) were recognized in operating income. An additional $14 was recognized in restructuring and other charges in 2005 for charges primarily due to the plan to restructure the supply chain operations nationally (see Note 3). The majority of the charges in 2004 resulted from the repositioning of the Ontario, Canada banner portfolio. The fair values were determined using quoted market prices where available, independent offers to purchase where available or prices for similar assets.

**Note 11. Goodwill**

In the normal course of business, the Company may acquire from time to time franchisee stores and convert them to corporate stores. In 2005, the Company acquired 7 franchisee businesses (2004 – 5 franchisee businesses). The acquisitions were accounted for using the purchase method of accounting with the results of the businesses acquired included in the consolidated financial statements from the date of acquisition. The fair value of the net assets acquired consisted of a nominal amount of fixed assets (2004 – nominal), other assets principally inventory of $3 (2004 – $2) and goodwill of $3 (2004 – $6) for cash consideration of $5 (2004 – $6), net of accounts receivable due from the franchisees of $1 (2004 – $2).

The consolidated balance sheet as at December 31, 2005 includes $4 of goodwill of independent franchisees that were consolidated by the Company pursuant to the requirements of AcG 15.

During 2005, the Company reduced goodwill by $41 due to the resolution of certain income tax matters previously accrued for as part of the Provigo Inc. purchase equation.

The Company performed the annual impairment test for goodwill and determined that there was no impairment to the carrying value of goodwill.

In 2004, Westfair Foods Ltd. (“Westfair”), a subsidiary of the Company, redeemed its Class A shares at a price of 350 dollars per share for cash consideration of $8. Previously, the minority interest related to these Class A shares was included in other liabilities. This transaction was accounted for as a step-by-step purchase of Westfair, which resulted in the Company recognizing $8 of goodwill.

**Note 12. Other Assets**

| | 2005 | 2004 |
|---|---|---|
| Franchise investments and other receivables | $ 194 | $ 323 |
| Accrued benefit plan asset (note 13) | 139 | 106 |
| Unrealized equity forwards receivable (note 18) | 30 | 109 |
| Unrealized cross currency basis swaps receivable (notes 7 and 18) | 168 | 155 |
| Deferred charges and other | 157 | 99 |
| | $ 688 | $ 792 |

**Note 13. Employee Future Benefits**

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

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

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

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

The most recent actuarial valuations of the defined benefit pension plans for funding purposes ("funding valuations") were as of December 31, 2003 for all plans except two small plans which were as of December 31, 2004. The Company is required to file funding valuations at least every three years; accordingly, the next required funding valuations will be as of December 31, 2006 and 2007, respectively.

Total cash payments made by the Company during 2005, consisting of contributions to funded defined benefit pension plans, defined contribution pension plans, multi-employer pension plans, long term disability benefit plan and benefits paid directly to beneficiaries of the unfunded defined benefit pension plans and unfunded other benefit plans, were $134 (2004 – $105).

The aggregate of the funded defined benefit pension plans and long term disability benefit plan contributions for 2006 are estimated to be $77, and may vary subject to actuarial valuations being completed. The Company also expects to make contributions in 2006 to defined contribution pension plans and multi-employer pension plans, as well as benefit payments directly to beneficiaries of the unfunded defined benefit pension plans and other unfunded benefit plans.

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

| | 2005 | | | 2004 | | |
|---|---|---|---|---|---|---|
| | **Pension Benefit Plans** | **Other Benefit Plans[1]** | **Total** | Pension Benefit Plans | Other Benefit Plans[1] | Total |
| **Benefit Plan Assets** | | | | | | |
| Fair value, beginning of year | **$ 838** | **$ 35** | **$ 873** | $ 771 | $ 30 | $ 801 |
| Actual return on plan assets | **98** | **2** | **100** | 74 | 1 | 75 |
| Employer contributions | **61** | **22** | **83** | 42 | 18 | 60 |
| Voluntary employee contributions | **2** | | **2** | 2 | | 2 |
| Benefits paid | **(53)** | **(17)** | **(70)** | (49) | (14) | (63) |
| Other | **(2)** | | **(2)** | (2) | | (2) |
| Fair value, end of year | **$ 944** | **$ 42** | **$ 986** | $ 838 | $ 35 | $ 873 |
| **Accrued Benefit Plan Obligations** | | | | | | |
| Balance, beginning of year | **$ 937** | **$ 181** | **$ 1,118** | $ 887 | $ 190 | $ 1,077 |
| Current service cost | **37** | **4** | **41** | 33 | 4 | 37 |
| Interest cost | **60** | **11** | **71** | 56 | 11 | 67 |
| Benefits paid | **(53)** | **(17)** | **(70)** | (49) | (14) | (63) |
| Actuarial loss | **173** | **64** | **237** | 11 | 1 | 12 |
| Plan amendments/ past service costs | | **2** | **2** | 1 | (11) | (10) |
| Contractual termination benefits[2] | **9** | | **9** | | | |
| Curtailment gain[3] | **(6)** | **(2)** | **(8)** | | | |
| Other | **(2)** | | **(2)** | (2) | | (2) |
| Balance, end of year | **$ 1,155** | **$ 243** | **$ 1,398** | $ 937 | $ 181 | $ 1,118 |
| **Deficit of Plan Assets Versus Plan Obligations** | **$ (211)** | **$ (201)** | **$ (412)** | $ (99) | $ (146) | $ (245) |
| Unamortized cost of plan amendments/past service costs | **6** | **(7)** | **(1)** | 6 | (9) | (3) |
| Unamortized net actuarial loss | **271** | **128** | **399** | 137 | 70 | 207 |
| Net accrued benefit plan asset (liability) | **$ 66** | **$ (80)** | **$ (14)** | $ 44 | $ (85) | $ (41) |
| Recorded in the consolidated balance sheets as follows: | | | | | | |
| Other assets (note 12) | **102** | **37** | **139** | 78 | 28 | 106 |
| Other liabilities (note 15) | **(36)** | **(117)** | **(153)** | (34) | (113) | (147) |
| Net accrued benefit plan asset (liability) | **$ 66** | **$ (80)** | **$ (14)** | $ 44 | $ (85) | $ (41) |

(1) Other Benefit Plans include post-retirement, post-employment and long term disability benefits.

