



Building Out From the Core

2010 ANNUAL REPORT

Loblaw

COMPANIES LIMITED

Loblaw's mission is to be Canada's best food, health and home retailer by exceeding customer expectations through innovative products at great prices.

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Halifax, NS



Toronto, ON



Vancouver, BC



Toronto, ON



Barrie, ON



Toronto, ON



Spryfield, NS



Verdun, QC



Pointe-Aux-Trembles, QC



Sherwood Park, AB



Toronto, ON

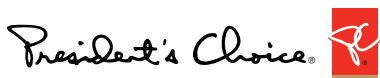


West Vancouver, BC



Loblaw Companies Limited is Canada's largest food distributor and a leading provider of drugstore, general merchandise and financial products and services.

Over
14 million
Canadians shop
with us every week



Loblaw at a Glance

Every day, over 136,000 full-time and part-time Loblaw and franchisee employees serve customers in more than 1,000 corporate and franchised stores from coast to coast. Together with its franchisees, Loblaw is one of Canada's largest private sector employers. Loblaw is committed to being socially responsible by respecting the environment, sourcing with integrity, making a positive difference in the communities it serves, reflecting the nation's diversity and being a great place to work.

22

banners across the country

24

Company and

6

third-party-operated distribution centres service our stores

576

corporate and

451

franchised stores coast to coast

Control Brand Advantage

Loblaw offers customers high-quality products and great value through Canada's strongest control label program with famous brands including *President's Choice*, *no name* and *Joe Fresh*. The Company also offers Canadians innovative financial products and services under the *President's Choice Financial* brand, including *President's Choice Financial MasterCard®* and the *PC points* loyalty program.

#1 & #2

Our *President's Choice* and *no name* control brands are the number one and number two consumer packaged goods brands by sales in Canada, respectively.*

*Source: AC Nielsen Market Track, 52 weeks ending December 18, 2010



WEST



ONTARIO



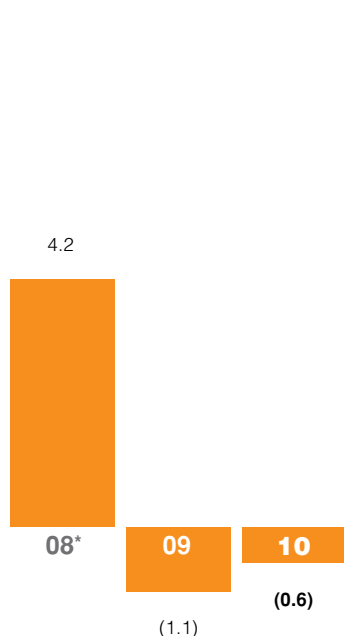
QUEBEC



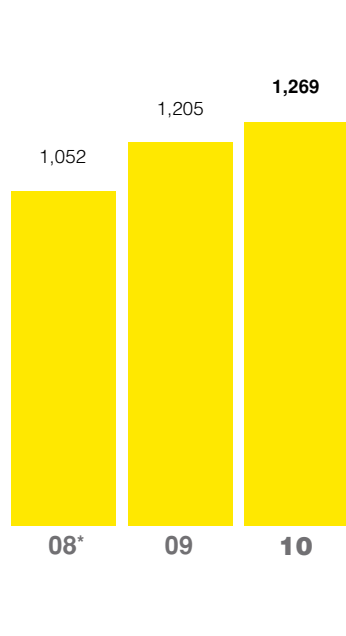
ATLANTIC

Financial Highlights¹

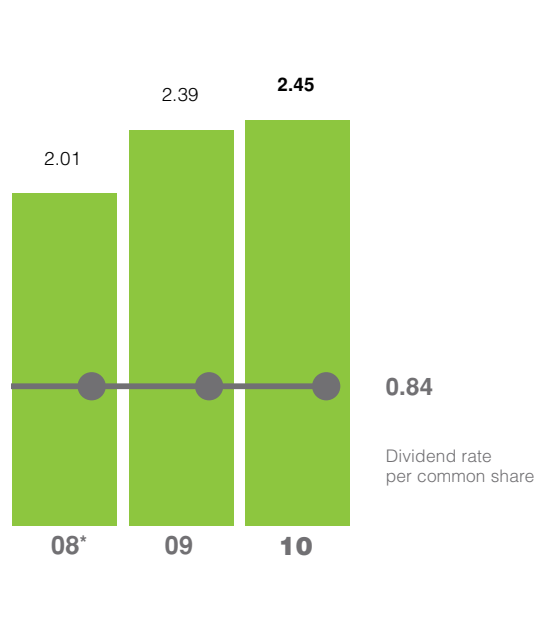
Same-store sales
(decline) growth (%)



Operating income
(\$ millions)



Basic net earnings per
share and dividend rate
per common share (\$)



*53 weeks ending January 3, 2009.

FORWARD-LOOKING STATEMENTS

This Annual Report contains forward-looking statements about Loblaw Companies Limited's (the "Company") objectives, plans, goals, aspirations, strategies, financial condition, obligations, results of operations, cash flows, performance, prospects and opportunities. Words such as "anticipate", "expect", "believe", "foresee", "could", "estimate", "goal", "intend", "plan", "seek", "strive", "will", "may" and "should" and similar expressions, as they relate to the Company and its management, are intended to identify forward-looking statements. These forward-looking statements are not historical facts but reflect the Company's current expectations concerning future results and events. These forward-looking statements are subject to a number of risks and uncertainties that could cause actual results or events to differ materially from current expectations, including the possibility that the Company's plans and objectives will not be achieved. These risks and uncertainties include, but are not limited to, those discussed in the forward-looking statements disclaimer found on page 2 of the 2010 Annual Report – Financial Review, and the Enterprise Risks and Risk Management Section of the Management's Discussion and Analysis on pages 18 to 28 of the 2010 Annual Report – Financial Review. These forward-looking statements reflect management's current assumptions regarding these risks and uncertainties and their respective impact on the Company. Other risks and uncertainties not presently known to the Company or that the Company presently believes are not material could also cause actual results or events to differ materially from those expressed in its forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which reflect the Company's expectations only as of the date of this Annual Report. The Company disclaims any intention or obligation to update or revise these forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

For the years ended January 1, 2011, January 2, 2010 and January 3, 2009
(\$ millions except where otherwise indicated)

2008
(53 weeks)

2009
(52 weeks)

2010
(52 weeks)

OPERATING RESULTS

| | | | |
|--|-----------|-----------|------------------|
| Sales | \$ 30,802 | \$ 30,735 | \$ 30,997 |
| Gross profit | 6,911 | 7,196 | 7,604 |
| Operating income | 1,052 | 1,205 | 1,269 |
| Interest expense and other financing charges | 263 | 269 | 273 |
| Net earnings | 550 | 656 | 681 |

CASH FLOW

| | | | |
|--------------------------------------|-----|-------|--------------|
| Cash flows from operating activities | 960 | 1,945 | 1,594 |
| Capital investment | 750 | 1,067 | 1,280 |

PER COMMON SHARE (\$)

| | | | |
|---|-------|-------|--------------|
| Basic net earnings | 2.01 | 2.39 | 2.45 |
| Dividend rate at year end | 0.84 | 0.84 | 0.84 |
| Cash flows from operating activities ¹ | 3.50 | 7.07 | 5.74 |
| Book value | 21.16 | 22.71 | 24.52 |
| Market price at year end | 35.23 | 33.88 | 40.37 |

FINANCIAL RATIOS

| | | | |
|--|-------|-------|--------------|
| Operating margin | 3.4% | 3.9% | 4.1% |
| EBITDA ² | 1,602 | 1,794 | 1,924 |
| EBITDA margin ² | 5.2% | 5.8% | 6.2% |
| Net debt ² | 3,293 | 2,783 | 2,513 |
| Net debt ² to EBITDA ² | 2.1x | 1.6x | 1.3x |
| Net debt ² to equity ² | 0.5:1 | 0.4:1 | 0.4:1 |
| Interest coverage ¹ | 3.7x | 4.2x | 4.3x |
| Return on average net assets ² | 10.7% | 12.0% | 12.4% |
| Return on average shareholders' equity | 9.7% | 10.9% | 10.4% |

OPERATING STATISTICS

| | | | |
|---|--------|--------|---------------|
| Retail square footage (in millions) | 49.8 | 50.6 | 50.7 |
| Corporate square footage (in millions) | 37.7 | 38.2 | 37.3 |
| Franchise square footage (in millions) | 12.1 | 12.4 | 13.4 |
| Average corporate store size (square feet) | 61,900 | 62,300 | 64,800 |
| Average franchise store size (square feet) | 28,400 | 29,700 | 29,500 |
| Corporate stores sales per average square foot (\$) | 624 | 597 | 601 |
| Same-store sales (decline) growth | 4.2% | (1.1%) | (0.6%) |
| Number of corporate stores | 609 | 613 | 576 |
| Number of franchise stores | 427 | 416 | 451 |
| Percentage of corporate real estate owned | 74% | 72% | 74% |
| Percentage of franchise real estate owned | 48% | 48% | 46% |

¹ For financial definitions and ratios refer to the Glossary of Terms on page 87 of the 2010 Annual Report – Financial Review.

² See Non-GAAP Financial Measures on page 38 of the 2010 Annual Report – Financial Review.



Galen G. Weston
Executive Chairman

As we continue to focus on strengthening our core businesses, we now have an eye on Loblaw's next evolution – new opportunities to build out from the core.

Fellow Shareholders,

In 2010, the fourth year of renewal, Loblaw Companies made steady progress. Every step towards the completion of our program brings us closer to our goal of being the best retailer in Canada.

During the year, food retailers faced a difficult economic environment. Deflationary pressures, including intense promotional activity across the country, made sales growth difficult to achieve. Despite lower prices on a wide variety of goods, Canadians did not buy more. Unemployment, household debt and personal bankruptcies – the key drivers of consumer spending – all remained high during the year, and Canadian consumers became more value-conscious than ever in their weekly grocery shop.

Although consumer confidence has shown some signs of improvement, it is still low, and volumes in the Canadian grocery industry continue to be relatively flat.

In a highly competitive market, and against these economic conditions, Loblaw delivered solid results for 2010. Sales grew by 0.9%, while volume was relatively flat. Our earnings improved by 3.8%, and we finished the year with 12 consecutive quarters of year-over-year EBITDA improvement. Our balance sheet remains strong, and we reduced our net debt by \$270 million to \$2.5 billion. At the same time, we invested \$1.3 billion in capital this year to build out our system's infrastructure and improve our stores.

Since the launch of our internal renewal program, we have focused our efforts and investments on the building blocks of our business – products, stores, systems and colleagues. This year, we have taken measured steps forward in each of these areas.

We invested more than \$700 million directly into our stores, touching more than 200 stores from coast to coast, improving the overall customer proposition through a combination of improved freshness, assortment and customer service. These renovations are performing in line with our expectations and we expect to finish upgrading our network over the next few years.

In addition to renovations, this year, our Ontario stores also benefited from the successful negotiation of a new labour contract that will enable us to improve how we deliver in-store service directly to our customers. These were difficult negotiations but collaboration with our United Food and Commercial Workers Union (UFCW) partners delivered the ratification of five-year collective agreements that met our twin objectives of remaining the highest-paying employer in our industry and giving us significantly enhanced and critical scheduling flexibility.

When combined with our new store time and attendance system (STAS), we now have the management tools and information needed to ensure that the right people are in the right places at the right times. We currently have more than

300 stores using STAS and all corporate stores will be on the system by mid-2011.

Our acquisition of T&T Supermarket Inc. (T&T) in September 2009 continues to provide us with valuable insight into the important and growing Asian market and we are busy integrating that learning into our core business. In 2010, we added another T&T store, bringing the banner's total to 19.

In addition to improving our store base and operational standards, we continued to enhance our key brands. This year, we improved our overall control brand profitability while at the same time investing in innovation and creative marketing programs. Over the summer months, "Canada's Largest BBQ" event toured the country to showcase exciting new products. Our *President's Choice* Ice Cream Shop Flavours ice cream and Angus Beef Sliders proved to be a huge hit with customers as we promoted them through fun events for our customers in their communities. The combination of compelling marketing and excellent execution drove improvements in market share across the entire ice cream and burger categories. This now provides a template for future innovation in, and promotion of, control brands.

Whether it is ice cream, *Joe Fresh* apparel, *PC* mobile phones or *PC Financial* services, our customers expect quality and value from our control brands, which continue to prove themselves as key differentiators and a competitive advantage for Loblaw.

Alongside our progress in store renovations and control brand development, our supply chain continued on its steady improvement and optimization path. Today, we believe that our supply chain is better than it has ever been. We're delivering better value, improved availability and fresher produce – more efficiently every day – but we still have work to do.

In 2010, we completed the national rollout of our transport management system. We continue to implement our new warehouse management system with virtually no disruption to operations. And this year, we opened new distribution centres in Moncton and Regina. As with others opened over the last few years, these centres will improve our route productivity and provide significant delivery efficiencies. Our supply chain teams are also transitioning to a new forecasting system for more accurate ordering and replenishment. As they develop good historical data, we are seeing encouraging improvements in service levels.

The biggest project for Loblaw in 2010 was the ongoing implementation of our new Enterprise Resource Planning (ERP) system. This year, we integrated our general ledger and related financial reporting across the business onto the new ERP system, building on the learnings from our implementations in our real estate and financial services divisions earlier in the year. We also initiated rollouts in merchandising for roughly 20 categories.

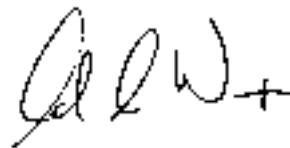
These ERP implementations have been executed successfully without disruptions to our day-to-day business and with each one we learn something new and improve. As we continue to roll out the system through the other parts of the business, we must also maintain our legacy systems. This co-existence elevates our risk and will remain until our final store is converted.

Loblaw experienced many changes during 2010. Our colleagues continue to adapt to and embrace these changes. With the help of increased communication, better training and colleague recognition, we are seeing a higher level of engagement in the workforce. Voluntary turnover in 2010 declined by 11.5% and our efforts to make Loblaw a great place to work were recognized with the Company being named as one of Canada's Top 100 Employers for the second year in a row. Loblaw was also named a Regional Winner in the Canada's 10 Most Admired Corporate Cultures program.

I am pleased with what our Company has accomplished in 2010 and with what has been achieved over the last four years. We are now operating as a centralized, marketing-led retailer and we are investing in our existing asset base to drive profitable growth. We have improved our infrastructure, our stores, our products, our balance sheet and our people. And while there is still a great deal of work to be done, with our five-year renewal period drawing to a close, we are also focused on the future.

As we have developed our thinking around the next stage of growth for the Company, we have also spent considerable time planning management succession. As agreed by the Board of Directors, Vicente Trius will succeed Allan Leighton as President of Loblaw Companies in the second half of 2011. Mr. Trius will bring his vast experience as a global retailer to Canada, building on the solid foundation established by Mr. Leighton and moving the Company further forward.

As you might expect, the future is both bright and challenging. As competitive pressures increase, only the strongest Canadian retailers will prosper. I am confident that the right things are being done to make sure Loblaw Companies will be one of them.



Galen G. Weston
Executive Chairman



7 million
 cans of *President's Choice* 100% Sparkling Fruit Juice sold since May – at two servings per can, that's 14 million servings of fruit!

10 million +
President's Choice Angus Beef Sliders consumed since launch – three sliders = one regular burger. How many can you eat?



Lori Brown Zehrs, Barrie, ON

Lori likes being able to recommend her favourite *PC Organics* products to customers who share her health-conscious lifestyle.

We are proud to be the home of some of Canada's most successful and highly recognized consumer brands, including *President's Choice*, *no name*, *Joe Fresh*, *Exact* and *Teddy's Choice*.

Our control brands are key differentiators and give Loblaw a competitive advantage. They offer our customers quality products and services that can only be found in our stores – making Loblaw banner stores a shopping destination for customers from coast to coast.

In 2010, we focused on improving the profitability of our control brands. Our process involved an in-depth review of every facet of our key control brand products in order to enhance cost efficiency without compromising quality and value for our customers. The improvements we implemented helped to deliver a significant basis point lift in control brand profitability.

The foundation of Loblaw's control brand success is innovation, not only in terms of new products and improvements but also in the innovative marketing campaigns and events we use to reach existing and potential customers. This year we launched more than 1,200 new control brand products, including *President's Choice* Ice Cream Shop Flavours ice cream with 14 nostalgic parlour flavours such as Tiger's Tail, Sprinkle Party Cake and Bubble Gum Candy. The hot-pink Loblaw ice cream truck toured across the country along with our "Canada's Largest BBQ" event to serve Canadians our must-try, mouth-watering products, including our new ice cream, Angus beef sliders and sparkling fruit juices, right in their own communities. The resounding success of our ice cream innovation and promotion drove sales across the entire category and set a new standard for event marketing.



Reduced sodium levels in

130+

control brand products – that's over 27 million fewer grams of sodium sold to consumers



Clockwise from top left *President's Choice* 100% Sparkling Fruit Juice; *President's Choice* Ice Cream Shop; *Natural Value* Department, Zehrs Essa Road, Barrie, ON; *Blue Menu* Cut Beans; *President's Choice* Ice Cream Shop Flavours Ice Cream; *no name* Lemon Juice; *PC Organics* Mild Salsa.

In 2010, we continued with our biggest store revitalization program in 20 years. Investments in our existing stores are focused on making sure that Canadians' favourite Loblaw store locations continue to provide the best shopping experience for them.

As we apply lessons that we learn as we renovate, our process has become faster, less expensive and less disruptive, all of which have a positive impact for our customers.

Store refreshes in the Atlantic region included the conversion of six more *no frills* – today, we have seven *no frills* in that region with our customers benefiting from our discount offering. In Quebec, we franchised 25 *Provigo* stores providing local, family-run businesses in rural communities. Based on our successful “Great Food” initiative in Ontario, we have turned our attention to *Zehrs* and *Fortinos*, with 16 and seven renovations in 2010, respectively. Our *no frills* expansion program in the West has gained critical mass with a total of 28 *no frills* stores to date. We made real headway with renovations of our large *Real Canadian Superstore* locations in the West based on our Produce First model, presenting our customers with the freshest of products upon arrival and a revitalized, optimized general merchandise layout with a new *Joe Fresh* look.



200 +
stores touched as part of revitalization program in 2010, impacting almost 10 million square feet of retail space

\$700 million +
invested in our stores = improved standards, conditions and overall shopping experience



Clockwise from top left *Real Canadian Superstore* Vancouver-Grandview Hwy, Vancouver, BC; *Atlantic Superstore* Barrington Street, Halifax, NS; *Bloor Street Market*, Toronto, ON; *Atlantic Superstore* Barrington Street, Halifax, NS; *Bloor Street Market*, Toronto, ON.



▶ Ron Brown Atlantic Superstore, Halifax, NS

Ron appreciates how the clean and fresh feel of the renovated store matches the quality and freshness of the seafood products he offers our customers.





Cheryl Whitebone Real Canadian Superstore, Sherwood Park, AB

Cheryl finds the new technology systems installed in the store help her complete her inventory checks more efficiently. She likes how much easier it is to find products for customers.



30%

of computer generated reports eliminated with ERP integration – colleagues can get the information they need faster

1 million +

retail-ready cases shipped weekly = less case cutting and shelf stacking, and more customer service



1st

Canadian retailer to pilot Hybrid Class 8 Trucks – improving fuel efficiency and reducing carbon emissions

Supply chain and information technology infrastructure remain key areas of focus for Loblaws. In 2010, we invested nearly half a billion dollars in the infrastructure needed to help us be the best retailer in Canada and position Loblaws for future growth.