(2) Contractual termination benefits resulted from the plan to restructure the supply chain operations nationally and were recorded in restructuring and other charges. See Note 3.

(3) Certain defined benefit pension and other benefit plans affected by the plan to restructure the supply chain operations nationally were remeasured as at March 31, 2005 and costs subsequent to April 1, 2005 were determined using a discount rate of 5.75%. This resulted in a nominal impact to net earnings and curtailment gains which were offset against unamortized net actuarial losses for those plans.

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

| | 2005 | | 2004 | |
|---|---|---|---|---|
| | **Pension Benefit Plans** | **Other Benefit Plans** | Pension Benefit Plans | Other Benefit Plans |
| Fair Value of Benefit Plan Assets | **$ 944** | | $ 773 | |
| Accrued Benefit Plan Obligations | **1,155** | **$ 202** | 873 | $ 151 |
| Deficit | **$ 211** | **$ 202** | $ 100 | $ 151 |

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

| | 2005 | | 2004 | |
|---|---|---|---|---|
| | **Pension Benefit Plans** | **Other Benefit Plans** | Pension Benefit Plans | Other Benefit Plans |
| Accrued Benefit Plan Obligations | | | | |
| Discount rate | **5.25%** | **5.2%** | 6.25% | 6.1% |
| Rate of compensation increase | **3.5%** | | 3.5% | |
| Net Defined Benefit Plan Cost | | | | |
| Discount rate[(1)] | **6.25%** | **6.1%** | 6.25% | 6.0% |
| Expected long term rate of return on plan assets | **8.0%** | **5.5%** | 8.0% | 4.5% |
| Rate of compensation increase | **3.5%** | | 3.5% | |

(1) Certain defined benefit pension and other benefit plans affected by the plan to restructure the supply chain operations nationally were remeasured as at March 31, 2005 and costs subsequent to April 1, 2005 were determined using a discount rate of 5.75%. This resulted in a nominal impact to net earnings and curtailment gains which were offset against unamortized net actuarial losses for those plans.

The Company's growth rate of health care costs, primarily drug and other medical costs, was estimated at 10.0% (2004 – 9.0%) and is assumed to decrease to 5.0% by 2013 (2004 – 5.0% by 2008) and remain at that level thereafter.

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

| Percentage of Plan Assets | 2005 | | 2004 | |
|---|---|---|---|---|
| Asset Category | **Pension Benefit Plans** | **Other Benefit Plans** | Pension Benefit Plans | Other Benefit Plans |
| Equity securities | **64%** | | 64% | |
| Debt securities | **34%** | **99%** | 34% | 95% |
| Cash and cash equivalents | **2%** | **1%** | 2% | 5% |
| Total | **100%** | **100%** | 100% | 100% |

Pension benefit plan assets include securities issued by the Company's majority shareholder, George Weston Limited ("Weston") having a fair value of $4 as at September 30 for each of 2005 and 2004. Other benefit plan assets do not include any Weston or Loblaw securities.

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

| | 2005 | | 2004 | |
|---|---|---|---|---|
| | **Pension Benefit Plans** | **Other Benefit Plans** | Pension Benefit Plans | Other Benefit Plans |
| Current service cost, net of employee contributions | **$ 35** | **$ 4** | $ 31 | $ 4 |
| Interest cost on plan obligations | **60** | **11** | 56 | 11 |
| Actual return on plan assets | **(98)** | **(2)** | (74) | (1) |
| Actuarial loss | **173** | **64** | 11 | 1 |
| Plan amendments/past service costs | | **2** | 1 | (11) |
| Contractual termination benefits[(1)] | **9** | | | |
| Benefit plan cost, before adjustments to recognize the long term nature of employee future benefit costs | **179** | **79** | 25 | 4 |
| Difference between cost arising in the year and cost recognized in the year in respect of: | | | | |
| Return on plan assets | **30** | | 13 | |
| Actuarial (loss) gain | **(170)** | **(59)** | (7) | 5 |
| Plan amendments/past service costs | | **(2)** | | 9 |
| Net defined benefit plan cost | **39** | **18** | 31 | 18 |
| Defined contribution plan cost | **6** | | 6 | |
| Multi-employer pension plan cost | **45** | | 39 | |
| Net benefit plan cost | **$ 90** | **$ 18** | $ 76 | $ 18 |
| Recognized in the consolidated statement of earnings as follows: | | | | |
| Pension and other benefit plan costs | **$ 81** | **$ 18** | $ 76 | $ 18 |
| Restructuring and other charges[(1)] | **9** | | | |
| Net benefit plan cost | **$ 90** | **$ 18** | $ 76 | $ 18 |

(1) Contractual termination benefits resulted from the plan to restructure the supply chain operations nationally and were recorded in restructuring and other charges. See Note 3.

**Sensitivity of Key Assumptions** The following table outlines the key assumptions for 2005 and the sensitivity of a 1% change in each of these assumptions on the accrued benefit plan obligations and on the benefit plan cost for defined benefit pension plans and other benefit plans. The table reflects the impact on the current service and interest cost components for the discount rate and expected growth rate of health care costs assumptions.

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

| | Pension Benefit Plans | | Other Benefit Plans | |
|---|---|---|---|---|
| | Accrued Benefit Plan Obligations | Benefit Plan Cost[1] | Accrued Benefit Plan Obligations | Benefit Plan Cost[1] |
| Expected long term rate of return on plan assets | | 8.0% | | |
| Impact of: 1% increase | n/a | $ (7) | n/a | |
| 1% decrease | n/a | 7 | n/a | |
| Discount rate | 5.25% | 6.25% | 5.2% | 6.1% |
| Impact of: 1% increase | $ (160) | $ (8) | $ (31) | $ (1) |
| 1% decrease | $ 186 | $ 8 | $ 36 | $ 3 |
| Expected growth rate of health care costs[2] | | | 10.0% | 9.0% |
| Impact of: 1% increase | n/a | n/a | $ 25 | $ 2 |
| 1% decrease | n/a | n/a | $ (28) | $ (3) |

n/a – not applicable

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

(2) Gradually decreasing to 5.0% by 2013 for the accrued benefit plan obligation and decreasing to 5.0% by 2008 for the benefit plan cost and remaining at that level thereafter.