Building a strong foundation ensures that our business is able to put the right products and the right people in the right places at the right times – all with the goal of exceeding our customers' expectations today, tomorrow and for years to come.

Our infrastructure renewal program includes both the physical aspects of our supply chain, from warehouses to transportation, and the information technology systems to connect every point in the supply chain. Together, these infrastructure initiatives will give us accurate, up-to-the-minute visibility of our inventory to improve on-shelf availability for our customers. This year, we completed the rollout of our new transport management system, giving our transport teams a single, integrated platform to schedule the most efficient routes for moving products from our suppliers to our distribution centres and on to our stores. We are making steady progress with the implementation of our new Warehouse Management System and have nearly completed the design of our forecasting, planning and replenishment system. We also introduced new retail-ready packaging to our supply chain, making the replenishment process faster and easier for our colleagues and enhancing the shopping experience for our customers.

In 2010, we made significant headway with the implementation of our Enterprise Resource Planning (ERP) system. Loblaws' ERP information technology project is currently the largest retail implementation underway in the world. We completed three successful "go-live" system transitions during the year, integrating our real estate, financial services divisions and our general ledger and related financial reporting across the business onto the new system. We also completed two pilot launches involving approximately 20 categories for our merchandising team without any disruption to the business. There is still much work ahead on this important project. The new ERP system will impact every Loblaws colleague in some way. It will provide standard processes and tools across the Company, leading to greater collaboration, and ultimately, better service to our customers.

Clockwise from top left Real Canadian Superstore Sherwood Park, Sherwood Park, AB; Maple Grove Distribution Centre, Cambridge, ON; Real Canadian Superstore Vancouver-Grandview Hwy, Vancouver, BC; PC Origins Coffee; Maxi Pointe-Aux-Trembles, Pointe-Aux-Trembles, QC; Real Canadian Superstore Sherwood Park, Sherwood Park, AB.





Loblaw is Canada's largest and leading food distributor. We plan on keeping it that way by continually striving to exceed our customers' expectations with innovative products at great prices.

Canadians are increasingly health-conscious in their purchasing decisions. When it comes to providing choices that help consumers to lead healthier lifestyles, Loblaw has been at the forefront with *Blue Menu* and *PC Organics* products offering delicious and nutritious alternatives in multiple food categories.

Complementing our emphasis on healthy eating, our drugstore business is growing, with nearly 500 in-store pharmacies operating across the country, and new, small-format pharmacy pilots launched in 2010. Together with a network of almost 100 medical centres and nearly 60 onsite fitness facilities, Loblaw offers Canadians an effective combination of products and services to help them eat well, stay healthy and feel great.



Canada is one of the world's most diverse, multicultural countries and home to a growing number of new Canadians. We believe that engaging and supporting Canada's diversity is a key area of future growth for Loblaw. Since our acquisition of T&T in September 2009, we have opened two new stores and currently have plans to open three more within the next 12 months. We have a dedicated merchandising team that is focused on providing our culturally diverse customers with well-known brands from their home countries, as well as introducing them to our products and services.

Extending beyond our core focus on food, we continue to build our strength in apparel with *Joe Fresh* and its growing line of accessories and beauty products. In only five years, the *Joe Fresh* brand has become the fourth-largest apparel brand in Canada with positive sales growth despite a tough economy. In 2010, we opened the first of 20 announced true standalone *Joe Fresh* stores on Granville Street in the heart of Vancouver's shopping district to fantastic customer response.

Like all *President's Choice* products, *President's Choice Financial* services delivers unprecedented value to Canadian consumers. The division continues to expand its offering of cost-effective alternatives to traditional banking, credit services, insurance and one of the most popular retail loyalty programs in Canada, *PC points*. In 2010, *President's Choice Financial* relaunched its home and auto insurance under a broker model and offers the best product and value to suit each individual consumer's specific needs. In October, *The Mobile Shop* kiosks were launched in over 500 Loblaw banner stores across the country and now offer a new and expanded line-up of Canada's top nine mobile phone brands, including the *PC* mobile brand.

1 million +

hours of pharmacist/
customer consultations
at Loblaw banner
stores = 1,300
healthcare practitioners
working full time



Clockwise from top left *The Mobile Shop*; *Joe Fresh* Spring 2011 Lookbook; *PC Financial* Pavilion; *Osaka Supermarket*, West Vancouver, BC; *Blue Menu* Yogurt; *Osaka Supermarket*, West Vancouver, BC; *Real Canadian Superstore* Vancouver-Grandview Hwy, Vancouver, BC.



70,000+

additional square feet for
Joe Fresh = more affordable
fashion for our customers



Sun Chun Yan (Sea) *Osaka Supermarket*, North Vancouver, BC

Sun Chun Yan (Sea) is taking courses towards her goal of becoming a professional baker; she appreciates everything that she is learning as part of the in-store bakery team at the new *Osaka Supermarket*.



Corporate Social Responsibility

As Canada's largest grocery retailer, Loblaw feeds Canadians from coast to coast. We also create jobs and help support local economies. Every day, we work hard to make a positive difference in our communities, our country and our planet.

Loblaw's commitment to corporate social responsibility (CSR) is part of that difference. Our five CSR pillars shape the way we do business: Respect the Environment, Source with Integrity, Make a Positive Difference in Our Community, Reflect Our Nation's Diversity and Be a Great Place to Work.

Our initiatives have earned us top accolades such as being included in the Corporate Knights' 2010 Best 50 Corporate Citizens in Canada list and the Globe and Mail's 2010 Corporate Social Responsibility Rankings. Following are some other highlights:

Sustainable Seafood

Loblaw is Canada's largest buyer and seller of seafood. To protect our oceans from overfishing and other detrimental impacts, we are committed to sourcing 100% of seafood sold in Loblaw banner stores from sustainable sources by the end of 2013.

To date, we've changed our procurement practices for fresh swordfish, implemented high-profile customer education campaigns and, at select stores in Ontario and Quebec, introduced *WiseSource* Salmon, which is a more responsibly sourced farmed Atlantic salmon. At year end, we carried 22 sustainable seafood products certified by the Marine Stewardship Council, with many more to come. We are also participating in global initiatives such as the Salmon Aquaculture Dialogue, which aims to develop and implement verifiable environmental and social performance levels that reduce or eliminate the key impacts of salmon farming while permitting the industry to remain economically viable.





Plastic Bag Reduction

Loblaw's results in reducing plastic shopping bag use with the pay-for-plastic-shopping-bag approach speak volumes. In 2010, our customers used 73% fewer plastic shopping bags than they did prior to the pay-for-plastic-shopping-bag approach. Since 2007, we have reduced the number of plastic bags from our stores by 2.5 billion.

Partial proceeds of the plastic bag charge are used in partnership with WWF-Canada to help mobilize Canadians to take action on the environment in events such as the Great Canadian Shoreline Cleanup™, National Sweater Day™ and the Green CommUnity School Grants Program.

Sustainable Food Production

In 2010, we announced the creation of The Loblaw Companies Limited Chair in Sustainable Food Production at the University of Guelph. The Chair was made possible by a \$3 million gift from Loblaw and will be the centre of the University's research focus on creating sustainable, robust food production systems. It will help lead change in food production systems through education, research, practice and outreach within the context of the essential elements of sustainability – the environment, communities and the economy.

grad@Loblaw

Our 18-month rotational program for recent university and college graduates earned Loblaw a spot on Canada's Top Employers for Young People list for 2010. Graduates are hired as full-time salaried employees and work in various store management positions, or in merchandising, supply chain or other departments, before assuming their regular role. To build an additional pipeline of future talent, our goal is to hire 1,000 graduates into the program by 2013.

Solar Energy Projects

To help reduce our carbon footprint, in partnership with Northland Power Inc., we installed photovoltaic panels on the rooftops of two Ontario stores as pilot projects to generate clean, renewable power. The panels generate solar energy, which is supplied to the provincial energy grid. This green energy offsets a portion of the stores' electricity requirements. We'll add two more stores in 2011 and, if the pilots are successful, we'll expand to more stores in the future.



Clockwise from top left President's Choice Children's Charity Breakfast for Learning; MSC-Certified Sustainable Seafood Control Brand Products; Atlantic Superstore Barrington Street, Halifax, NS; Limei Li, grad@Loblaw; Solar Energy Project; President's Choice Green Box.



Corporate Governance Practices

The Board of Directors and management of Loblaw Companies Limited are committed to sound corporate governance practices and believe they contribute to the effective management of the Corporation and its achievement of strategic and operational objectives.

The Governance Committee regularly reviews the Company's corporate governance practices and considers any changes necessary to maintain the Company's high standards of corporate governance in a rapidly changing environment. Our website, www.loblaw.ca, sets out additional governance information, including the Company's Code of Business Conduct (the "Code"), its Disclosure Policy and the Mandates of the Board of Directors (the "Board") and of its committees.

Director Independence

The Canadian Securities Administrators' corporate governance disclosure rules provide that a director is independent if he or she has no material relationship with the Company or its affiliates that could reasonably be expected to interfere with the exercise of the director's independent judgment.

The independent directors of the Board meet separately following each Board meeting and on other occasions as required or desirable. Additional information relating to each director, including other public company boards on which they serve, as well as their attendance record for all Board and committee meetings, can be found in the Company's Management Proxy Circular.

Board Leadership

Galen G. Weston is the Executive Chairman of the Board and Allan L. Leighton is the Deputy Chairman and President of the Company. The Board has established a position description, which sets out key responsibilities for each of the Executive Chairman and the Deputy Chairman and President.

The Executive Chairman directs the operations of the Board. He chairs each meeting of the Board and is responsible for the management and effective functioning 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.

Board Responsibilities and Duties

The Board, directly and through its committees, supervises the management of the business and affairs of the Company. A copy of the Board's mandate can be found at www.loblaw.ca. 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 also oversees the enterprise risk management process. The Board's expectations of management are communicated to management directly and through committees of the Board.

The Board regularly receives reports on the operating results of the Company as well as reports on certain non-operational matters, including insurance, pensions, corporate governance, health and safety, legal and treasury matters.

The directors are also subject to the Code.

Ethical Business Conduct

The Code reflects the Company's long-standing commitment 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. All 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 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 anonymous receipt, retention and handling of complaints regarding accounting, internal control or auditing matters. These procedures are available at www.loblaw.ca.

Board Committees

There are five committees of the Board: Audit; Governance, Employee Development, Nominating and Compensation; Pension; Environmental, Health and Safety; and Executive. The following is a brief summary of some of the responsibilities of each committee.

AUDIT COMMITTEE

The Audit Committee is responsible for supporting the Board in overseeing the quality and 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.

GOVERNANCE, EMPLOYEE DEVELOPMENT, NOMINATING AND COMPENSATION COMMITTEE

The Governance Committee is responsible for the identification of new director nominees for the Board and for the oversight of 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. The Board has appointed the Chair of the Governance Committee, who is an independent director, to serve as lead director.

PENSION COMMITTEE

The Pension Committee is responsible for reviewing the performance and overseeing the administration of the Company's and its subsidiaries' pension plans and pension funds.

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.

Opposite page, top to bottom: Bloor Street Market, Toronto, ON; Atlantic Superstore Barrington Street, Halifax, NS; Mike's no frills, Spryfield, NS.

Board of Directors

Our Board represents the interests of all Loblaw stakeholders. Through its oversight of the management of the Company and its affairs, the Board actively demonstrates Loblaw's commitment to the principles of transparency, accountability and sound corporate governance.

GALEN G. WESTON, B.A., M.B.A.^{1*}

Executive Chairman, Loblaw Companies Limited; Director, Wittington Investments, Limited; Former Director, George Weston Limited.

ALLAN L. LEIGHTON¹

Deputy Chairman and President, Loblaw Companies Limited; Deputy Chairman, George Weston Limited, Selfridges & Co. Ltd.; Former Chairman, Royal Mail Group (U.K. Postal Service); Former President and Chief Executive Officer, Wal-Mart Europe; Former Chief Executive, Asda Stores Ltd.; Director, George Weston Limited, Selfridges & Co. Ltd., Brown Thomas Group Limited, Holt, Renfrew & Co., Limited, BskyB plc and PANDORA A/S.

STEPHEN E. BACHAND, B.A., M.B.A.³

Corporate Director; Retired President and Chief Executive Officer, Canadian Tire Corporation, Limited; Director, Harris Financial Corp, a subsidiary of Bank of Montreal.

PAUL M. BEESTON, C.M., B.A., F.C.A.^{2,3}

President and Chief Executive Officer of Toronto Blue Jays Baseball Team; Former President and Chief Executive Officer, Major League Baseball; Director, President's Choice Bank and Gluskin Sheff & Associates Inc.

GORDON A.M. CURRIE, B.A., LL.B.⁴

Executive Vice President and Chief Legal Officer of the Corporation and George Weston Limited; Former Senior Vice President and General Counsel, Direct Energy; Former Partner, Blake, Cassels & Graydon LLP.

ANTHONY S. FELL, O.C.^{3*,4*}

Corporate Director; Former Chairman, RBC Capital Markets Inc.; Former Chairman and Chief Executive Officer, RBC Dominion Securities; Former Deputy Chairman, Royal Bank of Canada; Director, Bell Aliant Regional Communications Income Fund, BCE Inc. and CAE Inc.

ANTHONY R. GRAHAM^{1,3,4}

President and Director, Wittington Investments, Limited; President and Chief Executive Officer, Sumarria Inc.; Former Vice-Chairman and Director, National Bank Financial; Chairman and Director, President's Choice Bank; Director, George Weston Limited, Brown Thomas Group Limited, Holt, Renfrew & Co., Limited, Selfridges & Co. Ltd., De Bijenkorf B.V., Graymont Limited, Power Corporation of Canada, Power Financial Corporation, Grupo Calidra and Victoria Square Ventures Inc.

JOHN S. LACEY, B.A.

Consultant to the Chairman of the Board of George Weston Limited; Chairman of the Advisory Board of Brookfield Special Situations Funds; Former President and Chief Executive Officer, the Oshawa Group (now part of Sobeys Inc.); Director, George Weston Limited, Telus Corporation and Ainsworth Lumber Co. Ltd.

NANCY H.O. LOCKHART, O. ONT.^{3,5*}

Chief Administrative Officer, Frum Development Group; Former Vice President, Shoppers Drug Mart Corporation; Director, The Stratford Chefs School; Member, Advisory Board for the Belinda Stronach Foundation and Centre for Addiction and Mental Health.

PIERRE MICHAUD, C.M.⁵

President and Director, Capital GVR Inc.; Founder, Chairman and Chief Executive Officer, Réno-Dépôt Inc.; Former Director and Past Chairman, Provigo Inc.; Laurentian Bank of Canada, Director, Bombardier Recreational Products Inc.

THOMAS C. O'NEILL, B. COMM., F.C.A.^{2*}

Corporate Director; Chairman, BCE Inc.; Retired Chairman, PricewaterhouseCoopers Consulting; Former Chief Executive Officer and Chief Operating Officer, PricewaterhouseCoopers LLP; Director, Adecco S.A., Nexen Inc., BCE Inc., St. Michael's Hospital and The Bank of Nova Scotia.

KAREN RADFORD, B.SC., M.B.A.⁵

Corporate Director; Former Executive Vice President and President, Telus; Special Advisor, Youth in Motion; Member, Alberta Children's Hospital Foundation; President and Co-Founder, Women's Leadership Foundation.

JOHN D. WETMORE, B. MATH.^{2,4}

Corporate Director; Former President and Chief Executive Officer, IBM Canada; Retired Vice President, Contact Centre Development, IBM Americas; Director, Research In Motion Ltd.

NOTES

¹ Executive Committee

² Audit Committee

³ Governance, Employee Development, Nominating and Compensation Committee

⁴ Pension Committee

⁵ Environmental, Health and Safety Committee

* Chair of the committee

Our Leadership

GALEN G. WESTON
Executive Chairman

ALLAN L. LEIGHTON
President and Deputy Chairman

MARK C. BUTLER
Executive Vice President, Brands

BARRY K. COLUMB
President, PC Bank

GORDON A.M. CURRIE
Executive Vice President and Chief Legal Officer

SARAH R. DAVIS
Chief Financial Officer

GRANT FROESE
Executive Vice President, Hard Discount and Superstore

S. JANE MARSHALL
Executive Vice President, Loblaw Properties Limited and
Business Strategies

JUDY A. McCRIE
Executive Vice President, Human Resources and
Labour Relations

CALVIN McDONALD
Executive Vice President, Conventional

PETER K. McMAHON
Executive Vice President, Chief Operating Officer

*Top to bottom: Zehrs Essa Road, Barrie, ON; Osaka Supermarket,
West Vancouver, BC; Mike's no frills, Spryfield, NS.*



Shareholder and Corporate Information

NATIONAL HEAD OFFICE AND SUPPORT CENTRE

Loblaw Companies Limited

1 President's Choice Circle
Brampton, Ontario, Canada L6Y 5S5
Tel: 905-459-2500
Fax: 905-861-2206
Web: www.loblaw.ca

STOCK EXCHANGE LISTING AND SYMBOL

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

COMMON SHARES

W. Galen Weston, directly and indirectly, including through his controlling interest in Weston, owns approximately 64% of the Company's common shares.

At year end 2010 there were 280,578,130 common shares issued and outstanding and 100,476,181 common shares available for public trading.

The average daily trading volume of the Company's common shares for 2010 was 359,460.

PREFERRED SHARES

At year end 2010 there were 9,000,000 second preferred shares issued and outstanding and available for public trading.

The average daily trading volume of the Company's second preferred shares for 2010 was 8,387.

COMMON DIVIDEND POLICY

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

COMMON DIVIDEND DATES

The declaration and payment of quarterly dividends are made subject to approval by the Board of Directors. The anticipated record and payment for dates in 2011 are:

| RECORD DATE | PAYMENT DATE |
|-------------|--------------|
| March 15 | April 1 |
| June 15 | July 1 |
| Sept. 15 | Oct. 1 |
| Dec. 15 | Dec. 30 |

PREFERRED SHARE DIVIDEND DATES

The declaration and payment of quarterly dividends are made subject to approval by the Board of Directors. The anticipated payment dates for 2011 are: January 31, April 30, July 31 and October 31.

NORMAL COURSE ISSUER BID

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

VALUE OF COMMON SHARES

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

REGISTRAR AND TRANSFER AGENT

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

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

INDEPENDENT AUDITORS

KPMG LLP
Chartered Accountants
Toronto, Canada

ANNUAL MEETING OF SHAREHOLDERS

Loblaw Companies Limited Annual Meeting of Shareholders will be held on Thursday, May 5, 2011, at 11:00 a.m. EST at the Metro Toronto Convention Centre, South Building, Meeting Room 701, 222 Bremner Boulevard, Toronto, Ontario, 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 the Company 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 Kim Lee, Vice President, Investor Relations 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 at www.loblaw.ca.