## Note 14. Long Term Debt

| | 2005 | 2004 |
|---|---|---|
| **Provigo Inc. Debentures** | | |
| Series 1996, 8.70%, due 2006 | **$ 125** | $ 125 |
| Other (i) | **1** | 5 |
| **Loblaw Companies Limited Notes** | | |
| 6.95%, due 2005 (ii) | | 200 |
| 6.00%, due 2008 | **390** | 390 |
| 5.75%, due 2009 | **125** | 125 |
| 7.10%, due 2010 | **300** | 300 |
| 6.50%, due 2011 | **350** | 350 |
| 5.40%, due 2013 | **200** | 200 |
| 6.00%, due 2014 | **100** | 100 |
| 7.10%, due 2016 | **300** | 300 |
| 6.65%, due 2027 | **100** | 100 |
| 6.45%, due 2028 | **200** | 200 |
| 6.50%, due 2029 | **175** | 175 |
| 11.40%, due 2031 | | |
| – principal | **151** | 151 |
| – effect of coupon repurchase | **(26)** | (18) |
| 6.85%, due 2032 | **200** | 200 |
| 6.54%, due 2033 | **200** | 200 |
| 8.75%, due 2033 | **200** | 200 |
| 6.05%, due 2034 | **200** | 200 |
| 6.15%, due 2035 | **200** | 200 |
| 5.90%, due 2036 (ii) | **300** | |
| 6.45%, due 2039 | **200** | 200 |
| 7.00%, due 2040 | **150** | 150 |
| 5.86%, due 2043 | **55** | 55 |
| Other at a weighted average interest rate of 7.21%, due 2006 to 2043 | **33** | 43 |
| VIE loans payable (iii) | **126** | |
| Total long term debt | **4,355** | 4,151 |
| Less amount due within one year | **161** | 216 |
| | **$ 4,194** | $ 3,935 |

The five year schedule of repayment of long term debt based on maturity is as follows: 2006 – $161; 2007 – $24; 2008 – $406; 2009 – $140; 2010 – $314.

(i) Other of $1 (2004 – $5) represents the unamortized portion of the adjustment to fair value the Provigo Inc. Debentures. This adjustment was recorded as part of the Provigo purchase equation and was calculated using the average credit spread applicable at that time to the remaining life of the Provigo Inc. Debentures. The adjustment is being amortized over the remaining term of the Provigo Inc. Debentures.

(ii) During 2005, the Company issued $300 of 5.90% Medium Term Notes ("MTN") due 2036 and $200 of 6.95% MTN matured and was repaid.

(iii) Pursuant to the requirements of AcG 15, the consolidated balance sheet as at December 31, 2005 includes $126 of loans payable of VIEs consolidated by the Company, $23 of which is due within one year. The loans payable represent financing obtained by eligible independent franchisees through a structure involving independent trusts to facilitate the purchase of the majority of their inventory and fixed assets, consisting mainly of fixturing and equipment. The loans payable, which have an average term to maturity of 7 years, are due and payable on demand under certain predetermined circumstances and are secured through a general security agreement made by the independent franchisees in favour of the independent funding trust. Interest is charged on a floating rate basis and prepayment of the loans may be made without penalty. The independent funding trust within the structure finances its activities through the issuance of short term asset-backed notes to third-party investors.

As disclosed in Note 19, a standby letter of credit has been provided by a major Canadian bank for the benefit of the independent funding trust equal to approximately 10% of the total principal amount of the loans outstanding at any point in time. The Company has agreed to reimburse the issuing bank for any amount drawn on the standby letter of credit. In the event of a default by an independent franchisee the independent funding trust may assign the loan to the Company and draw upon the standby letter of credit. No amount has ever been drawn on the standby letter of credit.

**Note 15. Other Liabilities**

| | **2005** | 2004 |
|---|---|---|
| Accrued benefit plan liability (note 13) | **$ 153** | $ 147 |
| Stock-based compensation | **13** | 76 |
| Restructuring and other charges (note 3) | **25** | |
| Goods and Services Tax and provincial sales tax (note 4) | **16** | |
| Other | **64** | 60 |
| | **$ 271** | $ 283 |

**Note 16. Common Share Capital (authorized – unlimited)**

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

| | 2005 | | 2004 | |
|---|---|---|---|---|
| | Number of Common Shares | Common Share Capital | Number of Common Shares | Common Share Capital |
| Issued and outstanding, beginning of year | **274,255,914** | **$ 1,192** | 274,829,014 | $ 1,194 |
| Issued for stock options exercised (note 17) | **25,000** | **1** | 3,000 | |
| Purchased for cancellation | **(226,100)** | **(1)** | (576,100) | (2) |
| Issued and outstanding, end of year | **274,054,814** | **$ 1,192** | 274,255,914 | $ 1,192 |
| Weighted average outstanding | **274,183,823** | | 274,253,178 | |

**Normal Course Issuer Bids ("NCIB")** During 2005, the Company purchased for cancellation 226,100 (2004 – 576,100) of its common shares for $16 (2004 – $35).

The Company intends to renew its NCIB to purchase on the Toronto Stock Exchange or enter into equity forwards to purchase up to 5% of its common shares outstanding. The Company, in accordance with the rules and by-laws of the Toronto Stock Exchange, may purchase its shares at the then market price of such shares.

**Note 17. Stock-Based Compensation** ($, except where otherwise indicated)

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

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

| ($ millions) | 2005 | 2004 |
|---|---|---|
| Stock option plan (income)/expense | **$ (35)** | $ 24 |
| Equity forwards loss/(gain) (note 18) | **71** | (24) |
| Restricted share unit plan expense | **7** | |
| Net stock-based compensation cost | **$ 43** | $ – |

**Stock Option Plan** The Company maintains a stock option plan for certain employees. Under this plan, the Company may grant options for up to 20.4 million common shares; however, the Company has set a guideline which limits the number of stock option grants to a maximum of 5% of outstanding common shares at any time. Stock options have up to a 7-year term, vest 20% cumulatively on each anniversary date of the grant and are exercisable at the designated common share price, which is 100% of the market price of the Company's common shares on the last trading day prior to the effective date of the grant. Each stock option is exercisable into one common share of the Company at the price specified in the terms of the option, or option holders may elect to receive in cash the share appreciation value equal to the excess of the market price at the date of exercise over the specified option price.

During 2005, the Company granted 2,247,627 (2004 – 45,000) stock options with a weighted average exercise price of $69.729 (2004 – $65.453) per common share under its existing stock option plan, which allows for settlement in shares or in the share appreciation value in cash at the option of the employee.

The share appreciation value of $41 million (2004 – $33 million) was paid on the exercise of 1,135,221 (2004 – 985,395) stock options. In 2005, the Company issued 25,000 (2004 – 3,000) common shares on the exercise of stock options for cash consideration of $0.9 million (2004 – $0.1 million) for which it had recorded a stock-based compensation liability of $1 million (2004 – nominal).

At year end, a total of 5,305,422 (2004 – 4,365,958) stock options were outstanding, and represented approximately 1.9% (2004 – 1.6%) of the Company's issued and outstanding common shares, which was within the Company's guideline of 5%. Of the 5,305,422 outstanding options, 5,151,682 relate to stock option grants that allow for settlement in shares or in the share appreciation value in cash at the option of the employee and 153,740 relate to stock option grants, issued prior to December 30, 2001 that will be settled by issuing common shares.

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

| | **2005** | | 2004 | |
|---|---|---|---|---|
| | **Options (number of shares)** | **Weighted Average Exercise Price/Share** | Options (number of shares) | Weighted Average Exercise Price/Share |
| Outstanding options, beginning of year | **4,365,958** | **$ 45.039** | 5,407,026 | $ 42.533 |
| Granted | **2,247,627** | **$ 69.729** | 45,000 | $ 65.453 |
| Exercised | **(1,160,221)** | **$ 36.411** | (988,395) | $ 32.440 |
| Forfeited/cancelled | **(147,942)** | **$ 59.494** | (97,673) | $ 43.201 |
| Outstanding options, end of year | **5,305,422** | **$ 56.983** | 4,365,958 | $ 45.039 |
| Options exercisable, end of year | **1,701,050** | **$ 43.251** | 1,736,769 | $ 39.268 |

| | **2005 Outstanding Options** | | | **2005 Exercisable Options** | |
|---|---|---|---|---|---|
| **Range of Exercise Prices** | **Number of Options Outstanding** | **Weighted Average Remaining Contractual Life (years)** | **Weighted Average Exercise Price/Share** | **Number of Exercisable Options** | **Weighted Average Exercise Price/Share** |
| $ 32.000 – $ 48.500 | **991,215** | **1** | **$ 35.691** | **938,977** | **$ 34.978** |
| $ 49.050 – $ 53.600 | **2,059,568** | **4** | **$ 53.442** | **745,073** | **$ 53.208** |
| $ 61.950 – $ 72.950 | **2,254,639** | **6** | **$ 69.578** | **17,000** | **$ 63.805** |

Subsequent to year end 2005, the Company granted 48,742 stock options under its current stock option plan, that allow for settlement in shares or in the share appreciation value in cash at the option of the employee, to 1 employee with an exercise price of $54.71 per common share. Including stock option grants issued subsequent to year end, total stock options outstanding represent approximately 2.0% of the Company's issued and outstanding common shares.

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

During 2005, the Company granted 393,335 RSUs to 236 employees and 10,151 RSUs were cancelled. At year end, a total of 383,184 RSUs were outstanding.

Subsequent to year end 2005, the Company granted 644,712 RSUs to 231 employees.

**Employee Share Ownership Plan ("ESOP")** The Company maintains an ESOP which allows employees to acquire the Company's common shares through regular payroll deductions of up to 5% of their gross regular earnings. The Company contributes an additional 25% (2004 – 15%) of each employee's contribution to the plan. The ESOP is administered through a trust which purchases the Company's common shares on the open market on behalf of employees. A compensation cost of $5 million (2004 – $2 million) related to this plan was recognized in operating income.

**Deferred Share Units ("DSUs") Plan** Members of the Company's Board of Directors may elect annually to receive all or a portion of their annual retainer(s) and fees in the form of DSUs, the value of which is determined by the market price of the Company's common shares at the time the director's annual retainer(s) or fees are earned. Upon termination of Board service, the common shares due to the director, as represented by the DSUs, will be purchased on the open market on the director's behalf. At year end, 36,666 (2004 – 30,908) DSUs were outstanding. The year-over-year change in the deferred share units liability was minimal and was recognized in operating income.

## Note 18. Financial Instruments

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

| | Notional Amounts Maturing | | | | | | **2005** | 2004 |
|---|---|---|---|---|---|---|---|---|
| | 2006 | 2007 | 2008 | 2009 | 2010 | Thereafter | **Total** | Total |
| Cross currency basis swaps | $ 11 | $ 76 | $ 140 | $ 31 | $ 174 | $ 604 | **$ 1,036** | $ 1,114 |
| Interest rate swaps (receive)/pay | $ (43) | | $ 240 | $ 140 | $ 50 | $ 50 | **$ 437** | $ 598 |
| Equity forwards | | | | | $ 117 | $ 123 | **$ 240** | $ 236 |
| Electricity forward contract | | | | | | | | $ 16 |

**Cross Currency Basis Swaps** The Company enters into cross currency basis swaps to hedge its exposure to fluctuations in the foreign currency exchange rate on a portion of its United States dollar denominated assets, principally cash, cash equivalents and short term investments.