VERSION FRANÇAIS DU RAPPORT

Pour obtenir la version français du rapport annuel de Les Companies Loblaw limitée, écrire à :

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
ou
investor@loblaw.ca





Loblaw

COMPANIES LIMITED



Building Out From the Core

Loblaw
COMPANIES LIMITED

2010 Annual Report
Financial Review

2010 Annual Report – Financial Review

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Financial Highlights⁽¹⁾

For the years ended January 1, 2011, January 2, 2010 and January 3, 2009
(\$ millions except where otherwise indicated)

| | 2010 (52 weeks) | 2009 (52 weeks) | 2008 (53 weeks) |
|---|--------------------|--------------------|--------------------|
| Operating Results | | | |
| Sales | \$ 30,997 | \$ 30,735 | \$ 30,802 |
| Gross profit | 7,604 | 7,196 | 6,911 |
| Operating income | 1,269 | 1,205 | 1,052 |
| Interest expense and other financing charges | 273 | 269 | 263 |
| Net earnings | 681 | 656 | 550 |
| Cash Flow | | | |
| Cash flows from operating activities | 1,594 | 1,945 | 960 |
| Capital investment | 1,280 | 1,067 | 750 |
| Per Common Share (\$) | | | |
| Basic net earnings | 2.45 | 2.39 | 2.01 |
| Dividend rate at year end | 0.84 | 0.84 | 0.84 |
| Cash flows from operating activities ⁽¹⁾ | 5.74 | 7.07 | 3.50 |
| Book value | 24.52 | 22.71 | 21.16 |
| Market price at year end | 40.37 | 33.88 | 35.23 |
| Financial Measures and Ratios | | | |
| Operating margin | 4.1% | 3.9% | 3.4% |
| EBITDA ⁽²⁾ | 1,924 | 1,794 | 1,602 |
| EBITDA margin ⁽²⁾ | 6.2% | 5.8% | 5.2% |
| Net debt ⁽²⁾ | 2,513 | 2,783 | 3,293 |
| Net debt ⁽²⁾ to EBITDA ⁽²⁾ | 1.3x | 1.6x | 2.1x |
| Net debt ⁽²⁾ to equity ⁽²⁾ | 0.4:1 | 0.4:1 | 0.5:1 |
| Interest coverage ⁽¹⁾ | 4.3x | 4.2x | 3.7x |
| Return on average net assets ⁽²⁾ | 12.4% | 12.0% | 10.7% |
| Return on average shareholders' equity | 10.4% | 10.9% | 9.7% |
| Operating Statistics | | | |
| Retail square footage (in millions) | 50.7 | 50.6 | 49.8 |
| Corporate square footage (in millions) | 37.3 | 38.2 | 37.7 |
| Franchise square footage (in millions) | 13.4 | 12.4 | 12.1 |
| Average corporate store size (square feet) | 64,800 | 62,300 | 61,900 |
| Average franchise store size (square feet) | 29,500 | 29,700 | 28,400 |
| Corporate stores sales per average square foot (\$) | 601 | 597 | 624 |
| Same-store sales (decline) growth | (0.6%) | (1.1%) | 4.2% |
| Number of corporate stores | 576 | 613 | 609 |
| Number of franchised stores | 451 | 416 | 427 |
| Percentage of corporate real estate owned | 74% | 72% | 74% |
| Percentage of franchise real estate owned | 46% | 48% | 48% |

(1) For financial definitions and ratios refer to the Glossary of Terms on page 87.

(2) See Non-GAAP Financial Measures on page 38.

Management's Discussion and Analysis

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(1) See Non-GAAP Financial Measures on page 38.

Management's Discussion and Analysis

The following Management's Discussion and Analysis ("MD&A") for Loblaw Companies Limited and its subsidiaries (collectively, the "Company" or "Loblaw") should be read in conjunction with the consolidated financial statements and the accompanying notes on pages 48 to 84 of this Financial Report. The consolidated financial statements and the accompanying notes have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and are reported in Canadian dollars. The consolidated financial statements include the accounts of the Company and its subsidiaries and variable interest entities ("VIEs") that the Company is required to consolidate in accordance with Accounting Guideline ("AcG") 15, "*Consolidation of Variable Interest Entities*". A glossary of terms used throughout this Financial Report can be found on page 87. The information in this MD&A is current to February 23, 2011, unless otherwise noted.

1. Forward-Looking Statements

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

These forward-looking statements are subject to a number of risks and uncertainties that could cause actual results or events to differ materially from current expectations, including, but not limited to:

- the possibility that the Company's plans and objectives will not be achieved;
- changes in economic conditions including the rate of inflation or deflation and changes in interest and currency exchange rates;
- changes in consumer spending and preferences;
- heightened competition, whether from new competitors or current competitors;
- changes in the Company's or its competitors' pricing strategies;
- failure of the Company's franchised stores to perform as expected;
- failure to realize sales growth, anticipated cost savings or operating efficiencies from the Company's major initiatives, including investments in the Company's information technology systems, supply chain investments and other cost reduction initiatives, or unanticipated results from these initiatives;
- increased costs relating to utilities, including electricity and fuel;
- the inability of the Company to successfully implement its infrastructure and information technology components of its plan;
- the inability of the Company's information technology infrastructure to support the requirements of the Company's business;
- the inability of the Company to manage inventory to minimize the impact of obsolete or excess inventory and to control shrink;
- failure to execute successfully and in a timely manner the Company's introduction of innovative and reformulated products or new and renovated stores;
- the inability of the Company's supply chain to service the needs of the Company's stores;
- failure to achieve desired results in labour negotiations, including the terms of future collective bargaining agreements, which could lead to work stoppages;
- changes to and failure to comply with the legislative/regulatory environment in which the Company operates, including failure to comply with environmental laws and regulations;
- the adoption of new accounting standards and changes in the Company's use of accounting estimates;
- fluctuations in the Company's earnings due to changes in the value of stock based compensation and equity forward contracts relating to its Common Shares;
- changes in the Company's income, commodity and other tax liabilities including changes in tax laws or future assessments;
- reliance on the performance and retention of third-party service providers including those associated with the Company's supply chain and apparel business;
- public health events including those related to food safety;
- the inability of the Company to collect on its credit card receivables;
- any requirement of the Company to make contributions to its registered funded defined benefit pension plans in excess of those currently contemplated;

- the inability of the Company to attract and retain key executives;
- supply and quality control issues with vendors; and
- failure by the Company to maintain appropriate documentation to support its compliance with accounting, tax or legal rules, regulations and policies.

These and other risks and uncertainties are discussed in the Company's materials filed with the Canadian securities regulatory authorities from time to time, including the Enterprise Risks and Risk Management section of this MD&A. These forward looking statements reflect management's current assumptions regarding these risks and uncertainties and their respective impact on the Company.

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

2. Overview

The Company is a subsidiary of George Weston Limited ("Weston") and is Canada's largest food distributor and a leading provider of drugstore, general merchandise and financial products and services. Loblaw is one of the largest private sector employers in Canada. With more than 1,000 corporate and franchised stores from coast to coast, Loblaw and its franchisees employ approximately 136,000 full-time and part-time employees. Through its portfolio of store formats, Loblaw is committed to providing Canadians with a wide range of products and services to meet the everyday household demands of Canadian consumers. Loblaw is known for the quality, innovation and value of its food offering. It offers Canada's strongest control (private) label program, including the unique *President's Choice*, *no name* and *Joe Fresh* brands. In addition, through its subsidiaries, the Company makes available to consumers *President's Choice Financial* services and offers the *PC* points loyalty program.

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

| | 2010 | 2009 | 2008 |
|---|-------------------|------------|------------|
| | (52 weeks) | (52 weeks) | (53 weeks) |
| (\$ millions except where otherwise indicated) | | | |
| Sales | \$ 30,997 | \$ 30,735 | \$ 30,802 |
| Net earnings | 681 | 656 | 550 |
| Basic net earnings per common share (\$) | 2.45 | 2.39 | 2.01 |
| Diluted net earnings per common share (\$) | 2.44 | 2.38 | 2.01 |
| Total assets | \$ 15,919 | \$ 14,991 | \$ 13,943 |
| Long term debt | 4,646 | 4,505 | 4,235 |
| Capital securities | 221 | 220 | 219 |
| Dividends declared per common share(\$) | 0.84 | 0.84 | 0.84 |
| Dividends declared per Second Preferred Shares, Series A (\$) | 1.49 | 1.49 | 0.91 |

Management's Discussion and Analysis

Total sales increased 0.9% and same-store sales declined 0.6% in 2010 compared to 2009. Sales and same store sales declined 0.2% and 1.1% respectively in 2009 compared to 2008. During the year, the number of corporate stores decreased to 576 (2009 – 613, 2008 – 609) and the number of franchised stores increased to 451 (2009 – 416, 2008 – 427). In 2010, the Company converted 31 corporate stores to franchised stores. In 2009, the number of corporate stores increased due to the addition of 17 stores related to the acquisition of T&T Supermarket Inc. ("T&T"), partially offset by a conversion of corporate stores to franchised stores. The number of franchised stores decreased in 2009 due to the conversion of franchised stores to independent affiliates. During 2010, corporate store sales per average square foot was \$601 (2009 – \$597, 2008 - \$624), with retail square footage increasing to 50.7 million (2009 – 50.6 million, 2008 – 49.8 million).

Net earnings and basic net earnings per common share increased in 2010 by \$25 million and \$0.06, respectively compared to 2009. The improvement was a result of an increase in operating income, substantially offset by an increase in income tax expense, including the impact of a \$12 million charge due to changes in the federal tax legislation that resulted in the elimination of the Company's ability to deduct costs associated with cash-settled stock options. The increase in operating income was primarily due to an improvement in gross profit of \$408 million, which was offset by an increase in selling and administrative expenses of \$278 million and an increase in depreciation and amortization of \$66 million. Operating income in 2010 included incremental costs of \$142 million related to the Company's investment in information technology and supply chain, an asset impairment charge of \$26 million incurred on the closure of a distribution centre in Quebec, a charge of \$17 million incurred in connection with the ratification of new collective agreements with certain Ontario union locals, and an incremental charge of \$15 million in stock-based compensation, net of equity forwards.

In 2009 net earnings and basic net earnings per common share increased by \$106 million and \$0.38 compared to 2008 as a result of an increase in operating income primarily due to an improvement in gross profit of \$285 million, offset by an increase in selling and administrative expenses of \$93 million and an increase in depreciation and amortization of \$39 million. Operating income in 2009 included incremental costs of \$73 million related to the Company's investment in information technology and supply chain, an incremental charge of \$15 million in stock-based compensation, net of equity forwards, and a lower gain on the sale of financial investments by President's Choice Bank ("PC Bank"), a wholly owned subsidiary of the Company.

Total assets in 2010 increased by 6.2% mainly due to an increase in the Company's cash and cash equivalents, short term investments, security deposits and fixed assets as a result of the Company's capital investment program, including its incremental investment in information technology and supply chain. In 2009, total assets increased by 7.5%, primarily as a result of an increase in cash and short term investment balances, an increase in goodwill and intangible assets from the acquisition of T&T and an increase in fixed assets primarily as a result of the Company's capital investment program including its incremental investment in information technology and supply chain as well as the acquisition of a distribution centre.

Long term debt and capital securities increased by 3.0% in 2010 compared to 2009 primarily due to new capital lease obligations, a net increase in Medium Term Notes and the issuance of guaranteed investment certificates, partially offset by a revaluation for foreign exchange rates on US dollar fixed rate private placement notes. Long term debt and capital securities increased by 6.1% in 2009 compared to 2008 due to a net increase in Medium Term Notes and the assumption of a mortgage on the acquisition of a distribution centre. Cash flows from operating activities covered the Company's funding requirements and exceeded the capital investment program in both 2010 and 2009.

3. Vision and Strategies

The Company's mission is to be Canada's best food, health and home retailer by exceeding customer expectations through innovative products at great prices. The Company initiated renewal plans four years ago to achieve its mission by transforming into a centralized, marketing-led organization focused on customers, value, innovative and fresh products and stores, while leveraging its scale and asset base to drive profitable growth.

In 2010, the Company continued to make steady progress in its renewal program. Progress during the year was achieved despite a difficult economic environment. Deflationary pressures combined with heightened promotional and competitive activity resulted in soft sales throughout 2010. Throughout the year, the Company delivered enhanced fresh food offerings, renovated and revitalized stores, and introduced innovative and differentiated control label brands to provide an enhanced customer shopping experience. In addition, the Company continued to invest and build its core infrastructure, including both information technology and supply chain.

Some of Loblaw's key accomplishments in 2010 included:

- Improved fresh food quality and assortment;
- Touched over 200 stores as part of the Company's store revitalization program of which 160 were considered renovations;
- Continued *nofrills* expansion program with an additional nine *nofrills* stores in Western Canada and six more *nofrills* stores in Atlantic Canada;
- Improved overall control brand profitability;
- Completed the roll-out of a new transportation management system and continued to implement a new warehouse management system;
- Enhanced supply chain efficiency that resulted in improved product availability;
- Moved forward in implementing the Enterprise Resource Planning ("ERP") system by integrating the real estate and financial services divisions and the general ledger and related financial reporting across the business onto the new system with nearly 1,000 colleagues now using the system;
- Initiated the next wave of ERP implementation with two successful pilots in merchandising involving approximately 20 categories;
- Strengthened the balance sheet providing enhanced financial flexibility;
- Successfully completed labour negotiations in Ontario and British Columbia providing new and critical scheduling flexibility; and
- Recognized as one of Canada's Top 100 employers.

While the Company achieved many of its goals in 2010, the Company expects to continue the pace and focus on execution of its renewal plan in a market environment that remains unpredictable and competitively intense. In 2011, the Company intends to continue to drive initiatives that strengthen its base business including investments in infrastructure, and keeping a vigilant watch on cost control and cash management as it turns its sights on new opportunities by:

- Building out from its core food business to capitalize on opportunities in apparel, financial services, health and wellness and Canada's multicultural population.
- Continuing to invest in and execute its information technology strategy through the rollout of subsequent supply chain and ERP functionality releases with a focus on rolling-out to its merchandising organization and ensuring converted data has integrity for its ERP implementation;
- Improving in-store, distribution centre, and store support centre processes in an effort to make the business simpler and more efficient;
- Continuing its store upgrade program that will roll out the food renewal and customer service enhancement programs;
- Continuing to innovate its control label offering while enhancing profitability;
- Continuing to improve its general merchandise range, assortment and profitability;
- Focusing on in-store customer service and providing unmatched value; and
- Optimizing its customer offering and shopping experience by re-aligning around a new organizational structure.

4. Key Performance Indicators

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

Management's Discussion and Analysis

Key financial performance indicators are set out below:

| | 2010 (52 weeks) | 2009 ⁽³⁾ (52 weeks) |
|--|--------------------|-----------------------------------|
| Sales growth (decline) | 0.9% | (0.2%) |
| Same-store sales decline | (0.6%) | (1.1%) |
| EBITDA ⁽¹⁾ (\$ millions) | \$ 1,924 | \$ 1,794 |
| EBITDA margin ⁽¹⁾ | 6.2% | 5.8% |
| Net earnings (\$ millions) | \$ 681 | \$ 656 |
| Basic net earnings per common share (\$) | \$ 2.45 | \$ 2.39 |
| Basic net earnings per common share increase | 2.5% | 18.9% |
| Cash flows from operating activities (\$ millions) | \$ 1,594 | \$ 1,945 |
| Net debt ⁽¹⁾ (\$ millions) | 2,513 | 2,783 |
| Net debt ⁽¹⁾ to EBITDA ⁽¹⁾ | 1.3x | 1.6x |
| Net debt ⁽¹⁾ to equity ⁽¹⁾ | 0.4:1 | 0.4:1 |
| Interest coverage ⁽²⁾ | 4.3x | 4.2x |
| Return on average shareholders' equity | 10.4% | 10.9% |
| Return on average net assets ⁽¹⁾ | 12.4% | 12.0% |

(1) See Non-GAAP Financial Measures on page 38.

(2) See glossary of terms on page 87.

(3) Compared to a 53-week year in 2008.

5. Financial Performance

While the Company delivered solid earnings growth, deflationary pressures and competitive intensity resulted in declines in sales and same-store sales, particularly in the fourth quarter 2010.

5.1 Results of Operations

Sales Sales in 2010 increased \$262 million, or 0.9%, to \$31.0 billion compared to \$30.7 billion in 2009.

Total sales, sales growth (decline) and same-store sales declines were as follows:

| For the years ended January 1, 2011 and January 2, 2010 (\$ millions) | 2010 (52 weeks) | 2009 ⁽¹⁾ (52 weeks) |
|--|--------------------|-----------------------------------|
| Total sales | \$ 30,997 | \$ 30,735 |
| Total sales growth (decline) | 0.9% | (0.2%) |
| Same-store sales decline | (0.6%) | (1.1%) |

(1) Compared to a 53-week year in 2008.

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

- same-store sales declined 0.6%;
- T&T sales positively impacted sales by 1.4%;
- sales in food and drugstore were flat;
- sales growth in apparel was strong while sales of other general merchandise declined significantly due to lower discretionary consumer spending and reductions in assortment and square footage;
- gas bar sales increased significantly as a result of higher retail gas prices and strong volume growth;
- the Company's average annual internal retail food price index was deflated. This compared to average annual internal food price inflation in 2009. Average annual national food price inflation was 1.0% (2009 – 5.5%) as measured by "The Consumer Price Index for Food Purchased from Stores" ("CPI"). CPI does not necessarily reflect the effect of inflation on the specific mix of goods sold in Loblaw stores; and
- 11 (2009 – 41) corporate and franchised stores were opened and 13 (2009 – 33) corporate and franchised stores were closed, resulting in a net increase of 0.1 million square feet, or 0.2%.

In 2010, the Company launched over 1,200 new control label products and redesigned the packaging of approximately 300 products. Sales of control label products in 2010 were \$8.2 billion compared to \$8.3 billion in 2009.

Gross Profit 2010 gross profit increased by \$408 million to \$7,604 million (24.5% of sales) compared to \$7,196 million in 2009 (23.4% of sales). The increase in gross profit was attributable to improved control label profitability and continued buying synergies and more disciplined vendor management, a stronger Canadian dollar, improved shrink and the shift of pharmaceutical vendor rebates from selling and administrative expenses to gross profit. Increased transportation costs partially offset these improvements.

Operating Income Operating income for 2010 increased by \$64 million, or 5.3%, to \$1,269 million, resulting in an operating margin of 4.1% compared to 3.9% in 2009. The increases in operating income and operating margin for 2010 were primarily due to the improvement in gross profit and the impact of the acquisition of T&T, partially offset by incremental costs of \$142 million related to the Company's investment in information technology and supply chain including incremental depreciation and amortization of \$59 million, a charge of \$37 million (2009 – \$22 million) related to stock-based compensation net of equity forwards, a \$26 million asset impairment charge on the closure of a distribution centre in Quebec, a charge of \$17 million in connection with the ratification of new collective agreements with certain Ontario union locals, and a charge of \$28 million (2009 – \$27 million) for fixed asset impairments related to asset carrying values in excess of fair values for specific store locations. Operating income in 2009 included a gain of \$8 million from the sale of financial investments by PC Bank.

EBITDA⁽¹⁾ 2010 EBITDA⁽¹⁾ increased by \$130 million, or 7.2%, to \$1,924 million resulting in an EBITDA margin⁽¹⁾ of 6.2% (2009 – 5.8%). The increases in EBITDA⁽¹⁾ and EBITDA margin⁽¹⁾ were primarily due to the increases in operating income and operating margin as described above.