The Company entered into cross currency basis swaps to exchange United States dollars for $1.0 billion (2004 – $1.1 billion) Canadian dollars, which mature by 2016. Currency adjustments receivable or payable arising from these swaps are settled in cash on maturity. At year end, a cumulative unrealized foreign currency exchange rate receivable of $168 (2004 – $155) was recorded in other assets.

**Interest Rate Swaps** The Company enters into interest rate swaps to hedge a portion of its exposure to fluctuations in interest rates. The Company's interest rate swaps convert a net notional $437 (2004 – $598) of its floating rate investments to fixed rate investments at 4.76% (2004 – 5.80%), which mature by 2013.

**Equity Forwards ($)** 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. At year end 2005, the Company had cumulative equity forwards to buy 4.8 million (2004 – 4.8 million) of its common shares at an average forward price of $50.02 (2004 – $49.25) including $5.15 (2004 – $4.38) per common share of interest expense net of dividends that has been recognized in net earnings and will be paid at termination. The equity forwards allow for settlement in cash, common shares or net settlement. The Company has included a cumulative unrealized market gain of $30 million (2004 – $109 million) in other assets relating to these equity forwards.

**Electricity Forward Contract** The Company entered into an electricity forward contract to minimize price volatility and to maintain a portion of the Company's electricity costs in Ontario, Canada at approximately 2001 rates. This electricity forward contract had an initial term of three years and expired in May 2005.

**Fair Value of Financial Instruments** The fair value of a financial instrument is the estimated amount that the Company would receive or pay to terminate the instrument agreement at the reporting date. The following methods and assumptions were used to estimate the fair value of each type of financial instrument by reference to various market value data and other valuation techniques as appropriate.

The fair values of cash, cash equivalents, short term investments, accounts receivable, bank indebtedness, commercial paper, accounts payable and accrued liabilities approximated their carrying values given their short term maturities.

The fair value of the cross currency basis swaps was estimated based on the market spot exchange rates and forward interest rates and approximated their carrying value.

The fair value of long term debt issues was estimated based on the discounted cash flows of the debt at the Company's estimated incremental borrowing rates for debt of the same remaining maturities.

The fair value of the interest rate swaps was estimated by discounting net cash flows of the swaps at market and forward interest rates for swaps of the same remaining maturities.

The fair value of the equity forwards, which approximated carrying value, was estimated by multiplying the number of the Company's common shares outstanding under the equity forwards by the difference between the market price of its common shares and the average forward price of the outstanding forwards at year end.

In 2004, the fair value of the electricity forward contract was provided by the counterparty based on expected future electricity prices.

| | **2005** | | 2004 | |
|---|---|---|---|---|
| | **Carrying Value** | **Estimated Fair Value** | Carrying Value | Estimated Fair Value |
| Long term debt liability | **$ 4,355** | **$ 5,027** | $ 4,151 | $ 4,665 |
| Interest rate swaps net (liability) asset | | **$ (11)** | $ (2) | $ 5 |
| Electricity forward contract net asset | | | | $ 3 |

**Counterparty Risk** The Company may be exposed to losses should any counterparty to its financial derivative agreements fail 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 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, principal amounts on cross currency basis swaps and equity forwards are each netted by agreement and there is no exposure to loss of the original notional principal amounts on the interest rate swaps and equity forwards.

**Credit Risk** The Company's exposure to credit risk relates to the Company's cash equivalents and short term investments, PC Bank's credit card receivables and accounts receivable from franchisees, associates and independent accounts.

Credit risk associated with the Company's cash equivalents and short term investments results from the possibility that a counterparty may default on the repayment of a security. This risk is mitigated by established 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 issuers.

Credit risk from PC Bank's credit card receivables and receivables from franchisees, associates and independents 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 and actively monitoring the credit card portfolio. In addition, these receivables are dispersed among a large, diversified group of credit card customers. Accounts receivable from franchisees, associates 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.

### Note 19. Contingencies, Commitments and Guarantees

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

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

There are various operating leases that have been committed to. Future minimum lease payments relating to these operating leases are as follows:

| | Amounts Maturing in | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2006 | 2007 | 2008 | 2009 | 2010 | Thereafter to 2049 | **2005 Total** | 2004 Total |
| Operating lease payments | $ 192 | $ 184 | $ 166 | $ 146 | $ 126 | $ 823 | **$ 1,637** | $ 1,400 |
| Expected sub-lease income | (44) | (37) | (31) | (26) | (19) | (46) | **(203)** | (296) |
| Net operating lease payments | $ 148 | $ 147 | $ 135 | $ 120 | $ 107 | $ 777 | **$ 1,434** | $ 1,104 |

At year end, the Company has committed approximately $264 (2004 – $354) with respect to capital investment projects such as the construction, expansion and renovation of buildings and the purchase of real property.

The Company establishes standby letters of credit used in connection with certain obligations mainly related to real estate transactions and benefit programs. The aggregate gross potential liability related to these standby letters of credit is approximately $143 (2004 – $104). Other standby letters of credit related to the financing program for the Company's franchisees and securitization of PC Bank's credit card receivables have been identified as guarantees and are discussed further in the Guarantees section below.

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

**Standby Letters of Credit** A standby letter of credit for the benefit of an independent trust with respect to the credit card receivables securitization program of PC Bank has been issued by a major Canadian bank. This standby letter 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 bank for any amount drawn on the standby letter of credit. The Company believes that the likelihood of this occurrence is remote. The aggregate gross potential liability under this arrangement, which represents 9% (2004 – 15%) of the securitized credit card receivables amount, is approximately $91 (2004 – $118).