Interest Expense and Other Financing Charges Interest expense consists primarily of interest on short term and long term debt, the interest on derivative instruments, the amortization of financing costs and interest earned on short term investments and security deposits net of interest capitalized to fixed assets. Other financing charges consist of dividends on capital securities. In 2010 interest and other financing charges increased \$4 million, or 1.5%, to \$273 million from \$269 million in 2009 primarily due to an increase in interest on long term debt to \$288 million (2009 – \$282 million). The 2010 weighted average fixed interest rate on long term debt (excluding capital lease obligations) was 6.3% (2009 – 6.4%) and the weighted average term to maturity was 14 years (2009 – 14 years).

Income Taxes The Company's 2010 effective income tax rate increased to 29.8% from 28.7% in 2009. The 2009 tax rate was affected by the inclusion of the impact of a statutory income tax rate reduction and accelerated utilization of loss carry forwards, which did not reoccur in 2010. The 2010 tax rate was further affected by a \$12 million charge related to the changes in the federal tax legislation that resulted in the elimination of the Company's ability to deduct costs associated with cash-settled stock options. Net income taxes paid in 2010 were \$298 million (2009 – \$199 million).

(1) See Non-GAAP Financial Measures on page 38.

Management's Discussion and Analysis

Net Earnings In 2010, net earnings increased by \$25 million, or 3.8%, to \$681 million from \$656 million in 2009. Basic net earnings per common share increased by \$0.06, or 2.5%, to \$2.45 from \$2.39 in 2009.

Basic net earnings per common share were impacted in 2010 by a charge of \$0.10 (2009 – \$0.08) per common share for the net effect of stock-based compensation including equity forwards. The impact of the changes in the federal tax legislation that resulted in the elimination of the Company's ability to deduct costs associated with cash-settled stock options was a charge of \$0.04 (2009 – nil) to basic net earnings per common share. The incremental costs associated with the Company's investment in information technology and supply chain impacted basic net earnings per common share by a charge of \$0.36 (2009 – \$0.19). A charge of \$0.07 (2009 – nil) to basic net earnings per common share was incurred in relation to an asset impairment charge incurred on the closure of a distribution centre in Quebec. Additional fixed asset impairments resulted in a charge of \$0.07 (2009 – \$0.07) to basic net earnings per common share.

5.2 Financial Condition

Financial Ratios The Company's net debt⁽¹⁾ to equity⁽¹⁾ ratio was flat at 0.4:1 at the end of 2010 and is consistent with the Company's internal guideline of less than 1:1. Equity⁽¹⁾ for the purpose of calculating the net debt⁽¹⁾ to equity⁽¹⁾ ratio is defined by the Company as capital securities plus shareholders' equity. The net debt⁽¹⁾ to EBITDA⁽¹⁾ ratio was 1.3 times at the end of 2010 compared to 1.6 times at the end of 2009. The decrease in this ratio was due to the decrease in net debt⁽¹⁾ as described below and the increase in EBITDA⁽¹⁾ as described in Section 5.1.

The increase in operating income as described in Section 5.1 resulted in an improvement in the interest coverage ratio to 4.3 times in 2010 from 4.2 times in 2009.

The 2010 return on average net assets⁽¹⁾ was 12.4% compared to 12.0% in 2009. This ratio was positively impacted by the increase in operating income as described in Section 5.1, partially offset by an increase in average net assets. The 2010 return on average shareholders' equity was 10.4% compared to the 2009 return of 10.9%. The decrease in this ratio was primarily a result of the increase in common shares related to the Dividend Reinvestment Plan ("DRIP").

Equity Forward Contracts As at January 1, 2011, Glenhuron Bank Limited ("Glenhuron") a wholly owned subsidiary of the Company, had cumulative equity forward contracts to buy 1.5 million (2009 – 1.5 million) of the Company's common shares at an average forward price of \$56.26 (2009 – \$66.25) including \$0.04 (2009 – \$10.03) per common share of interest expense. As at January 1, 2011, the cumulative interest, dividends and unrealized market loss of \$24 million (2009 – \$48 million) was included in accounts payable and accrued liabilities. During 2009, Glenhuron paid \$55 million to terminate equity forwards representing 3.3 million shares, which led to the extinguishment of a corresponding portion of the associated liability.

Net Debt⁽¹⁾ As at January 1, 2011, net debt⁽¹⁾ was \$2,513 million compared to \$2,783 million as at January 2, 2010. The decrease of \$270 million was primarily due to positive cash flows from operating activities and proceeds from fixed asset sales, partially offset by fixed asset purchases.

In 2009, net debt⁽¹⁾ decreased by \$510 million due to improvements in non-cash working capital and cash savings associated with the DRIP. The decrease was partially offset by the acquisition of T&T, the long term debt secured by a mortgage associated with the acquisition of a distribution centre and a purchase of common shares for cancellation in the fourth quarter of 2009.

(1) See Non-GAAP Financial Measures on page 38.

6. Liquidity and Capital Resources

6.1 Cash Flows

Major Cash Flow Components

| (\$ millions) | 2010 (52 weeks) | 2009 (52 weeks) | Change |
|----------------------------|--------------------|--------------------|----------|
| Cash flows from (used in): | | | |
| Operating activities | \$ 1,594 | \$ 1,945 | \$ (351) |
| Investing activities | (1,448) | (1,212) | (236) |
| Financing activities | 18 | (173) | 191 |

Cash Flows from Operating Activities Cash flows from operating activities for 2010 were \$1,594 million, which included net earnings of \$681 million, depreciation and amortization of \$655 million and an improvement in non-cash working capital of \$66 million due to changes in accounts payable and accrued liabilities, partially offset by accounts receivable.

Cash flows from operating activities decreased by \$351 million in 2010 to \$1,594 million from \$1,945 million in 2009. In 2009, the cash flows from operating activities were positively impacted by a significant improvement in non-cash working capital as a result of the improvement in inventory levels and changes in accounts payable and accrued liabilities. Improvements in non-cash working capital in 2010 were less than those in 2009 and contributed to the year-over-year decrease in cash flows from operating activities.

Cash Flows used in Investing Activities Cash flows used in investing activities were \$1,448 million compared to \$1,212 million in 2009. The change was primarily due to an increase in fixed asset purchases of \$309 million and a change in security deposits of \$263 million primarily as a result of PC Bank's accumulation of cash of \$167 million in 2010, partially offset by an increase in proceeds from fixed assets sales of \$63 million, and the acquisition of T&T of \$204 million which was completed in 2009.

Capital investment in 2010 was \$1.3 billion (2009 – \$1.1 billion). Approximately 10% (2009 – 9%) of these investments were for new store developments, expansions and land, approximately 44% (2009 – 38%) were for store conversions and renovations, and approximately 46% (2009 – 53%) were for infrastructure investments. The capital investment benefited the regions to varying degrees and strengthened the existing store base. In 2009, the capital investment of \$1.1 billion included the purchase of a distribution centre for \$140 million plus closing costs. The Company assumed long term debt secured by a mortgage of \$96 million in connection with the purchase, resulting in net fixed asset purchases of \$971 million in 2009.

The 2010 corporate and franchised store capital investment program, which included the impact of store openings and closures, resulted in an increase in net retail square footage of 0.2% compared to 2009. During 2010, 11 (2009 – 41) corporate and franchised stores were opened, 13 (2009 – 33) corporate and franchised stores were closed, resulting in a net increase of 0.1 million square feet (2009 – 0.5 million square feet). In 2010, 160 (2009 – 211) corporate and franchised stores underwent renovations.

As at January 1, 2011, the Company had committed approximately \$95 million (2009 – \$76 million) for the construction, expansion and renovation of buildings and the purchase of real property.

The Company expects to invest approximately \$1.0 billion in capital expenditures in 2011. Approximately 50% of these funds are expected to be expended upgrading the information technology and supply chain infrastructure. The remainder will be spent on retail operations as the Company plans to renovate certain banners and to add approximately 1.1 million square feet of retail space.

Management's Discussion and Analysis

Capital Investment and Store Activity

| | 2010 (52 weeks) | 2009 (52 weeks) | % Change |
|---|--------------------|--------------------|----------|
| Capital investment (\$ millions) | \$ 1,280 | \$ 1,067 | 20.0% |
| Corporate square footage (in millions) | 37.3 | 38.2 | (2.4%) |
| Franchise square footage (in millions) | 13.4 | 12.4 | 8.1% |
| Retail square footage (in millions) | 50.7 | 50.6 | 0.2% |
| Number of corporate stores | 576 | 613 | (6.0%) |
| Number of franchised stores | 451 | 416 | 8.4% |
| Percentage of corporate real estate owned | 74% | 72% | |
| Percentage of franchise real estate owned | 46% | 48% | |
| Average store size (square feet) | | | |
| Corporate | 64,800 | 62,300 | 4.0% |
| Franchised | 29,500 | 29,700 | (0.7%) |

Cash Flows from Financing Activities In 2010, cash flows from financing activities were \$18 million compared to cash flows used in financing activities of \$173 million in 2009. The increase in cash flows from financing activities was primarily due to the repayment of the Company's short term debt and bank indebtedness in the second quarter of 2009, an increase in long term debt issued, the purchase of common shares in 2009 and the cash savings associated with the DRIP during 2010, partially offset by repayment of long term debt in 2010.

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

During the second quarter of 2010, the Company issued \$350 million principal amount of 10 year unsecured Medium Term Notes, Series 2-B pursuant to its Medium Term Notes, Series 2 program. Interest on the notes is payable semi-annually at a fixed rate of 5.22%. The notes are unsecured obligations and are redeemable at the option of the Company. In the second quarter of 2009, the Company issued \$350 million principal amount of 5 year unsecured Medium Term Notes, Series 2-A which pay a fixed rate of interest of 4.85% payable semi-annually.

During the second quarter of 2010, the \$300 million, 7.10% Medium Term Note due May 11, 2010 matured and was repaid. In the first quarter of 2009, the \$125 million, 5.75% Medium Term Note matured and was repaid. Subsequent to the end of the year, the \$350 million 6.50% Medium Term Note due January 19, 2011, matured and was repaid.

Employee Future Benefits During 2011, the Company expects to contribute approximately \$100 million to its registered funded defined benefits plans. The actual amount paid may vary from the estimate based on actuarial valuations being completed, market performance and regulatory requirements. The Company also expects to make contributions in 2011 to defined contribution plans and multi-employer pension plans as well as benefit payments to the beneficiaries of the supplemental unfunded defined benefit pension plans and other benefit plans.

6.2 Sources of Liquidity

The Company expects that cash and cash equivalents, short term investments, future operating cash flows and the amounts available to be drawn against its committed credit facility will enable the Company to finance its capital investment program and fund its ongoing business requirements, including working capital, pension plan funding and financial obligations, over the next 12 months. The Company has traditionally obtained its long term financing primarily through a Medium Term Notes program. The Company may refinance maturing long term debt with Medium Term Notes if market conditions are appropriate or it may consider other alternatives. In addition, given reasonable access to capital markets, the Company does not foresee any impediments in obtaining financing to satisfy its long term obligations.

During the third quarter of 2010, the Company's Short Form Base Shelf Prospectus dated June 5, 2008 which allowed for the issuance of up to \$1.0 billion of unsecured debentures and/or preferred shares, expired. During the fourth quarter of 2010, the Company filed a Short Form Base Shelf Prospectus which allows for the issuance of up to \$1.0 billion of unsecured debentures and/or preferred shares over a 25-month period.

During 2008, the Company entered into an \$800 million, 5-year committed credit facility with a syndicate of third party lenders. The facility contains certain financial covenants with which the Company was in compliance throughout the year. In addition to cash and short term investments, this facility is the primary source of the Company's short term funding requirements and permits borrowings having up to a 180-day term that accrue interest based on short term floating interest rates. As at January 1, 2011 and January 2, 2010, the Company had not drawn on the 5-year committed credit facility.

PC Bank participates in various securitization programs that provide the primary source of funds for the operation of its credit card business. Under these securitization programs, a portion of the total interest in the credit card receivables is sold to independent trusts pursuant to co-ownership agreements. PC Bank purchases receivables from and sells receivables to the trusts from time to time depending on PC Bank's financing requirements. In 2010, PC Bank securitized \$600 million (2009 – nil) credit card receivables and repurchased \$690 million (2009 – \$50 million) of co-ownership interests in the securitized receivables from independent trusts. On December 15, 2010, Eagle Credit Card Trust ("Eagle"), an independent trust through which the Company securitizes its accounts receivable, issued two series of senior and subordinated notes maturing December 17, 2013 and December 17, 2015 for notional amounts of \$250 million and \$350 million respectively. A portion of the securitized receivables was also renewed for two years during 2010.

The independent trusts' recourse to PC Bank's assets is limited to PC Bank's excess collateral of \$114 million as at January 1, 2011 (January 2, 2010 – \$121 million) as well as standby letters of credit issued by the Company as at January 1, 2011 of \$48 million (January 2, 2010 – \$116 million) based on a portion of the securitized amount.

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

During 2010, Dominion Bond Rating Service and Standard & Poor's reaffirmed the Company's credit ratings and trend and outlook, respectively. These rating organizations base their forward-looking credit ratings on both quantitative and qualitative considerations.

The following table sets out the current credit ratings of the Company:

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

Management's Discussion and Analysis

During the second quarter of 2010, Loblaw renewed its Normal Course Issuer Bid ("NCIB") to purchase on the Toronto Stock Exchange ("TSX"), or to enter into equity derivatives to purchase, up to 13,865,435 of the Company's common shares, representing approximately 5% of the common shares outstanding. In accordance with the requirements of the TSX, any purchases must be at the then market prices of such shares. During 2010, the Company did not purchase any shares under its NCIB. During 2009, the Company purchased for cancellation 1,698,400 of its common shares at a price of \$33.14. In 2011, the Company intends to renew its NCIB.

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

The gross principal amount of loans issued to the Company's independent franchisees by the independent funding trusts as at January 1, 2011 was \$405 million (2009 – \$390 million) including \$202 million (January 2, 2010 – \$163 million) of loans payable by VIEs consolidated by the Company. The Company has agreed to provide credit enhancement of \$66 million (2009 – \$66 million) in the form of a standby letter of credit for the benefit of the independent funding trust representing not less than 15% of the principal amount of the loans outstanding. This standby letter of credit has never been drawn upon. This credit enhancement allows the independent funding trust to provide financing to the Company's independent franchisees. As well, each independent franchisee provides security to the independent funding trust for its obligations by way of a general security agreement. In the event that an independent franchisee defaults on its loan and the Company has not, within a specified time period, assumed the loan, or the default is not otherwise remedied, the independent funding trust would assign the loan to the Company and draw upon this standby letter of credit.

During the second quarter of 2010, the \$475 million, 364-day revolving committed credit facility that is the source of funding to the independent trusts was renewed. The financing structure has been reviewed and the Company has determined there were no additional VIEs to consolidate as a result of this financing.

Capital Securities 12.0 million non-voting Second Preferred Shares, Series A, are authorized, 9.0 million of which were outstanding at year end. These preferred shares are classified as capital securities and included in long term liabilities on the consolidated balance sheet.

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

Common Share Capital An unlimited number of common shares is authorized, 280,578,130 of which were outstanding at year end. Further information on the Company's outstanding share capital is provided in note 19 to the consolidated financial statements.

At year end, a total of 9,320,865 stock options were outstanding, representing 3.3% of the Company's issued and outstanding common shares, which was within the Company's internal guideline of no more than 5%. Each stock option is exercisable into one common share of the Company at the price specified in the terms of the option agreement, or option holders may elect to receive in cash the share appreciation value equal to the excess of the market price at the date of exercise over the specified option price. Subsequent to the end of 2010, the right to receive a cash payment in lieu of exercising an option for shares was removed. Further information on the Company's stock option plans is provided in note 21 to the consolidated financial statements.

Dividends The declaration and payment of common share dividends are at the discretion of the Board of Directors of the Company ("Board") which takes into account the Company's financial results, capital requirements, available cash flow and other factors considered relevant from time to time. Over the long term, the Company's objective is for its common share dividend payment ratio to be in the range of 20% to 25% of the prior year's basic net earnings per common share adjusted as appropriate for items which are not regarded to be reflective of ongoing operations giving consideration to the year-end cash position, future cash flow requirements and investment opportunities. Dividends on the preferred shares shall be entitled to preference over the common shares with respect to the priority in the payment of dividends and with respect to the priority in the distribution of assets of the Company in the event of liquidation, dissolution, or winding up of the Company. During 2010, the Board declared dividends of \$0.84 (2009 - \$0.84) per common share. During 2010, the Board declared dividends of \$1.49 (2009 – \$1.49) per Second Preferred Share, Series A. For financial statement presentation purposes, Second Preferred Share, Series A have been classified as Capital Securities and the associated dividend of \$14 million (2009 – \$14 million) is included as a component of

interest expense and other financing charges in the Consolidated Statement of Earnings (see note 4). Subsequent to year end, the Board declared a quarterly dividend of \$0.21 per common share payable April 1, 2011 and a quarterly dividend of \$0.37 per Second Preferred Share, Series A payable April 30, 2011. At the time such dividends are declared, the Company identifies on its website (www.loblaw.ca) the designation of eligible and ineligible dividends in accordance with the administrative position of the Canada Revenue Agency (CRA).

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

6.3 Contractual Obligations

The following illustrates certain of the Company’s significant contractual obligations and discusses other obligations as at January 1, 2011:

Summary of Contractual Obligations

| (\$ millions) | Payments due by year | | | | | | Total |
|---|----------------------|---------------|---------------|---------------|---------------|-----------------|-----------------|
| | 2011 | 2012 | 2013 | 2014 | 2015 | Thereafter | |
| Long term debt (including capital lease obligations) | \$ 433 | \$ 77 | \$ 419 | \$ 482 | \$ 182 | \$ 3,053 | \$ 4,646 |
| Operating leases ⁽¹⁾ | 219 | 199 | 177 | 156 | 128 | 629 | 1,508 |
| Contracts for purchases of Real property and capital Investment projects ⁽²⁾ | 92 | – | – | 3 | – | – | 95 |
| Purchase obligations ⁽³⁾ | 39 | 33 | 26 | 10 | 10 | – | 118 |
| Total contractual obligations | \$ 783 | \$ 309 | \$ 622 | \$ 651 | \$ 320 | \$ 3,682 | \$ 6,367 |

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

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

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

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

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

Management's Discussion and Analysis

6.4 Off-Balance Sheet Arrangements

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

Letters of Credit Standby and documentary letters of credit are used in connection with certain obligations mainly related to real estate transactions, benefit programs, purchase orders and performance guarantees. The aggregate gross potential liability related to the Company's letters of credit is approximately \$325 million (2009 – \$277 million).

Guarantees The Company has entered into various guarantee agreements including standby letters of credit in relation to the securitization of PC Bank's credit card receivables, third-party financing made available to the Company's independent franchisees, and obligations to indemnify third parties in connection with leases, business dispositions and other transactions in the normal course of the Company's business. Additionally, the Company has a guarantee on behalf of PC Bank in the amount of US \$180 million. For a detailed description of the Company's guarantees, see note 26 to the consolidated financial statements.

Securitization of Credit Card Receivables PC Bank participates in bank supported and term securitization programs. Under these programs, PC Bank sells a portion of the total interest in its credit card receivables to independent trusts in exchange for cash. The trusts fund these purchases by issuing debt securities in the form of asset-backed commercial paper or asset-backed term notes to third-party investors. The securitizations are accounted for as asset sales only when PC Bank transfers control of the transferred assets and receives consideration other than beneficial interests in the transferred assets. All transactions between the trusts and PC Bank have been accounted for as sales as contemplated by Canadian GAAP, specifically AcG 12, "*Transfers of Receivables*". The trusts are either not controlled by PC Bank or are qualifying special purpose entities and therefore the financial results of the trusts are not included in the Company's consolidated financial statements.