A standby letter of credit has been issued by a major Canadian bank in the amount of $42 (2004 – $42) for the benefit of an independent funding trust which provides loans to the Company's franchisees for their purchase of inventory and fixed assets, mainly fixturing and equipment. The amount of the standby letter of credit is based on a formula and is equal to approximately 10% of the principal amount of the loans outstanding at any point in time. 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 may 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.

**Lease Obligations** In connection with historical dispositions of certain of its assets, the Company has assigned leases to third parties. The Company remains contingently liable for these lease obligations in the event any of the assignees are in default of their lease obligations. The estimated amount for minimum rent, which does not include other lease related expenses such as property tax and common area maintenance charges, is $138 (2004 – $143).

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

## Note 20. Related Party Transactions

The Company's majority shareholder, George Weston Limited, and its affiliates (other than the Company) 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% (2004 – 3%) of the cost of sales, selling and administrative expenses.

**Cost Sharing Agreements** George Weston Limited 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 George Weston Limited concerning these costs, the Company has agreed to be responsible to George Weston Limited for its proportionate share of the costs incurred on its behalf. Payments by the Company pursuant to these cost sharing agreements were approximately $22 (2004 – $21).

**Real Estate Leases** The Company leases certain properties from an affiliate of George Weston Limited, namely office space for approximately $4 (2004 – $3) and a property designated for future development for a total one time payment made in 2004 of $8.

**Borrowings/Lendings** The Company, from time to time, may borrow from or may lend to George Weston Limited on a short term basis at commercial paper rates. There were no such amounts outstanding as at year end.

**Income Tax Matters** From time to time, the Company and George Weston Limited 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 do not have any material impact on the Company.

**Management Agreements** The Company, through Glenhuron, manages certain United States cash, cash equivalents and short term investments for wholly owned non-Canadian subsidiaries of George Weston Limited. Management fees are based on market rates and included in interest expense.

**Sale of Loan Portfolio** During 2005, Glenhuron sold a portfolio of third-party long term loans receivable to a wholly owned subsidiary of George Weston Limited, the Company's majority shareholder. Originally, the loans in this portfolio were acquired from third-party financial institutions in 2001. This transaction was undertaken by Glenhuron as part of its overall ongoing management of its investment portfolio.

The amount of the cash consideration of U.S. $106 was based on a fair market value of the loan portfolio and was approximately equal to carrying value. An independent review of the valuation analysis has been obtained by the Company to ensure that Glenhuron's methodology used in arriving at fair market value was reasonable. As at the date of sale, the current portion of this loan portfolio of U.S. $13 was included in accounts receivable and the long term portion of U.S. $93 was included in other assets.

Glenhuron has entered into an agreement with the George Weston Limited subsidiary for the administration of the loan portfolio.

**Electricity Forward Contract** Pursuant to an agreement between the Company and George Weston Limited, George Weston Limited agreed to remain responsible for its proportionate share of all costs and liability associated with its usage of the Company's electricity forward contract that expired during 2005.

## Note 21. Other Information

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

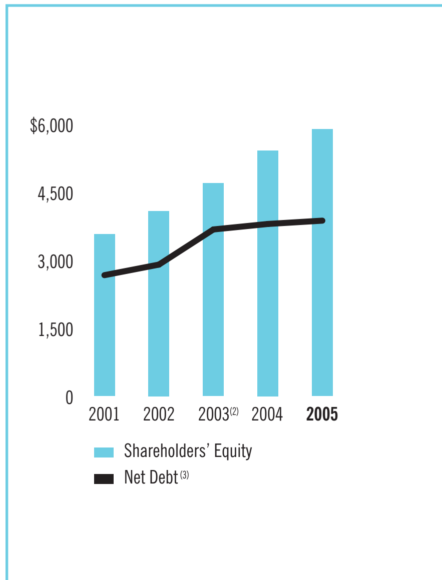
## Five Year Summary[1]

| Year[2]<br>($ millions except where otherwise indicated) | **2005** | 2004 | 2003 | 2002 | 2001 |
|---|---|---|---|---|---|
| **Operating Results** | | | | | |
| Sales | **27,801** | 26,209 | 25,220 | 23,082 | 21,486 |
| Sales excluding impact of VIEs | **27,423** | 26,209 | 25,220 | 23,082 | 21,486 |
| Adjusted EBITDA[3] | **2,132** | 2,125 | 1,881 | 1,671 | 1,451 |
| Operating income | **1,401** | 1,652 | 1,467 | 1,303 | 1,136 |
| Adjusted operating income | **1,600** | 1,652 | 1,488 | 1,317 | 1,136 |
| Interest expense | **252** | 239 | 196 | 161 | 158 |
| Net earnings | **746** | 968 | 845 | 728 | 563 |
| **Financial Position** | | | | | |
| Working capital | **539** | 290 | 356 | 320 | 290 |
| Fixed assets | **7,785** | 7,113 | 6,390 | 5,557 | 4,931 |
| Goodwill | **1,587** | 1,621 | 1,607 | 1,599 | 1,599 |
| Total assets | **13,761** | 12,949 | 12,113 | 11,047 | 10,025 |
| Net debt[3] | **3,901** | 3,828 | 3,707 | 2,932 | 2,699 |
| Shareholders' equity | **5,886** | 5,414 | 4,690 | 4,082 | 3,569 |
| **Cash Flow** | | | | | |
| Cash flows from operating activities | **1,489** | 1,443 | 1,032 | 998 | 818 |
| Capital investment | **1,156** | 1,258 | 1,271 | 1,079 | 1,108 |
| **Per Common Share** ($) | | | | | |
| Basic net earnings | **2.72** | 3.53 | 3.07 | 2.64 | 2.04 |
| Basic earnings before goodwill charges | **2.72** | 3.53 | 3.07 | 2.64 | 2.20 |
| Adjusted basic net earnings[3] | **3.35** | 3.48 | 3.10 | 2.68 | 2.20 |
| Dividend rate at year end | **.84** | .76 | .60 | .48 | .40 |
| Cash flows from operating activities | **5.43** | 5.26 | 3.75 | 3.61 | 2.96 |
| Capital investment | **4.22** | 4.59 | 4.62 | 3.91 | 4.01 |
| Book value | **21.48** | 19.74 | 17.07 | 14.79 | 12.92 |
| Market price at year end | **56.37** | 72.02 | 67.85 | 54.00 | 51.85 |
| **Financial Ratios** | | | | | |
| Adjusted EBITDA margin (%)[3] | **7.8** | 8.1 | 7.5 | 7.2 | 6.8 |
| Operating margin (%) | **5.0** | 6.3 | 5.8 | 5.6 | 5.3 |
| Adjusted operating margin (%) | **5.8** | 6.3 | 5.9 | 5.7 | 5.3 |
| Return on average total assets (%)[3] | **11.2** | 14.2 | 13.9 | 13.8 | 13.4 |
| Return on average shareholders' equity (%) | **13.2** | 19.2 | 19.3 | 19.0 | 16.8 |
| Interest coverage | **5.6** | 6.9 | 7.5 | 8.1 | 7.2 |
| Net debt[3] to equity | **.66** | .71 | .79 | .72 | .76 |
| Cash flows from operating activities to net debt[3] | **.38** | .38 | .28 | .34 | .30 |
| Price/net earnings ratio at year end | **20.7** | 20.4 | 22.1 | 20.5 | 25.4 |
| Market/book ratio at year end | **2.6** | 3.6 | 4.0 | 3.7 | 4.0 |