PC Bank sells interest in its credit card receivables to the trusts on a fully serviced basis. PC Bank does not receive a servicing fee from the trusts for its servicing responsibilities and accordingly a servicing obligation is recorded. When a sale occurs, PC Bank retains rights to future cash flows after obligations to the investors in the trusts have been met, which is considered to be a retained interest. The independent trusts' recourse to PC Bank's assets is limited to PC Bank's excess collateral as well as standby letters of credit provided by major Canadian chartered banks for 9% (2009 – 9%) on a portion of the securitized amount. These standby letters of credit could be drawn upon in the event of a major decline in the income flow from, or in the value of, the securitized credit card receivables. The subordinated notes issued by Eagle provide credit support to those notes which are more senior. The retained interest is recorded at fair value.

As at year end 2010, the total amount of securitized credit card receivables outstanding which PC Bank continues to service was \$1.6 billion (2009 – \$1.7 billion) and the associated retained interest was \$21 million (2009 – \$13 million). During 2010, PC Bank earned income of \$245 million (2009 – \$235 million) related primarily to PC Bank's rights to excess cash flows earned on the securitized credit card receivables. In the absence of securitization, the Company would be required to use its cash and short term investments or raise alternative financing by issuing debt or equity instruments. Further disclosure regarding this arrangement is provided in notes 8 and 26 to the consolidated financial statements.

Independent Funding Trusts Certain independent franchisees of the Company obtain financing through a structure involving independent trusts, which were created to provide loans to the independent franchisees to facilitate their purchase of inventory and fixed assets, consisting mainly of fixtures and equipment. Further disclosure regarding this arrangement is provided in Section 6.2, "Independent Funding Trusts" and in note 26 to the consolidated financial statements.

7. Quarterly Results of Operations

7.1 Results by Quarter

Under an accounting convention common in the food distribution industry the Company follows a 52-week reporting cycle which periodically necessitates a fiscal year of 53 weeks. 2008 was a 53-week fiscal year. The 52-week reporting cycle 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.

Summary of Quarterly Results (unaudited)

| (\$ millions except where otherwise indicated) | 2010 | | | | | 2009 | | | | |
|--|-----------------------------|------------------------------|-----------------------------|------------------------------|----------------------------------|-----------------------------|------------------------------|-----------------------------|---|---|
| | First Quarter (12 weeks) | Second Quarter (12 weeks) | Third Quarter (16 weeks) | Fourth Quarter (12 weeks) | Total (audited) (52 weeks) | First Quarter (12 weeks) | Second Quarter (12 weeks) | Third Quarter (16 weeks) | Fourth Quarter (12 weeks) ⁽¹⁾ | Total (audited) (52 weeks) ⁽²⁾ |
| Sales | \$6,926 | \$7,317 | \$9,593 | \$7,161 | \$30,997 | \$6,718 | \$7,233 | \$9,473 | \$7,311 | \$30,735 |
| Net earnings | 137 | 180 | 213 | 151 | 681 | 109 | 193 | 189 | 165 | 656 |
| Net earnings per common share | | | | | | | | | | |
| Basic (\$) | 0.50 | 0.64 | 0.77 | 0.54 | 2.45 | 0.40 | 0.70 | 0.69 | 0.60 | 2.39 |
| Diluted (\$) | 0.49 | 0.64 | 0.76 | 0.54 | 2.44 | 0.40 | 0.70 | 0.69 | 0.59 | 2.38 |
| Average national food price inflation | 0.7% | 0.2% | 1.3% | 1.5% | 1.0% | 9.0% | 7.4% | 4.2% | 1.6% | 5.5% |
| Sales growth (decline) | 3.1% | 1.2% | 1.3% | (2.1%) | 0.9% | 2.9% | 2.8% | (0.2%) | (5.6%) | (0.2%) |
| Same-store sales growth (decline) | 0.3% | (0.3%) | (0.4%) | (1.6%) | (0.6%) | 2.1% | 2.5% | (0.6%) | (7.8%) | (1.1%) |
| T&T acquisition impact on sales | 2.0% | 1.9% | 1.7% | 0.0% | 1.4% | n/a | n/a | 0.2% | 1.8% | 0.5% |

(1) As compared to a 13-week quarter in 2008

(2) As compared to a 53-week year in 2008.

The Company's average quarterly internal retail food price inflation/deflation for 2009 and 2010 remained lower than the average quarterly national food price inflation as measured by CPI. CPI does not necessarily reflect the effect of inflation on the specific mix of goods sold in Loblaw stores.

In the last eight quarters, net retail square footage increased by 0.9 million square feet, to 50.7 million square feet, including the acquisition of 17 T&T stores in the third quarter of 2009 which increased net retail square footage by 0.8 million square feet.

Fluctuations in quarterly net earnings during 2010 reflect the underlying operations of the Company as well as the impact of specific charges including the impact of stock-based compensation, net of equity forwards and costs related to the incremental investment in information technology and supply chain. Quarterly net earnings are also impacted by seasonality and the timing of holidays.

7.2 Fourth Quarter Results

The following is a summary of selected consolidated unaudited financial information for the fourth quarter of 2010. This information was prepared in accordance with Canadian GAAP and is reported in Canadian dollars.

Management's Discussion and Analysis

Selected Consolidated Information for the Fourth Quarter

(unaudited)

| (\$ millions except where otherwise indicated) | 2010 (12 weeks) | 2009 (12 weeks) |
|--|--------------------|--------------------|
| Sales | \$ 7,161 | \$ 7,311 |
| Gross profit | 1,774 | 1,728 |
| Operating income | 289 | 277 |
| Interest expense and other financing charges | 63 | 64 |
| Income taxes | 71 | 39 |
| Net earnings | 151 | 165 |
| Basic net earnings per common share (\$) | 0.54 | 0.60 |
| Cash flows from (used in): | | |
| Operating activities | 603 | 615 |
| Investing activities | (481) | (647) |
| Financing activities | 6 | (51) |
| Dividends declared per common share (\$) | 0.21 | 0.21 |
| Dividends declared on second preferred share Series A (\$) | 0.37 | 0.37 |

Total sales, sales declines and same-store sales declines were as follows:

| (\$ millions) | 2010 (12 weeks) | 2009 ⁽¹⁾ (12 weeks) |
|--------------------------|--------------------|-----------------------------------|
| Total sales | \$ 7,161 | \$ 7,311 |
| Total sales decline | (2.1%) | (5.6%) |
| Same-store sales decline | (1.6%) | (7.8%) |

(1) As compared to a 13-week quarter in 2008.

Sales for the fourth quarter decreased 2.1% to \$7,161 million compared to \$7,311 million in the fourth quarter of 2009.

The following factors explain the major components that influenced sales for the fourth quarter of 2010 compared to the fourth quarter of 2009:

- same-store sales declined 1.6%;
- sales in food declined marginally;
- sales in drugstore declined moderately, impacted by deflation due to regulatory changes in Ontario and the impact of generic versions of certain prescription drugs;
- sales growth in apparel was moderate while sales of other general merchandise declined significantly due to lower discretionary consumer spending and reductions in assortment and square footage;
- gas bar sales growth was strong as a result of higher retail gas prices and moderate volume growth;
- the Company's average quarterly internal retail food price index was flat. This compared to average quarterly internal food price deflation in the fourth quarter of 2009. Average quarterly national food price inflation was 1.5% as measured by CPI. CPI does not necessarily reflect the effect of inflation on the specific mix of goods sold in Loblaw stores; and
- during the fourth quarter of 2010, six corporate and franchised stores were opened and one corporate store was closed, resulting in a net increase of 0.1 million square feet or 0.3%.

Gross profit increased by \$46 million to \$1,774 million (24.8% of sales) in the fourth quarter of 2010 compared to \$1,728 million (23.6% of sales) in 2009. This increase was primarily attributable to improved control label profitability and continued buying synergies and disciplined vendor management, the shift of pharmaceutical vendor rebates from selling and administrative expenses to gross profit, improved shrink and a stronger Canadian dollar. Increased transportation costs partially offset these improvements.

Operating income increased by \$12 million to \$289 million for the fourth quarter of 2010 compared to \$277 million in 2009. Operating margin was 4.0% for the fourth quarter of 2010 compared to 3.8% in 2009. Contributing to the increase in operating income was improved gross profit as described above, partially offset by incremental costs of \$27 million related to the Company's investment in information technology and supply chain including incremental depreciation and amortization of \$14 million, a charge of \$7 million (2009 –\$5 million) related to stock-based compensation net of equity forwards and a charge of \$28 million (2009 - \$27 million) for fixed asset impairments related to asset carrying values in excess of fair values for specific store locations.

EBITDA⁽¹⁾ increased by \$22 million, or 5.2%, to \$442 million in the fourth quarter of 2010 compared to \$420 million in the fourth quarter of 2009. EBITDA margin⁽¹⁾ increased to 6.2% compared to 5.7% in the fourth quarter of 2009. The increases in EBITDA⁽¹⁾ and EBITDA margin⁽¹⁾ were primarily due to the increase in operating income and operating margin.

Total interest expense and other financing charges for the fourth quarter of 2010 were \$63 million compared to \$64 million in 2009.

The effective income tax rate in the fourth quarter of 2010 was 31.4% (2009 – 18.3%). The 2009 tax rate was affected by the inclusion of the impact of a statutory income tax rate reduction and accelerated utilization of loss carry forwards, which did not reoccur in 2010. The 2010 tax rate was further affected by a \$12 million charge related to the changes in the federal tax legislation that resulted in the elimination of the Company's ability to deduct costs associated with cash-settled stock options. Net income taxes paid in the fourth quarter were \$81 (2009 – \$15).

Net earnings for the fourth quarter decreased by \$14 million, or 8.5%, to \$151 million from \$165 million in the fourth quarter of 2009. Basic net earnings per common share for the fourth quarter decreased by \$0.06, or 10%, to \$0.54 from \$0.60 in the fourth quarter of 2009. Basic net earnings per common share were impacted in the fourth quarter of 2010 by a charge of \$0.02 (2009 – \$0.01) per common share for the net effect of the stock-based compensation net of equity forwards. The impact of the change in federal tax legislation that resulted in the elimination of the Company's ability to deduct costs associated with cash-settled stock options was a charge of \$0.04 to basic net earnings per common share in the fourth quarter of 2010. The incremental costs associated with the Company's investments in information technology and supply chain impacted basic net earnings per common share by a charge of \$0.07 (2009 – \$0.03). Fixed asset impairments resulted in a charge of \$0.07 (2009 – \$0.07) to basic net earnings per common share.

Fourth quarter cash flows from operating activities were \$603 million in 2010 compared to \$615 million in the fourth quarter of 2009. The increase can be attributed to the settlement of equity forward contracts which occurred in 2009 and the increase in depreciation and amortization, partially offset by the change in non-cash working capital and a decrease in net earnings for the quarter. Fourth quarter cash flows used in investing activities were \$481 million in 2010 compared to \$647 million in 2009. The change was primarily due to the change in short term investments, a change in cash flows from credit card receivables, after securitization, an increase in proceeds from fixed asset sales, partially offset by an increase in fixed asset purchases and the change in security deposits. During the fourth quarter of 2009, a distribution centre that was sold in 2007 was acquired for approximately \$140 million including the assumption of a mortgage for \$96 million. Capital expenditures for the fourth quarter were approximately \$453 million (2009 – \$461 million). Fourth quarter cash flows from financing activities were \$6 million in 2010 compared to cash flows used in financing activities of \$51 million in 2009. The change was primarily due to the purchase of common shares in the fourth quarter of 2009.

8. Disclosure Controls and Procedures

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

(1) See Non-GAAP Financial Measures on page 38.

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As required by National Instrument 52-109 (Certification of Disclosure in Issuers' Annual and Interim Filings), the Executive Chairman, as Chief Executive Officer, and the Chief Financial Officer have caused to be evaluated under their supervision the effectiveness of such disclosure controls and procedures. Based on that evaluation, they have concluded that the design and operation of the system of disclosure controls and procedures were effective as at January 1, 2011.

9. Internal Control over Financial Reporting

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

As required by National Instrument 52-109 (Certification of Disclosure in Issuers' Annual and Interim Filings), the Executive Chairman, as Chief Executive Officer, and the Chief Financial Officer have caused to be evaluated under their supervision the effectiveness of such internal controls over financial reporting using the framework established in 'Internal Control – Integrated Framework (COSO Framework) published by The Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on that evaluation, they have concluded that the design and operation of the Company's internal controls over financial reporting were effective as at January 1, 2011.

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

Changes in Internal Control over Financial Reporting Management has also evaluated whether there were changes in the Company's internal controls over financial reporting that occurred during the period beginning on October 10, 2010 and ended on January 1, 2011 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. Management has determined that no material changes occurred during this period.

During the first and third quarters of 2010, the Company successfully implemented the first and second phases of its Enterprise Resource Planning system. The implementation resulted in material changes in those periods to the internal controls over financial reporting for the Company's real estate and financial services divisions, corporate administration functions and the general ledger.

10. Enterprise Risks and Risk Management

The Company is committed to establishing a framework that ensures risk management is an integral part of its activities. To ensure the continued growth and success of the Company, risks are identified and managed through an Enterprise Risk Management ("ERM") program. The Board has approved an ERM policy and oversees the ERM program through approval of the Company's risks and risk prioritization. The ERM program assists all areas of the business in managing appropriate levels of risk tolerance by bringing a systematic approach, methodology and tools for evaluating, measuring and monitoring key risks. The results of the ERM program and other business planning processes are used to identify emerging risks to the Company, prioritize risk management activities and develop a risk-based internal audit plan.

Risk is not eliminated through the ERM program. Risks are identified and managed within acceptable risk tolerances. The ERM program is designed to:

- Promote a cultural awareness of risk management and compliance within the Company;
- Facilitate corporate governance by providing a consolidated view of risks across the Company and insight into the methodologies for identification, assessment, measurement and monitoring of the risks;
- Assist in developing consistent risk management methodology and tools across the organization;
- Ensure that resources are acquired economically, used efficiently and adequately protected; and
- Allow the Company to focus on its key risks in the business planning process and optimize financial performance through responsible risk management.

Risk identification and assessments are important elements to the Company's ERM framework. An annual ERM assessment is completed to assist in the update and identification of financial, operational or reputational risks affecting the Company and to effectively prioritize the risks. The annual ERM assessment is primarily carried out through interviews and risk assessments with senior management. Risks are assessed and evaluated based on the Company's vulnerability to the risk and the potential impact that the underlying risk would have on the Company's ability to execute its strategies and achieve its objectives. Risk owners are assigned relevant risks and metrics are developed for the top risks for quarterly monitoring. Each quarter, management provides an update to the Audit Committee of the status of the top risks based on significant changes from the prior quarter, anticipated impacts in future quarters and significant changes in key risk metrics. In addition, the long-term (1-3 year) risk level is assessed in order to monitor potential long term impacts on the risk which may assist in risk mitigation planning activities.

The Internal Audit and Risk Management group manages the ERM program through the development of the risk framework and methodologies, completion of the annual ERM assessment, continuous monitoring of the key risks and quarterly reporting to the Audit Committee. The accountability for oversight of the management of each risk is allocated by the Audit Committee to either the full Board of Directors or to a Committee of the Board. At least once a year, the relevant business owners update the applicable Committee or the full Board of Directors on their risk management activities over the course of the preceding year.

In the normal course of business, the Company is exposed to financial and market risks that have the potential to negatively affect its financial performance. The Company operates with policies and guidelines covering funding, investing, equity, commodity, foreign currency exchange and interest rate management. Policies and guidelines prohibit the use of any financial derivative instrument for speculative purposes.

The operating, financial and reputational risks and risk management strategies are discussed below. Any of these risks has the potential to negatively affect financial performance. The Company has risk management strategies including insurance programs, which are intended to mitigate the potential impact of these risks. Although these strategies are designed to minimize these risks, the strategies do not guarantee that the associated risks will be mitigated or not materialize or that events or circumstances will not occur which could negatively affect the Company's financial condition or performance.

10.1 Operating Risks and Risk Management

ERP and Other Systems Implementations The Company has under-invested in its information technology ("IT") infrastructure in the past and its systems are in need of upgrading. An IT strategic plan was developed to guide the new systems environment that the Company requires.

In 2010, the Company began to deploy its new ERP system. This project, along with other systems implementations planned for 2011 and beyond, is one of the largest technology infrastructure programs ever implemented by the Company and is fundamental to its long-term growth strategies. The work will transform the systems used in virtually every area of the Company's business. Completing it will require continued focus and significant investment over the next two years. The failure to successfully migrate from legacy systems to the ERP could negatively affect the Company's reputation, operations and its revenues and financial performance. Failure or disruption in the Company's IT systems during the implementation of the ERP or other new systems may result in a lack of relevant and reliable information to enable

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management to effectively achieve its strategic plan or manage the day-to-day operations of the business, causing significant disruptions to business and potential financial losses. In addition, the failure to implement appropriate processes to support the ERP system may result in inefficiencies and duplication in current processes.

Change management risk and other associated risks will arise from the various projects which will be undertaken to upgrade existing systems and introduce new systems. Failure by the Company to appropriately invest in IT or failure to implement IT infrastructure in a timely or effective manner may negatively impact the Company's financial performance.

Information Integrity and Reliability To support the current and future requirements of the business the Company is reliant on IT systems. These systems are essential to provide management with the appropriate information for decision making, including its key performance indicators, and when necessary must be appropriately supported through systems upgrades to and maintenance of infrastructure.

Although the Company has the appropriate controls in place over the conversion of data, the process of converting data from legacy systems to the ERP and other new systems increases the risk of poor data integrity and reliability if the data are not accurate and complete upon conversion. In addition, for the next few years the business will operate in new and old systems at the same time. Ensuring that the data is flowing accurately between all systems and ensuring the integrity of this data once it is converted will be critical to maintain the integrity and reliability of the Company's financial information. Ownership of data management is essential to ensure ongoing reliability and relevancy of the data. Any failure or disruption of these systems or during the data conversion process for the ERP could negatively affect the Company's reputation, its operations, revenues and financial performance. Lack of relevant, reliable and accessible information that enables management to effectively manage the business may preclude the Company from optimizing its overall performance.

Change Management and Process Execution Significant initiatives in support of the Company's renewal plan are underway or planned. These initiatives include the execution of the IT strategic plan and ongoing organizational changes. Success of these initiatives is dependent on management effectively realizing the intended benefits and effectively executing the related processes. To assist in the management of change throughout the organization, the Company has positioned a team to support the major change initiatives in the Company. A team of colleagues has been assigned and is dedicated to business change management activities with a focus on integration of the business process and systems changes through communication, training and other change events in support of major change initiatives within the Company.

Ineffective change management or inexperienced colleagues leading change management could result in disruptions to the operations of the business or affect the ability of the Company to implement and achieve its long term strategic objectives. This could result from a lack of clear accountabilities, communication, training or lack of requisite knowledge, which may cause colleagues to act in a manner which is inconsistent with Company objectives. Failure to properly execute the various processes may increase the risk of customer dissatisfaction, which in turn could adversely affect the reputation, operations and financial performance of the Company. The failure to properly integrate several large, complex initiatives in a timely manner will adversely impact the operations of the Company. If colleagues are not able to develop and perform new roles, processes and disciplines, the Company may not always achieve the expected cost savings and other benefits of its initiatives.

Economic Environment Economic factors that impact consumer spending patterns could deteriorate or remain unpredictable due to global economic volatility. These factors include continued high levels of unemployment, household debt, changes in interest rates, changes in inflation, changes in exchange rates and access to consumer credit. Management regularly monitors economic conditions and estimates their impact on the Company's operations and incorporates these estimates in short term operating and longer term strategic decisions. Despite these activities, one or more of these factors could negatively affect the Company's sales and margins. Inflationary trends are unpredictable and changes in the rate of inflation or deflation will affect consumer prices, which in turn could have a negative impact on the results of the Company.

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

The Company's competitors include traditional supermarket operators, as well as mass merchandisers, warehouse clubs, drugstores, limited assortment stores, discount stores, convenience stores and specialty stores. Many of these competitors now offer a selection of food, drugstore and general merchandise. Others remain focused on supermarket-type merchandise. The Company is also subject to competitive pressures from new entrants into the marketplace and from the expansion or renovation of existing competitors, particularly those expanding into the grocery market. Some of these competitors have extensive resources that allow them to compete vigorously in the market. Several of these competitors operate in a non-union environment. The Company's unionized workforce environment may reduce the ability of the Company to compete on labour costs or may adversely impact the Company's ability to react to the competition in a timely manner. Increased competition and pressures on growth and pricing could adversely affect the Company's ability to achieve its objectives. The Company's inability to effectively predict market activity or compete effectively with its current or future competitors could result in, among other things, reduced market share and lower pricing in response to its competitors' pricing activities.

In addition, competitors could acquire or develop partnerships with other businesses, which could increase their market share or otherwise improve their competitiveness. If significant acquisitions or alliances are undertaken by competitors, the Company could lose opportunities for growth and partnerships in the market or otherwise experience adverse consequences.

The Company monitors its market share and the markets in which it operates and adjusts its operating strategies by closing underperforming stores, relocating stores or reformatting them under a different banner, reviewing and adjusting pricing, product offerings and marketing programs. Failure by the Company to sustain its competitive position could have a negative impact on the revenues and financial performance of the Company.

Food Safety and Public Health The Company is subject to risks associated with food safety and general merchandise product defects. These risks may arise as part of product procurement, distribution, preparation or display, including the development and manufacturing of the Company's control label products. A majority of the Company's sales are generated from food products and thus could be vulnerable in the event of a significant outbreak of food-borne illness or other public health concerns related to food products. The occurrence of such events or incidents could result in negative publicity, damage to the Company's brands and potentially lead to legal claims. In addition, failure to trace or locate any contaminated or defective products may affect the Company's ability to be effective in a recall situation. Any of these events could negatively impact the Company's revenues and financial performance

In addition, failure to maintain the cleanliness and health standards at store level, including pest control, may negatively impact revenues and the reputation of the Company.

The Company has an incident management process in place to manage such events, should they occur. The program identifies risks, provides clear procedures for communication to employees and consumers and is aimed at ensuring that potentially harmful products are expeditiously removed from inventory and are not available for sale. The Company also has extensive food safety procedures and training programs which address safe food handling and preparation standards. The Company endeavours to employ current best practices for the procurement, distribution and preparation and display of food products. Also, it actively supports customer awareness of safe food handling and healthy choices. The Company places special focus on applying a safety and quality management system to ensure its control label products meet all food safety and regulatory requirements. The ability of these programs and procedures to address such events is dependent on their successful execution. The existence of these procedures does not mean that the Company will in all circumstances be able to mitigate the underlying risks and any event related to these matters has the potential to adversely affect the Company's reputation and its financial performance.

Distribution and Supply Chain The need to invest in and improve the Company's supply chain may adversely affect the Company's capacity to effectively and efficiently attract and retain current and potential customers. A significant restructuring of the Company's supply chain will continue for the next eighteen months. Although this initiative is expected to result in improved service levels and product availability for the Company's stores, the scale of the change and the implementation of new processes could cause disruption in the flow of goods to stores, which would negatively affect revenues and financial performance. In addition, the integration of new supply chain systems with the ERP could cause disruptions to the network if not properly executed which would also negatively affect revenues and financial performance.

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Colleague Retention and Succession Planning The degree to which the Company is not effective in establishing appropriate succession planning processes and retention strategies could lead to a lack of requisite knowledge, skills and experience on the part of management. This, in turn, could affect the Company's ability to execute its strategies, efficiently run its operations and meet its goals for financial performance. Effective succession planning for senior management and colleague retention are essential to sustaining the growth and success of the Company. In addition, loss of talent to the competition can be a significant risk to the Company's business strategy. Effective retention strategies will be necessary due to the significant changes, potential increase in workload and marketability of those colleagues who have developed specialized skills during the implementation of the ERP and other significant initiatives in the Company.

Management has implemented new programs throughout 2010 to assist in colleague retention, succession planning and development. These will continue into 2011. The initiatives are focused on improving colleague engagement and succession plans as well as supporting the Company's goal to "Be a Great Place to Work". Should these initiatives not be successful, the Company may not be able to execute its strategies or efficiently run its operations which in turn could negatively affect financial performance.

Merchandising The Company may have inventory that customers don't want or need, is not reflective of current trends in customer tastes, habits, or regional preferences, is priced at a level customers are not willing to pay, is late in reaching the market or does not have optimal commercial product placement on store shelves. Innovation is critical to the Company in order to respond to customer demands and to stay competitive in the marketplace. In addition, the Company's operations as they relate to food, sales volumes and product mix are impacted to some degree by certain holiday periods in the year. In 2010, the active trading initiative was rolled out which included a focus on the merchandising group strategy, structure, roles and process improvements, to assist in installing best practices and efficiencies throughout the merchandising organization. If the Company is not successful with these initiatives, or if merchandising efforts are not effective or responsive to customer demand, the Company's revenues and financial performance could be negatively impacted.

Strategy Development and Execution The long term vision and strategies of the Company must be understood, communicated and properly managed in order to deliver growth for the Company. If these strategies are not clear or if consumer trends and expectations are not considered, stores may not be properly positioned in the marketplace. The execution of the Company's capital plans could pose a risk if they are not aligned with the strategy of the Company. In addition, the Company's ability to operate in the long term is affected by the development and location of real estate and spending decisions made in the short term. Areas of strategic focus are formulated annually by senior management and then communicated throughout the Company. These are reviewed on a periodic basis to drive execution and ensure ongoing relevance. If the Company's vision and strategies are not effectively developed, communicated and executed in the short term and long term, the financial performance of the Company could suffer.

Labour Relations A majority of the Company's store level and distribution centre workforce is unionized. Renegotiating collective agreements may result in work stoppages or slowdowns, delays to construction projects and increases in costs. Any of these could negatively affect the Company's financial performance. The Company successfully negotiated 58 collective agreements in 2010 and the Company continues to negotiate the 86 remaining collective agreements carried over from prior years. In 2011, 49 collective agreements affecting approximately 15,000 colleagues expire with the largest of the agreements covering approximately 11,000 colleagues in Ontario expiring in June 2011. Although the Company attempts to mitigate work stoppages and disputes through early negotiations, work stoppages or slowdowns and the resulting negative effects on revenues and financial performance are possible.

Disaster Recovery and Business Continuity The Company's ability to continue critical operations and processes could be negatively impacted by a weather disaster, work stoppage, prolonged IT failure, terrorist activity, power failures, border closures, a pandemic or other national or international catastrophe. The Company has an enterprise wide business continuity program which is being continually matured. However, ineffective contingency planning could result in reputational and/or financial losses to the Company. There can be no assurance that the existence of the program will ensure that the Company responds appropriately in the event of business interruptions, crises or potential disasters and negative impacts on revenue and financial performance could occur.

Inventory Management Inappropriate inventory management may lead to excess inventory or a shortage of inventory which may impact customer satisfaction and overall financial performance. The Company may experience excess inventory that cannot be sold profitably or which could increase levels of inventory shrink which in turn could negatively impact the Company's financial performance. The Company focuses on reducing inventory levels and early identification of inventory at risk. New information systems are being implemented that are

expected to improve demand forecasting. In order to reduce the amount of excess inventory, the Company monitors the impact of customer trends. Despite these efforts, the Company may experience excess inventory that cannot be sold profitably, which may negatively impact the Company's financial performance.

Privacy and Information Security The Company is subject to various laws regarding the protection of personal information of its customers and colleagues and has adopted a Privacy Code setting out guidelines for the handling of personal information. Any failure of the Company to comply with these laws could result in damage to its reputation and negatively affect financial performance. The Company's information systems contain personal information of customers and colleagues. Any failures or vulnerabilities in these security systems or non-compliance with information security standards, including those in relation to personal information belonging to the Company's customers and colleagues, could result in harm to the reputation of the Company and negatively affect financial performance.

Information security risks will also arise in the implementation of the Company's IT strategic plan. The strategic plan includes the upgrading of information security systems to adhere to information security standards by instituting more stringent security system protocols and corporate information security policies. A failure in these information systems or non-compliance with information security standards, including those in relation to personal information belonging to the Company's customers and colleagues, could result in harm to the reputation or competitive position of the Company and could negatively affect financial performance.

Tax and Regulatory Changes to any of the laws, rules, regulations or policies related to the Company's business including income, commodity and other taxes, and the production, processing, preparation, distribution, packaging and labelling of its products could have an adverse impact on the Company's financial and operational performance. New accounting pronouncements introduced by appropriate authoritative bodies may also impact the Company's financial results including the Company's transition to International Financial Reporting Standards. In the course of complying with such changes, the Company may incur significant costs. Changing regulations or enhanced enforcement of existing regulations could restrict its operations or profitability and thereby threaten the Company's competitive position and its capacity to efficiently conduct business. Failure by the Company to comply with applicable laws, rules, regulation and policies may subject it to civil or regulatory actions or proceedings, including fines, assessment, injunctions, recalls or seizures, which in turn could have an adverse effect on the Company's financial results. PC Bank operates in a highly regulated environment, failure to comply, understand, acknowledge and effectively respond to the regulators could result in monetary penalties, regulatory intervention and reputational damage. Taxing authorities may also disagree with the positions and conclusions taken by the Company in its filings with such authorities. An unfavourable resolution to any such dispute could have an adverse effect on the Company's financial results.

In 2010, the provincial governments of Quebec, Ontario, Alberta, Nova Scotia and British Columbia introduced amendments to the regulation of generic prescription drug prices paid by provincial governments pursuant to their respective public drug benefit plans. Under these amendments, manufacturer costs of generic drugs paid by the provincial drug plans are being reduced, and in Ontario, the current system of drug manufacturers paying professional allowances to pharmacies will be eliminated. The amendments also reduce the manufacturer costs of generic drugs purchased out-of-pocket or through private employer drug plans. The Company continues to identify opportunities to mitigate the impact of these amendments, including the introduction of programs to add new services and enhance existing services to attract customers. The amendments could have a material impact on the financial results of the Company if it is not able to effectively mitigate their negative impact.

Vendor Management and Third Party Service Providers The Company relies on suppliers that provide the Company with goods and services. Although contractual arrangements are put in place with these suppliers, the Company has no direct influence over how the companies are managed. Negative events affecting the suppliers could in turn negatively impact the Company's reputation in operations and its financial performance. Inefficient, ineffective or incomplete vendor management strategies, policies and/or procedures may impact the Company's ability to optimize financial performance, meet customer needs and control costs and quality.

Vendor production capacity or information technology capabilities may limit the Company's ability to service its customers or implement new processes to increase efficiencies and consistencies across vendors. Sourcing from developing markets results in enhanced risk which requires mitigation through additional safety, quality and management reviews.

Management's Discussion and Analysis

The Company's control label products are manufactured under contract by third-party suppliers. Product development and sourcing of the Company's control brand apparel products is conducted by a third party. In order to preserve brand equity, these suppliers are held to high standards of quality. Ineffective selection, contract terms, management and reliance on third party service providers may impact the Company's ability to source control brand products, to have products available for customers, to market to customers and to operate efficiently and effectively on a day to day basis.

The Company also uses third-party logistic services including the operation of dedicated warehouse and distribution facilities and third-party common carriers. The Company maintains a strategy of multiple sources for logistics providers so that in the event of a disruption of service from one supplier another supplier can be used. However, disruption in these services is possible which could interrupt the delivery of merchandise to stores thereby negatively affecting sales.

The Company continues to implement practices and performance expectations with its supplier base, including asking suppliers to support sales plans and cost reduction initiatives and to align with major program changes. However, failure to effectively implement these programs will have a negative impact on the Company's ability to realize the expected benefits and could negatively impact revenues and financial performance.

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 operationalize certain risk management strategies for the *President's Choice Financial MasterCard*®. To minimize operating risk, PC Bank and the Company actively manage and monitor their relationships with all third-party service providers. In addition, PC Bank has developed an outsourcing risk policy, approved by its Board of Directors, and has established a vendor governance team that provides its Board with regular reports on vendor governance and annual vendor risk assessments. Despite these activities, a significant disruption in the services provided by the bank would negatively impact revenues and the financial performance of PC Bank and the Company.

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

Workplace Health and Safety The failure of the Company to adhere to appropriate health and safety procedures and to ensure compliance with applicable laws and regulations could have an adverse effect on the organization's operations and financial performance.

The Company has established a national health and safety policy, a national health and safety management system and a 5 year injury reduction plan. Periodic updates are provided by health and safety colleagues to the executive team and quarterly updates are made to the Environmental, Health and Safety Committee of the Board. The Company has also developed a 3 year plan to establish a corporate wellness program. These initiatives cannot, however, prevent all workplace incidents. It remains possible that any such incident or series of incidents could have a negative impact on the Company's reputation, operations or financial performance.

Environmental The Company maintains a large portfolio of real estate and infrastructure and is subject to environmental risks associated with the contamination of such properties and facilities, whether by previous owners or occupants, neighbouring properties or from its own operations.

The Company operates a number of underground storage tanks, the majority of which are used for the retailing of automotive fuel. Contamination resulting from leaks from these tanks is possible. The Company employs monitoring and testing regimens, in addition to risk assessments and audits, to minimize the potential for subsurface impacts from fuel losses. The Company also operates refrigerant equipment in its stores and distribution centres to preserve perishable products through the supply chain. These systems contain refrigerant gases which could be released if the related equipment fails. It is possible that a release of these gases could have adverse effects on the environment. To minimize the potential for refrigerant releases, the Company has implemented preventative maintenance programs and refrigeration system inspections and is considering the implementation of new refrigeration system technologies.

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

The Company has environmental safety programs and has established policies and procedures aimed at ensuring compliance with applicable environmental legislative requirements. To this end, the Company employs environmental risk assessments and audits using internal and external resources together with employee awareness programs throughout its operating locations. The Environmental, Health and Safety Committee of the Board receives regular reporting from management addressing current and potential future issues, risks, programs/initiatives, identifying new regulatory concerns and related communication efforts. The Company's environmental affairs department works closely with operations to help ensure requirements are met.

Despite these mitigation activities, the Company could be subject to increased or unexpected costs associated with environmental incidents and the related remediation activities, including litigation and regulatory related costs, all of which could negatively impact the Company's reputation and financial performance.

Recent consumer trends include an increasing demand for products with less impact on the environment and that the Company's operations demonstrate environmentally responsible practices. As set out in its annual Corporate Social Responsibility report, the Company sets environmental goals and monitors its progress towards their achievement. Should the Company fail to meet consumer demand in this area or otherwise face adverse publicity with respect to the environmental impact of its business practices, its reputation may be negatively affected which may lead to decreased revenues and a negative impact on financial performance.

Franchise Independence and Relationships A substantial portion of the Company's revenues and earnings comes from amounts paid by franchisees. Franchisees are independent businesses and, as a result, their operations may be negatively affected by factors beyond the Company's control which in turn may damage the Company's reputation and potentially affect revenues and financial performance. Revenues and earnings could also be negatively affected, and the Company's reputation could be harmed, if a significant number of franchisees were to experience operational failures, including health and safety exposures, financial difficulty, or were unwilling or unable to pay the Company for products, rent or other fees, or fail to enter into renewals of franchise agreements. The Company's franchise system is also subject to franchise legislation enacted by a number of provinces. Any new legislation or failure to comply with existing legislation may negatively affect operations and could add administrative costs and burdens, any of which could affect the Company's relationship with its franchisees. Relationships with franchisees could pose significant risks if they are disrupted which could result in legal action, reputational damage and/or adverse financial consequences. Supply chain or system changes by the Company could cause or be perceived to cause disruptions to franchise operations and could result in negative effects on franchisee revenues or earnings. Reputational damage or adverse consequences for the Company, including litigation and disruption to sales from franchised stores, could result.

Contract Management and Records Retention The Company's contract management and records management processes are being upgraded. A lack of effective processes for the tendering, drafting, review and approval of Company contracts and the appropriate level of management and legal involvement increases the risk of financial losses to the business. In addition, inefficient, ineffective or incomplete document management and retention policies, procedures and practices increase the risk of incomplete Company records and potential non-compliance with laws and regulations, which could negatively impact the Company's reputation and financial performance.

Trademark and Brand Protection Decrease in value of the Company's trademarks, banners or control brands, as a result of adverse events, changes to the branding strategies or otherwise, could weaken the demand for the Company's products or services or damage the Company's reputation. The Company endeavours to have the appropriate contractual protections in its arrangements with control label vendors and suppliers of all marketing elements including, printing, flyers and advertising agencies. The Company actively monitors and manages its trademark portfolio. Despite these activities, adverse events could impact the value of the Company's trademarks, banners or brands and may negatively affect revenues and financial performance.

Management's Discussion and Analysis

Employee Future Benefit Contributions The Company manages the assets in its defined benefit pension plans by engaging professional investment managers who operate under prescribed investment policies and procedures in respect of permitted investments and asset allocations. The future contributions to the Company's pension plans are impacted by a number of variables, including the investment performance of the plan assets and the discount rate used to value the liabilities of the plans. The Company regularly monitors and assesses plan performance and the impact of changes in participant demographics, changes in capital markets and other economic factors that may impact funding requirements, employee future benefit costs and actuarial assumptions. If capital market returns are below assumed levels, or if the discount rate drops, the Company may be required to make contributions to its registered funded defined benefit pension plans in excess of those currently contemplated, which in turn may have a negative effect on the Company's financial performance and cash flows.

Multi-Employer Pension Plans In addition to the Company-sponsored pension plans, the Company participates in various multi-employer pension plans, providing pension benefits to union employees pursuant to provisions of collective bargaining agreements. Approximately 40% (2009 – 40%) of employees of the Company and of its independent franchisees participate in these plans. The administration of these plans and the investment of their assets are controlled by a board of independent trustees generally consisting of an equal number of union and employer representatives. In some circumstances, the Company may have a representative on the board of trustees of these multi-employer pension plans. The Company's responsibility to make contributions to these plans is limited by the amounts established pursuant to its collective agreements; however, poor performance of these plans could have an adverse impact on the Company's employees and former employees who are members of these plans. Pension cost for these plans is recognized as contributions are due.

The Company is the largest participating employer in the Canadian Commercial Workers Industry Pension Plan (CCWIPP), with approximately 54,000 (2009 – 55,000) employees as members. In 2010, the Company contributed \$55 million (2009 - \$54 million) to CCWIPP. At the end of 2010, the CCWIPP actuarial accrued benefit obligations exceeded the value of the assets held in trust. As a result of this underfunding, CCWIPP received approval from the pension regulator to reduce the accrued benefits and future service benefits of certain participants. Further benefit reductions would negatively affect the retirement benefits of the Company's employees, which in turn could negatively affect their morale and performance.