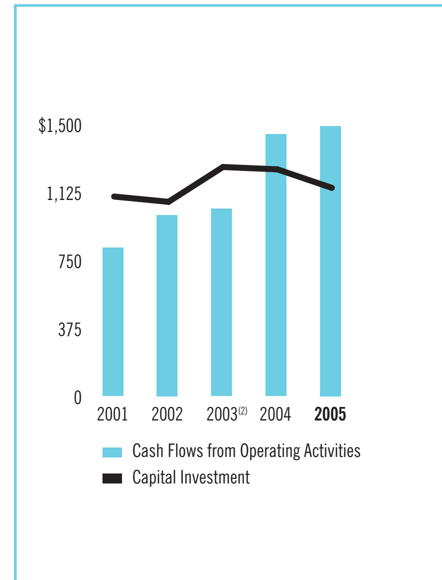
(1) For financial definitions and ratios refer to the Glossary of Terms on page 68.
(2) 2003 contained 53 weeks.
(3) See Non-GAAP Financial Measures on page 33.
(4) Certain prior years' information was reclassified to conform with current year's presentation.
(5) Basic earnings before goodwill charges per common share.

**Shareholders' Equity and Net Debt[3]**

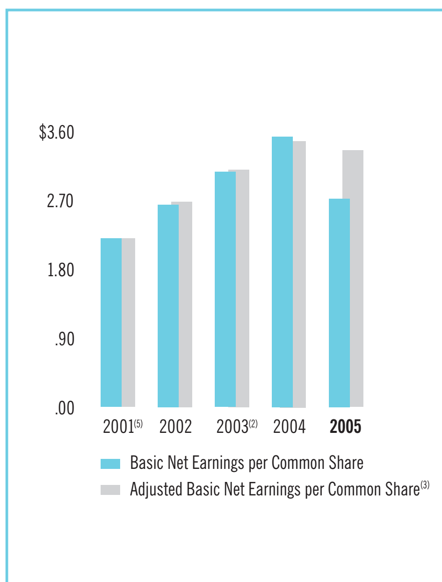
($ millions)




**Cash Flows from Operating Activities and Capital Investment** ($ millions)

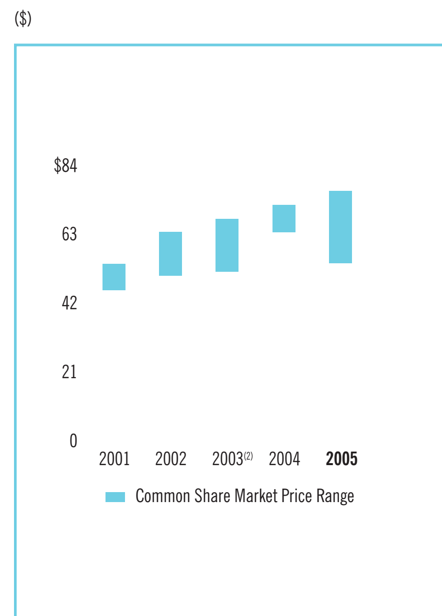



**Basic Net Earnings and Adjusted Basic Net Earnings per Common Share[3]** ($)




**Common Share Market Price Range**

($)