Real Estate and Store Renovations The Company maintains a significant portfolio of owned retail real estate and, whenever practical, pursues a strategy of purchasing sites for future store locations. This enhances the Company's operating flexibility by enabling the Company to introduce new departments and services that could be precluded under third party operating leases. As part of ongoing review of the performance of the Company's stores, the Company from time to time undertakes store renovations. Efforts are made to minimize the duration of these projects in order to limit the disruption at store level. However, the Company's revenues and financial performance will be negatively impacted if such renovations and remodelling are carried out in a manner that is disruptive to the ongoing store operations or results in a poor customer experience.

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

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

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

10.2 Financial Risks and Risk Management

Liquidity and Capital Availability Liquidity risk is the risk that the Company cannot meet a demand for cash or fund its obligations as they come due. Liquidity risk also includes the risk of not being able to liquidate assets in a timely manner at a reasonable price. Insufficient access to capital would impair the Company's capacity to grow, execute its business model and generate financial returns.

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

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

The Company may be exposed to losses if a counterparty to the Company's financial or non-financial derivative agreements fails to fulfill its obligations. Potential counterparty risk and losses are limited to the net amounts recoverable under such derivative agreements with any specific counterparty. These risks are further reduced by entering into 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 exposure to any single counterparty for financial derivative agreements. Internal policies, controls and reporting processes, which require ongoing assessment and corrective action, if necessary, are in place with respect to derivative transactions.

Credit risk associated with cash equivalents, short term investments and security deposits results from the possibility that a counterparty may default on the repayment of a security. Efforts to mitigate credit risk include policies and guidelines that require issuers of permissible investments to have at minimum a long term "A" credit rating from a recognized credit rating agency and that specify minimum and maximum exposures to specific industries, issuers and types of investment instruments. These investments are purchased and held directly in custody accounts and there is limited exposure to any third party money market portfolios and funds.

Credit risk from PC Bank's credit card receivables and receivables from independent franchisees, associated stores and independent accounts results from the possibility that customers may default on their payment obligations. PC Bank manages the credit card receivable risk by employing stringent credit scoring techniques, actively monitoring the credit card portfolio, and reviewing techniques and technology that can improve the effectiveness of the collection process. In addition, these receivables are dispersed among a large, diversified group of credit card customers. Accounts receivable from independent franchisees, associated stores and independent accounts are actively monitored on an ongoing basis and settled on a frequent basis in accordance with the terms specified in the applicable agreements.

Despite the mitigation strategies described above, it is possible that the Company's financial performance could be negatively impacted by the failure of a counterparty to fulfill its obligations, whether as a result of loss of value of receivables or increased costs associated with counterparty default.

Foreign Currency Exchange Rate The Company is exposed to foreign currency exchange rate variability, primarily on United States dollar denominated cash and cash equivalents, short term investments, security deposits held by Glenhuron, foreign denominated and foreign currency based purchases in accounts payable and accrued liabilities, and USD private placement notes included in long term debt. The Company and Glenhuron have cross currency swaps that partially offset their respective exposure to fluctuations in foreign currency exchange rates. Cross currency swaps are transactions in which interest payments and principal amounts in one currency are exchanged against the receipt of interest payments and principal amounts in a second currency. Despite these mitigation strategies the Company's financial performance could be negatively impacted by foreign currency variability.

Management's Discussion and Analysis

Commodity Prices The Company uses financial and non-financial derivative instruments in the form of future contracts, option contracts and forward contracts to manage its current and anticipated exposure to fluctuations in commodity prices. The Company is exposed to increases in the prices of commodities in operating its stores and distribution centres and is also exposed as a result of the direct link between commodities and the cost of consumer products. To manage a portion of this exposure, the Company uses purchase commitments for a portion of its needs for certain consumer products that may be commodities based and the Company expects to take delivery of these consumer products in the normal course of business. A non-financial derivative contract, which expires at the end of 2011, is used to hedge electricity price risk for a portion of the Company's expected electricity consumption in Alberta. The Company also enters into exchange traded futures and option contracts to minimize cost volatility in fuel prices. Despite these strategies, high commodity prices could negatively affect the Company's financial performance.

Common Share Market Price The Company issues stock-based compensation to certain of its employees in the form of stock options and Restricted Share Units ("RSUs") based on its common shares. Glenhuron's equity forwards provide a partial offset to fluctuations in stock-based compensation cost. The equity forwards allow for settlement in cash, common shares or net settlement. These forwards change in value as the market price of the Company's common shares changes and provide a partial offset to fluctuations in the Company's stock-based compensation cost, including RSU plan expense. The partial offset between the Company's stock-based compensation costs, including RSU plan expense, and the equity forwards is more effective when the market price of the Company's common shares exceeds the exercise price of the employee stock options. When the market price of the common shares is lower than the exercise price of the employee stock options, only RSUs will provide a partial offset to these equity forwards. The amount of net stock-based compensation cost recorded in operating income is mainly dependent upon the number of unexercised stock options and RSUs, their vesting schedules relative to the number of underlying common shares on the equity forwards, and the level of fluctuations in the market price of the underlying common shares. As at January 1, 2011, 2,840,638 stock options had exercise prices which were greater than the market price of the Company's common shares at year end. High share prices could negatively affect the Company's financial performance.

Interest Rate Interest rate risk arises from the issuance of short term debt by the Company and equity forwards by Glenhuron, net of cash and cash equivalents, short term investments and security deposits. The Company is exposed to changes in short term interest rates which is offset partly by Glenhuron's and the Company's interest rate swaps. Interest rate swaps are transactions in which interest flows are exchanged with a counterparty on a specified notional amount for a pre-determined period based on agreed-upon fixed and floating interest rates. Despite these strategies, changes in interest rates could negatively affect the Company's cash flows and financial performance.

Derivative Instruments Over-the counter derivative instruments offset certain risks. Policies and guidelines prohibit the use of any derivative instrument for trading or speculative purposes. See notes 1 and 23 to the consolidated financial statements for additional information about the Company's financial derivative instruments. The fair value of derivative instruments is subject to changing market conditions which could negatively impact the Company's cash flow and financial performance.

11. Related Party Transactions

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

Inventory Purchases Purchases of inventory from related parties for resale in the distribution network represented approximately 3% (2009 – 3%) of the cost of merchandise inventories sold.

Cost Sharing Agreements Weston has entered into certain contracts with third parties for administrative and corporate services, including telecommunication services and information technology related matters on behalf of the Company. Through cost sharing agreements that have been established between the Company and Weston concerning these costs, the Company has agreed to assume its proportionate share of costs incurred on its behalf. Payments by the Company pursuant to these cost sharing agreements in 2010 were approximately \$9 million (2009 – \$10 million).

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

Borrowings/Lending From time to time the Company may borrow funds from or may lend funds to Weston on a short term basis at short term market borrowing rates. There were no amounts outstanding as at January 1, 2011 or January 2, 2010.

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

Management Agreements The Company has an agreement with Weston to provide certain administrative services by each company to the other. The services to be provided under this agreement include those related to commodity management, pension and benefits, tax, medical, travel, information system, risk management, treasury and legal. Payments are made quarterly based on the actual costs of providing these services. When services are provided on a joint basis for the benefit of the Company and Weston together, each party pays the appropriate proportion of such costs. Net payments by the Company under this agreement in 2010 were \$16 million (2009 – \$16 million). Fees paid under this agreement are reviewed each year by the Audit Committee.

Glenhuron manages certain United States cash, cash equivalents and short term investments for wholly owned non-Canadian subsidiaries of Weston and management fees earned are based on market rates.

Dividend Reinvestment Plan During the year, the Company issued 3,621,086 (2009 – 3,163,375) common shares to Weston under the DRIP (see note 19 of the consolidated financial statements for more information).

12. Critical Accounting Estimates

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

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

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

12.1 Inventories

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

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

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

Additional information on inventories is provided in note 9 to the consolidated financial statements.

Management's Discussion and Analysis

12.2 Fixed Assets

Fixed assets are reviewed for impairment annually and also when events or circumstances indicate that their carrying value exceeds the sum of the undiscounted cash flows expected from their use and eventual disposition. An impairment loss is measured as the amount by which the fixed assets carrying value exceeds the fair value. As discussed in note 10 to the consolidated financial statements, the Company recorded a fixed asset impairment charge of \$28 million (2009 – \$27 million) and other related charges of \$18 million (2009 – \$19 million) in 2010. In addition, the Company recorded in operating income an asset impairment charge of \$26 million (2009 – nil) related to the closure of a distribution centre in Quebec.

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

12.3 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 rates, termination rates 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 2010 net cost for defined benefit pension and other benefit plans were 5.75% and 5.5%, respectively, on a weighted average basis, compared to 6.0% and 5.7%, respectively, in 2009.

The expected long term rate of return on plan assets is based on current market conditions, the asset mix, the active management of defined benefit pension plan assets and historical returns. The 2010 expected long term rate of return on plan assets was 6.75%.

The expected growth rate in health care costs for 2010 was based on external data and the Company's historical trends for health care costs. In 2011, the growth rate of health care costs is estimated at 8.0% and is assumed to gradually decrease to 5.0% by 2015, remaining at that level thereafter.

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

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 Section 10.1.

12.4 Goodwill and Indefinite Life Intangible Assets

Goodwill is assessed for impairment at the reporting unit level annually and whenever events or circumstances indicate that it is more likely than not that the carrying value may not be recoverable. Any potential goodwill impairment is identified by comparing the fair value of a reporting unit to its carrying value. If the fair value of the reporting unit exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value of the reporting unit exceeds its fair value, a more detailed goodwill impairment assessment must be undertaken. A goodwill impairment charge is recognized to the extent that, at the reporting unit level, the carrying value of goodwill exceeds the implied fair value.

The Company determines the fair value 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 of a long term nature including 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 a weighted average cost of capital. These estimates and assumptions are subject to change in the future due to uncertain competitive and economic market conditions and changes in business strategies.

The Company performed the annual goodwill impairment test in 2010 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.

Intangible assets with indefinite useful lives consist of T&T trademarks and brand names and are assessed for impairment annually and whenever events or circumstances indicate that it is more likely than not that the carrying value may not be recoverable. Any potential intangible asset impairment is identified by comparing the fair value of the indefinite life intangible asset to its carrying value. If the fair value of the intangible asset exceeds its carrying value, the intangible asset is considered not to be impaired. If the carrying value of the intangible asset exceeds its fair value, impairment is identified as the difference between the fair value and the carrying value and will result in a reduction in the carrying value of the intangible asset on the consolidated balance sheet and the recognition of an impairment charge in operating income in the consolidated statement of earnings.

The Company determines the fair value of its trademarks and brand names by using an income approach, specifically the "Relief from Royalty" method. The process of determining the fair values requires management to make assumptions of a long term nature regarding projected future sales, terminal growth rates, notional royalty rates and discount rates. Projected future sales are consistent with strategic plans presented to the Company's Board and discount rates correspond with the risk profile of the subject intangible assets. 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 impairment test of its indefinite life intangible assets in 2010 and determined that there was no impairment of the carrying value of indefinite life intangible assets.

12.5 Income and Other Taxes

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

At each balance sheet date, future income tax assets are reviewed to determine whether a valuation allowance is required. Such an allowance is not required when it is deemed more likely than not that projected future taxable income will be sufficient to realize the future income tax benefits.

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Changes or differences in underlying estimates or assumptions may result in changes to the current or future income tax balances on the consolidated balance sheet, a charge or credit to income tax expense in the consolidated statement of earnings and may result in cash payments or receipts.

All income, capital and commodity tax filings are subject to audits and reassessments. Management believes that adequate provisions have been made for all income and other tax obligations. However, changes in interpretations or judgments may result in a change in the Company's income, capital or commodity tax provisions in the future. The amount of such a change cannot be reasonably estimated.

13. Accounting Standards

13.1 Accounting Standards Implemented in 2009

Goodwill and Intangible Assets In November 2007, the Canadian Institute of Chartered Accountants ("CICA") issued amendments to Section 1000 "Financial Statement Concepts", and AcG 11 "Enterprises in the Development Stage", issued a new Handbook Section 3064 "Goodwill and Intangible Assets" ("Section 3064") to replace Section 3062 "Goodwill and Other Intangible Assets", withdrew Section 3450 "Research and Development Costs" and amended Emerging Issues Committee ("EIC") Abstract 27 "Revenues and Expenditures During the Pre-operating Period" to not apply to entities that have adopted Section 3064. These amendments, in conjunction with Section 3064, provide guidance for the recognition of intangible assets, including internally developed assets from research and development activities, ensuring consistent treatment of all intangible assets, whether separately acquired or internally developed. The Company implemented these requirements effective 2009, retroactively with restatement.

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

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

13.2 International Financial Reporting Standards

The Canadian Accounting Standards Board requires that all public companies adopt International Financial Reporting Standards ("IFRS") for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. As a result, the Company's audited annual consolidated financial statements for the year ending December 31, 2011 will be the first audited annual consolidated financial statements that will be prepared in accordance with the requirements of IFRS. Starting in the first quarter of 2011 the unaudited interim period consolidated financial statements will be prepared in accordance with International Accounting Standard ("IAS") 34, "Interim Financial Reporting", including 2010 comparative figures and required reconciliations prepared in accordance with IFRS 1, "First-Time Adoption of International Financial Reporting Standards" ("IFRS 1").

Project Structure and Status The Company has an IFRS team led by the Chief Financial Officer to ensure the timely and appropriate implementation of IFRS. The IFRS team consists of dedicated resources as well as consultants and other employees on an as needed basis. This team reports regularly to a steering committee comprised of senior management, as well as to the Audit Committee.

The Company's IFRS conversion project plan consists of three main phases:

Phase One: Diagnostic Impact Assessment This phase consisted of a high-level impact assessment that identified the key areas of accounting differences between Canadian GAAP and IFRS that were likely to impact the Company. The diagnostic impact assessment was completed in 2008 and resulted in the ranking of accounting differences as high, medium, or low priority.

Phase Two: Detailed Assessment This phase involved a comprehensive assessment of the differences between IFRS and the Company's current accounting policies and included reviews with the various finance groups and business process owners to further understand the impact of these differences. The detailed assessment was completed in April 2009 at which time the changes required to existing accounting policies, business process and information systems were identified.

Phase Three: Implementation This phase includes two components: implementation development and implementation transition and resulted in the compilation of IFRS transitional adjustments, as required, as well as IFRS financial statements for 2010 with required reconciliations to Canadian GAAP. To achieve this result the changes identified in the detailed assessment phase were implemented as discussed below.

Policy selection The analysis of policy alternatives under IFRS, including certain exemptions and elections available on transition in accordance with IFRS 1, was completed in 2010. Management has preliminarily concluded on all of its policy alternatives, and obtained preliminary audit committee approval of these choices. These preliminary conclusions and approvals will be finalized prior to the end of the first quarter of 2011.

Business Processes Changes to business processes, including the budgeting and planning process, arising as a result of IFRS were also identified in the detailed assessment phase. Certain immaterial changes were taken into account in the budgeting and planning cycle that occurred throughout 2010. All other required business process changes were also implemented by the end of 2010.

Information Systems Changes to supporting information systems were identified in the detailed assessment phase. Required changes to supporting information systems were designed, developed and implemented by the end of 2010. The IFRS conversion project is integrated with the Company's ERP implementation. As ERP phases have been deployed, the Company has ensured that the requirements of IFRS adoption were incorporated. For ERP phases that have not yet been deployed, the Company is ensuring that the requirements of IFRS are identified and incorporated.

Financial Statement Presentation In accordance with the Company's transition plan, the Company also completed its preliminary first quarter 2011 IFRS financial statement format and draft note disclosures. In addition, the Company has completed its preliminary unaudited opening transitional balance sheet as well as financial statements for each of the quarters of 2010 based on the preliminary elections and exemptions as discussed below. A summary of the significant impacts is provided below.

Training Targeted training regarding anticipated changes resulting from IFRS implementation was provided to appropriate business units and finance colleagues throughout 2010 and will continue as appropriate into 2011. In addition, the Company provided quarterly and supplementary IFRS information sessions to the Board which included updates on certain preliminary transitional and 2010 quarterly IFRS adjustments including preliminary policy choices, implications of IFRS standards to the business, and their impacts on financial statement disclosures. As previously announced, the Company will provide an information session on March 3, 2011 to key external stakeholders regarding the impacts of IFRS.

Contractual Arrangements and Covenants The implementation of IFRS is expected to have an impact on certain financial metrics that are used in calculating the Company's financial covenants under certain of its debt agreements. These debt agreements provide for the opportunity to renegotiate the covenants to reflect the impact of the transition to IFRS. The Company has reached an understanding with certain of its lenders to defer any adjustments that may be required to its borrowing agreements until such later date that the parties may agree following the adoption of IFRS. The Company will continue to demonstrate compliance with its borrowing agreements on a basis that is consistent with Canadian GAAP as it exists immediately prior to the conversion to IFRS, until such time that the parties agree to formalize the adjustments for IFRS.

Management's Discussion and Analysis

Internal Control Compliance Changes to the Company's internal controls over financial reporting and disclosure controls and procedures, which include enhancement of existing controls and the design and implementation of new controls, where needed, are in process and progressing to plan. At this time the Company expects no material change in internal controls over financial reporting or disclosure controls and procedures resulting from the adoption and implementation of IFRS.

Preliminary Estimated Impact of Conversion The information below is provided to allow investors and others to obtain an understanding of the preliminary unaudited effects on the Company's consolidated financial statements and operating performance measures. The changes described below should not be regarded as a complete description of the changes resulting from the transition to IFRS. Readers are cautioned that it may not be appropriate to use such information for any other purpose and the information is subject to change.

The International Accounting Standards Board has significant ongoing projects that could change the current standards under IFRS and their impact on the Company's consolidated financial statements. Therefore, the Company's analysis of changes and accounting policy decisions have been made based on the accounting standards that are currently in effect. To date, the Company has made preliminary decisions relating to certain IFRS policies as discussed below. The following information is contingent on the standards that will be effective as at December 31, 2011, the date of the Company's first audited annual consolidated financial statements prepared in accordance with IFRS.