## Glossary of Terms

| Term | Definition |
|---|---|
| **Adjusted basic net earnings per common share** | Basic net earnings per common share adjusted for items that affect the comparability of the financial results and are not a result of ongoing operations (see Non-GAAP Financial Measures on page 33). |
| **Adjusted EBITDA** | Adjusted operating income before depreciation and amortization (see Non-GAAP Financial Measures on page 33). |
| **Adjusted EBITDA margin** | Adjusted EBITDA divided by sales excluding impact of VIEs (see Non-GAAP Financial Measures on page 33). |
| **Adjusted operating income** | Operating income adjusted for items that affect the comparability of the financial results and are not a result of ongoing operations (see Non-GAAP Financial Measures on page 33). |
| **Adjusted operating income margin** | Adjusted operating income divided by sales excluding impact of VIEs (see Non-GAAP Financial Measures on page 33). |
| **Annual Report** | For 2005, the Annual Report consists of the Annual Summary and the Financial Report. |
| **Basic net earnings per common share** | Net earnings available to common shareholders divided by the weighted average number of common shares outstanding during the year. |
| **Basic earnings per common share before goodwill charges** | Net earnings available to common shareholders before goodwill charges, net of tax, divided by the weighted average number of common shares outstanding during the year. |
| **Book value per common share** | Shareholders' equity divided by the number of common shares outstanding at year end. |
| **Capital investment** | Fixed asset purchases. |
| **Capital investment per common share** | Capital investment divided by the weighted average number of common shares outstanding during the year. |
| **Cash flows from operating activities per common share** | Cash flows from operating activities divided by the weighted average number of common shares outstanding during the year. |
| **Cash flows from operating activities to net debt** | Cash flows from operating activities divided by net debt. |
| **Control label** | A brand and associated trademark that is owned by the Company for use in connection with its own products and services. |
| **Conversion** | A store that changes from one Company banner to another Company banner. |
| **Corporate stores sales per average square foot** | Sales by corporate stores divided by the average corporate stores' square footage at year end. |
| **Diluted net earnings per common share** | Net earnings available to common shareholders divided by the weighted average number of common shares outstanding during the period minus the dilutive impact of outstanding stock option grants at period end. |
| **Dividend rate per common share at year end** | Dividend per common share declared in the fourth quarter multiplied by four. |
| **Gross margin** | Sales less cost of sales and inventory shrinkage divided by sales. |
| **Interest coverage** | Operating income divided by interest expense. |
| **Major expansion** | Expansion of a store that results in an increase in square footage that is greater than 25% of the square footage of the store prior to the expansion. |
| **Market/book ratio at year end** | Market price per common share at year end divided by book value per common share at year end. |
| **Minor expansion** | Expansion of a store that results in an increase in square footage that is less than or equal to 25% of the square footage of the store prior to the expansion. |
| **Net debt** | Bank indebtedness, commercial paper, long term debt due within one year, long term debt and debt equivalents less cash, cash equivalents and short term investments (see Non-GAAP Financial Measures on page 33). |
| **Net debt to equity** | Net debt divided by total shareholders' equity. |
| **New store** | A newly constructed store, conversion or major expansion. |
| **Operating income** | Earnings before interest expense and income taxes. |
| **Operating margin** | Operating income divided by sales. |
| **Price/net earnings ratio at year end** | Market price per common share at year end divided by basic net earnings per common share for the year. |
| **Renovation** | A capital investment in a store resulting in no change to the store square footage. |
| **Retail sales** | Combined sales of stores owned by the Company and those owned by the Company's independent franchisees. |
| **Retail square footage** | Retail square footage includes corporate and independent franchised stores. |
| **Return on average total assets** | Operating income divided by average total assets excluding cash, cash equivalents and short term investments (see Non-GAAP Financial Measures on page 33). |
| **Return on average shareholders' equity** | Net earnings available to common shareholders divided by average total common shareholders' equity. |
| **Sales excluding impact of VIEs** | Total sales less sales attributable to the consolidation of VIEs pursuant to AcG 15 (see Non-GAAP Financial Measures on page 33 and Note 2 to the consolidated financial statements). |
| **Same-store sales** | Retail sales from the same physical location for stores in operation in that location in both periods being compared but excluding sales from a store that has undergone a conversion or major expansion in the period. |
| **Variable interest entity ("VIE")** | An entity that either does not have sufficient equity at risk to finance its activities without subordinated financial support or where the holders of the equity at risk lack the characteristics of a controlling financial interest (see Note 2 to the consolidated financial statements). |
| **Weighted average common shares outstanding** | The number of common shares outstanding determined by relating the portion of time within the year the common shares were outstanding to the total time in that year. |
| **Working capital** | Total current assets less total current liabilities. |
| **Year** | A fiscal year ends on the Saturday closest to December 31, usually 52 weeks in duration, but includes 53 weeks every 5 to 6 years. The year ended January 3, 2004 contained 53 weeks. |

## Shareholder and Corporate Information

**National Head Office and Store Support Centre**
Loblaw Companies Limited
1 President's Choice Circle
Brampton, Canada
L6Y 5S5
Tel: (905) 459-2500
Fax: (905) 861-2206
Internet: www.loblaw.ca

**Registered Office**
22 St. Clair Avenue East
Toronto, Canada
M4T 2S7
Tel: (416) 922-8500
Fax: (416) 922-7791

**Stock Exchange Listing and Symbol**
The Company's common shares are listed on the Toronto Stock Exchange and trade under the symbol "L".

**Common Shares**
63% of the Company's common shares are owned beneficially by W. Galen Weston and George Weston Limited.

At year end 2005 there were 274,054,814 common shares outstanding, 5,124 registered common shareholders and 100,737,979 common shares available for public trading.

The average daily trading volume of the Company's common shares for 2005 was 322,169.

**Common Dividend Policy**
It is the Company's policy to maintain a dividend payment equal to approximately 20% to 25% of the prior year's adjusted basic net earnings per common share.[1]

**Common Dividend Dates**
The declaration and payment of quarterly dividends are made subject to approval by the Board of Directors. The anticipated record and payment dates for 2006 are:

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

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

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

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

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

**Independent Auditors**
KPMG LLP
Chartered Accountants
Toronto, Canada

**Annual Meeting**
Loblaw Companies Limited Annual Meeting of Shareholders will be held on Thursday, May 4, 2006 at 11:00 a.m. at the Metro Toronto Convention Centre, Constitution Hall, Toronto, Canada.

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

**Investor Relations**
Shareholders, security analysts and investment professionals should direct their requests to Geoffrey H. Wilson, Senior Vice President, Investor Relations and Public Affairs at the Company's National Head Office or by e-mail at investor@loblaw.ca

Additional financial information has been filed electronically with various securities regulators in Canada through the System for Electronic Document Analysis and Retrieval (SEDAR) and with the Office of the Superintendent of Financial Institutions (OSFI) as the primary regulator for the Company's subsidiary, President's Choice Bank. The Company holds an analyst call shortly following the release of its quarterly results. These calls are archived in the Investor Zone section of the Company's website.

Ce rapport est disponible en français.

This Financial Report was printed in Canada on Husky Offset, manufactured elemental chlorine-free, at a mill independently certified as meeting the procurement provisions of the Sustainable Forestry Initiative® (SFI) standard.

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

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