The table below summarizes the estimated impact of conversion to IFRS on the Company's key financial highlights from the unaudited (except where otherwise noted) consolidated statements of earnings for each of the interim periods and year ended January 1, 2011, based on the preliminary elections and exemptions noted below:

| (\$ millions except where otherwise indicated) | First Quarter | | Second Quarter | | Third Quarter | | Fourth Quarter | | For the year ended January 1, 2011 | |
|--|---------------|----------|----------------|----------|---------------|----------|----------------|----------|------------------------------------|-----------|
| | Canadian GAAP | IFRS | Canadian GAAP | IFRS | Canadian GAAP | IFRS | Canadian GAAP | IFRS | Canadian GAAP (audited) | IFRS |
| Revenues | \$ 6,926 | \$ 6,914 | \$ 7,317 | \$ 7,267 | \$ 9,593 | \$ 9,536 | \$ 7,161 | \$ 7,110 | \$ 30,997 | \$ 30,827 |
| Operating income | 260 | 294 | 330 | 334 | 390 | 389 | 289 | 278 | 1,269 | 1,295 |
| Net earnings | 137 | 138 | 180 | 174 | 213 | 196 | 151 | 126 | 681 | 634 |
| Basic net earnings per common share (\$) | 0.50 | 0.50 | 0.64 | 0.63 | 0.77 | 0.70 | 0.54 | 0.45 | 2.45 | 2.28 |
| Diluted net earnings per common share (\$) | 0.49 | 0.47 | 0.64 | 0.61 | 0.76 | 0.70 | 0.54 | 0.45 | 2.44 | 2.24 |
| EBITDA | \$ 412 | \$ 436 | \$ 479 | \$ 474 | \$ 591 | \$ 584 | \$ 442 | \$ 430 | \$ 1,924 | \$ 1,924 |

The table below reconciles EBITDA to the unaudited IFRS net earnings for each of the interim periods and year ended January 1, 2011, based on the preliminary elections and exemptions noted below:

| (\$ millions) | First Quarter | Second Quarter | Third Quarter | Fourth Quarter | For the year ended January 1, 2011 |
|--|---------------|----------------|---------------|----------------|------------------------------------|
| Net earnings | \$ 138 | \$ 174 | \$ 196 | \$ 126 | \$ 634 |
| Add impact of the following: | | | | | |
| Income taxes | 67 | 79 | 89 | 67 | 302 |
| Net interest expense and other financing charges | 89 | 81 | 104 | 85 | 359 |
| Operating income | 294 | 334 | 389 | 278 | 1,295 |
| Add impact of the following: | | | | | |
| Depreciation and amortization | 142 | 140 | 195 | 152 | 629 |
| EBITDA | \$ 436 | \$ 474 | \$ 584 | \$ 430 | \$ 1,924 |

In addition, the table below summarizes the estimated impact of conversion to IFRS on the Company's unaudited opening transitional balance sheet as at January 3, 2010 and as at January 1, 2011, based on the preliminary elections and exemptions noted below:

| (\$ millions) | As at January 1, 2011 | | | As at January 3, 2010 | | |
|----------------------|-------------------------|------------------|--------|-------------------------|------------------|--------|
| | Canadian GAAP (audited) | IFRS (unaudited) | Change | Canadian GAAP (audited) | IFRS (unaudited) | Change |
| Total assets | \$ 15,919 | \$ 16,798 | 6% | \$ 14,991 | \$ 16,058 | 7% |
| Total liabilities | 9,039 | 11,255 | 25% | 8,718 | 10,997 | 26% |
| Shareholders' equity | 6,880 | 5,543 | (19%) | 6,273 | 5,061 | (19%) |

First-Time Adoption of IFRS

The adoption of IFRS will require the application of IFRS 1, which provides guidance for an entity's initial adoption of IFRS. IFRS 1 generally requires retrospective application of all IFRS standards, with the exception of certain mandatory exceptions and limited optional exemptions provided in the standard. The following are the significant optional exemptions that the Company expects to apply in preparing the opening transitional balance sheet in accordance with IFRS 1.

Employee Benefits The Company expects to apply the election to recognize, for all defined benefit plans, all cumulative unamortized actuarial gains and losses, which are currently deferred under Canadian GAAP, through opening retained earnings. The Company will apply this exemption to all defined benefit plans consistently and the expected impact has been quantified by the Company's external actuaries. The expected impact of IAS 19, "Employee Benefits" ("IAS 19"), including this IFRS 1 exemption is disclosed in the Changes in Accounting Policies – Employee Benefits section below.

Borrowing Costs The Company expects to apply IAS 23, "Borrowing Costs", prospectively and expects to eliminate all previously capitalized interest costs as at the date of transition through opening retained earnings. Upon implementation of IFRS, the Company expects to record a decrease in total assets and liabilities of approximately \$220 million and \$21 million, respectively, with a corresponding impact to shareholders' equity of \$199 million.

Business Combinations The Company expects to apply IFRS 3, "Business Combinations" prospectively only to those business combinations that occur after the date of transition.

Changes in Accounting Policies

Consolidation IAS 27, "Consolidated and Separate Financial Statements" and Standing Interpretations Committee Interpretation 12, "Consolidation – Special Purpose Entities" ("IAS 27") assess consolidation based on the control model and IFRS does not include the concept of a variable interest entity. Accordingly, the Company will no longer be required to consolidate certain independent franchisees and other entities subject to warehouse and distribution service agreements that were previously consolidated under Canadian GAAP pursuant to the requirements of Accounting Guideline 15, "Consolidation of Variable Interest Entities" ("AcG 15"). The independent funding trust through which franchisees obtain financing and Eagle, the independent credit card trust that finances certain PC Bank credit card receivables, will be subject to consolidation under IFRS based on the indicators of control as assessed in accordance with Standing Interpretations Committee Interpretation 12. As a result of the above, the Company will be required to re-measure the initial consideration received from the independent franchisee, in the form of a loan receivable, to exclude the benefit of the credit enhancement provided to the independent funding trust by the Company. Upon implementation of IFRS, the Company expects to record an increase in total assets and liabilities of approximately \$719 million and \$739 million, respectively, with a corresponding impact to shareholders' equity of \$20 million primarily resulting from the items described above. In addition, upon implementation the Company expects to record additional total assets and liabilities of \$39 million and \$117 million, respectively, with a corresponding impact to shareholders' equity of \$78 million related to immaterial adjustments of prior period balances. The Company has determined that these amounts were not material to its consolidated financial statements for any prior interim or annual periods.

Management's Discussion and Analysis

Revenue Under Canadian GAAP each franchise arrangement was evaluated under AcG 15. Revenues for independent franchisees that were not consolidated under AcG 15 were accounted for under AcG 2 "Franchise Fee Revenue". As a result of the Company no longer consolidating certain independent franchisees the Company was required to evaluate the sale of each franchise arrangement under IAS 18, "Revenue" ("IAS 18") at its inception. Based on the guidance in IAS 18, the Company concluded that each franchise arrangement contains separately identifiable components. As a result of this multi-element arrangement the Company will be required to determine the fair value of all consideration exchanged including certain loans and receivables. The impact of applying these requirements will result in the fair value of certain consideration being less than the amounts recorded at inception. Furthermore, the Company allocated the consideration to each component in the multi-element arrangement, on a relative fair value basis to both the delivered and undelivered components. The total impact of these items is included within the overall financial instruments impacts described below.

Financial Instruments As a result of no longer consolidating the franchise arrangements under IAS 27, the Company will recognize and evaluate additional financial assets and financial liabilities in accordance with IAS 39, "Financial Instruments: Recognition and Measurement" ("IAS 39") which requires application retrospectively to the inception of each arrangement. The Company's evaluation has identified one or more events that provide objective evidence that the cash flows associated with certain of these financial assets are such that the fair value has been determined to be impaired. Upon implementation of IFRS, the Company expects to record a decrease in certain financial assets and a corresponding decrease to shareholders' equity.

IAS 39 contains different criteria than Canadian GAAP for the derecognition of financial assets and requires an evaluation of the extent to which an entity retains the risks and rewards of ownership as well as control over the transferred assets. Under Canadian GAAP these financial assets qualify for sale treatment. The Company has determined that under IFRS, securitized credit card receivables will not qualify for derecognition. Upon implementation of IFRS, the Company expects to record an increase in credit card receivables of approximately \$1,179 million (excluding Eagle of \$500 million which is discussed above) before the provision for loan losses with a corresponding increase to liabilities.

Cross-currency and interest rate swaps were effective cash flow hedging relationships under Canadian GAAP. Certain tranches of the swaps that were part of the hedging relationship have expired in 2010 and will continue to expire up to mid-2011. The Company has decided not to apply hedge accounting under IFRS which will result in derecognition at the date of transition to IFRS. Upon implementation of IFRS, the Company expects to reclassify approximately \$16 million of deferred gains from accumulated other comprehensive income to retained earnings within shareholders' equity.

As a result of IAS 39 and IAS 18, the Company expects to record an increase in total assets and liabilities of approximately \$959 million and \$1,290 million, respectively, with a corresponding impact to shareholders' equity of \$331 million primarily resulting from the items described in IAS 18 and IAS 39 above.

Employee Benefits IAS 19 provides a policy choice regarding recognition of actuarial gains and losses for defined benefit pension plans and other defined benefit plans, permitting deferred recognition using the corridor method or immediate recognition in either other comprehensive income within equity or through earnings. Under Canadian GAAP the Company applies the corridor method. Upon implementation of IFRS, the Company intends to recognize actuarial gains and losses immediately in other comprehensive income within equity for defined benefit pension plans and other defined benefit plans and immediately in net earnings for other long term employee benefits. Upon implementation of IFRS, the Company expects to record a decrease in total assets and an increase in total liabilities of approximately \$242 million and \$25 million, respectively, with a corresponding impact to shareholders' equity of \$267 million primarily resulting from the items described above and the IFRS 1 exemption described in the First-Time Adoption of IFRS section above. In addition, upon implementation the Company expects to record additional total assets and liabilities of \$14 million and \$52 million, respectively, with a corresponding impact to shareholders' equity of \$38 million related to immaterial adjustments of prior period balances. The Company has determined that these amounts were not material to its consolidated financial statements for any prior interim or annual periods.

Share-based Payments IFRS 2, "Share-Based Payments", requires that cash-settled stock-based compensation be measured based on the fair value of the awards. Canadian GAAP requires that such compensation be measured based on the intrinsic value of the awards. This difference is expected to impact the accounting measurement of the Company's stock options, restricted share units and

deferred share units. Upon implementation of IFRS, the Company expects to record an increase in total assets and liabilities of approximately \$3 million and \$9 million, respectively, with a corresponding impact to shareholders' equity of \$6 million primarily resulting from the items described above.

Property, Plant and Equipment IAS 16, "Property, Plant and Equipment", provides specific guidance such that when an individual component of an item within property, plant and equipment is replaced and capitalized, the carrying value of the replaced component of the original asset must be derecognized even if the replacement part was not separately accounted for. In addition IFRS is more prescriptive with respect to eligible costs such as site-dismantling and restoration costs. Upon implementation of IFRS, the Company expects to record a decrease in total assets and liabilities of approximately \$60 million and \$2 million, respectively, with a corresponding impact to shareholders' equity of \$58 million primarily resulting from the items described above.

Impairment of Assets IAS 36, "Impairment of Assets", requires that assets be tested for impairment at the level of cash generating units ("CGU"), which are defined as the smallest group of assets that generate largely independent cash inflows. The Company has completed its analysis and has concluded that the CGU will predominantly be an individual retail location compared to Canadian GAAP where store net cash flows are grouped together by primary market areas, where they are largely dependent on each other. The Company has completed its preliminary assessment of the events triggering potential impairments and the events triggering the reversal of previously recorded impairments. Upon implementation of IFRS, the Company expects to record a decrease in total assets and liabilities of approximately \$216 million and \$29 million, respectively, with a corresponding impact to shareholders' equity of \$187 million primarily resulting from the items described above.

Leases IAS 17, "Leases" ("IAS 17"), requires the allocation of minimum lease payments between the land and building elements of a lease to be in proportion to the relative fair values of the leasehold interests in the land and building, whereas under Canadian GAAP it is based on the fair value of the land and building in aggregate. In addition, IFRS permits the immediate recognition of gains and losses on sale leaseback transactions which result in an operating lease, provided that the transaction is established at fair value. Under Canadian GAAP, gains and losses are generally deferred and amortized in proportion to the lease payments over the lease term. IAS 17 also provides additional indicators of a capital lease that were not provided under Canadian GAAP. Capital leases are referred to as finance leases under IFRS. Upon implementation of IFRS, the Company expects to record an increase in total assets and liabilities of approximately \$62 million and \$78 million, respectively, with a corresponding impact to shareholders' equity of \$16 million primarily resulting from the items described above. In addition, upon implementation the Company expects to record additional total assets and liabilities of \$50 million and \$61 million, respectively, with a corresponding impact to shareholders' equity of \$11 million related to immaterial unrecorded capital leases from prior periods. The Company has determined that these immaterial unrecorded amounts were not material to its consolidated financial statements for any prior interim or annual periods.

Customer Loyalty Programs International Financial Reporting Interpretations Committee 13, "Customer Loyalty Programs", requires the fair value of loyalty programs to be recognized as a separate component of the related sales transaction, such that a portion of the revenue from the initial sales transaction in which the awards were granted is deferred until the points are redeemed. The Company has made a policy choice to defer the relevant portion of the sales transaction based on the relative fair value of the awards granted. Under Canadian GAAP, the Company recognizes the net cost of the program in operating expenses measured at the cost to service the liability. Upon implementation of IFRS, the Company expects to record an increase in total assets and liabilities of approximately \$5 million and \$19 million, respectively, with a corresponding impact to shareholders' equity of \$14 million primarily resulting from the items described above.

Provisions IAS 37, "Provision, Contingent Liabilities and Contingent Assets" requires an entity to recognize a provision when a contract is determined to be onerous. A contract is onerous when the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. Canadian GAAP only requires the recognition of such a liability in certain prescribed situations. This difference could result in the recognition of a liability under IFRS that was not previously recognized under Canadian GAAP. Other measurement differences under IFRS could result in the earlier recognition of provisions or the recognition of a different amount than under Canadian GAAP. Upon implementation of IFRS, the Company expects to record an increase in total assets and liabilities of approximately \$4 million and \$22 million, respectively, with a corresponding impact to shareholders' equity of \$18 million primarily resulting from the items described above.

Management's Discussion and Analysis

Changes in Financial Statement Presentation and Cash Flows

In addition to the changes in recognition and measurement described above, the conversion to IFRS will result in a number of changes to financial statement presentation.

IFRS 8, "Operating Segments" is substantially converged with Canadian GAAP, however with the combined impact of IAS 39, resulting in securitized credit card receivables not qualifying for derecognition and the impact of IAS 27, resulting in the consolidation of Eagle, *PC Financial* will now meet quantitative thresholds requiring it to be disclosed as a reportable segment under IFRS.

On the consolidated balance sheets, the significant required reclassifications from Canadian GAAP to IFRS include: presenting all future income taxes as long-term, rather than presenting current and long term future income taxes separately; presenting investment properties separately from fixed assets; presenting current and long-term provisions separately from accounts payable and accrued liabilities and other liabilities, respectively; and presenting non-controlling interest as a component of equity instead of as a liability.

On the statement of earnings, minority interests will be presented as an allocation of net earnings rather than as a deduction in the calculation of net earnings. In addition, the Company has made a policy choice under IAS 19 to disaggregate pension costs and post retirement benefits on the statement of net earnings, and present the interest and expected return on asset components of total pension cost within interest and other financing charges. This change related to pension costs will have the effect of increasing operating income and EBITDA⁽¹⁾, and increasing interest and other financing charges reported under Canadian GAAP in 2010.

The impact of IFRS on total consolidated cash flows is due only to the change in entities that are recognized on-balance sheet under IFRS as compared to Canadian GAAP, as discussed above related to IAS 27 and IAS 39. In addition, within the consolidated statements of cash flows, there will be differences in the presentation of cash flows between operating, investing and financing.

14. Outlook⁽²⁾

2010 was a year of real progress towards completing the Company's renewal plan. Now entering its fifth and final year of renewal, the Company expects to continue its focus on executing the plan in a market environment that remains unpredictable and competitively intense. In 2011, the Company plans to continue its investments in information technology and supply chain which will negatively impact operating income by approximately \$135 million over 2010, and estimates capital expenditures for the year to be roughly \$1.0 billion.

15. Non-GAAP Financial Measures

The Company uses the following non-GAAP financial measures: EBITDA and EBITDA margin, net debt, net debt to EBITDA, net debt to equity and return on average net assets. The Company believes these non-GAAP financial measures provide useful information to both management and investors in measuring the financial performance and financial condition of the Company for the reasons outlined below. These measures do not have a standardized meaning prescribed by Canadian GAAP and therefore they may not be comparable to similarly titled measures presented by other publicly traded companies, and they should not be construed as an alternative to other financial measures determined in accordance with Canadian GAAP.

(1) See Non-GAAP financial measures beginning on page 38.

(2) To be read in conjunction with "Forward-Looking Statements" on page 2

EBITDA and EBITDA Margin The following table reconciles earnings before minority interest, income taxes, interest expense and depreciation and amortization (“EBITDA”) to operating income which is reconciled to Canadian GAAP net earnings measures reported in the consolidated statements of earnings for the years ended January 1, 2011, January 2, 2010 and January 3, 2009. 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) | 2010 (unaudited) (12 weeks) | 2009 (unaudited) (12 weeks) | 2010 (audited) (52 weeks) | 2009 (audited) (52 weeks) | 2008 (audited) (53 weeks) |
|--|-----------------------------------|-----------------------------------|---------------------------------|---------------------------------|---------------------------------|
| Net earnings | \$ 151 | \$ 165 | \$ 681 | \$ 656 | \$ 550 |
| Add impact of the following: | | | | | |
| Minority interest | 4 | 9 | 18 | 11 | 10 |
| Income taxes | 71 | 39 | 297 | 269 | 229 |
| Interest expense and other financing charges | 63 | 64 | 273 | 269 | 263 |
| Operating income | 289 | 277 | 1,269 | 1,205 | 1,052 |
| Add impact of the following: | | | | | |
| Depreciation and amortization | 153 | 143 | 655 | 589 | 550 |
| EBITDA | \$ 442 | \$ 420 | \$ 1,924 | \$ 1,794 | \$ 1,602 |

EBITDA margin is calculated as EBITDA divided by sales.

Net Debt The following table reconciles net debt used in the net debt to EBITDA and net debt to equity ratios to Canadian GAAP measures reported in the audited consolidated balance sheets as at the years ended. The Company calculates net debt as the sum of bank indebtedness, short term debt, long term debt, other liabilities and the fair value of financial derivatives less cash and cash equivalents, short term investments, security deposits and the fair value of financial derivatives. The Company believes that this measure is useful in assessing the amount of financial leverage employed.

| (\$ millions) | As at January 1, 2011 | As at January 2, 2010 | As at January 3, 2009 |
|--|--------------------------|--------------------------|--------------------------|
| Bank indebtedness | \$ 3 | \$ 2 | \$ 52 |
| Short term debt | - | - | 190 |
| Long term debt due within one year | 433 | 343 | 165 |
| Long term debt | 4,213 | 4,162 | 4,070 |
| Certain other liabilities | 35 | 36 | - |
| Fair value of financial derivatives related to the above | 37 | 58 | 63 |
| | 4,721 | 4,601 | 4,540 |
| Less: Cash and cash equivalents | 932 | 776 | 243 |
| Short term investments | 735 | 614 | 510 |
| Security deposits | 354 | 250 | 437 |
| Fair value of financial derivatives related to the above | 187 | 178 | 57 |
| | 2,208 | 1,818 | 1,247 |
| Net debt | \$ 2,513 | \$ 2,783 | \$ 3,293 |

The Second Preferred Shares, Series A are classified as capital securities and are excluded from the calculation of net debt. For the purpose of calculating net debt, fair value of financial derivatives is not credit value adjusted in accordance with EIC 173. As at January 1, 2011 the credit value adjustment was \$4 million (2009 – \$4 million).

Management's Discussion and Analysis

Net Assets The following table reconciles net assets used in the return on average net assets ratio to Canadian GAAP measures reported in the audited consolidated balance sheets as at the years ended. The Company believes the return on average net assets ratio is useful in assessing the return on productive assets.

Net assets is calculated as total assets as reported under Canadian GAAP less cash and cash equivalents, short term investments, security deposits and accounts payable and accrued liabilities. Return on average net assets is calculated as operating income for the year divided by average net assets.

| (\$ millions) | As at January 1, 2011 | As at January 2, 2010 | As at January 3, 2009 |
|--|--------------------------|--------------------------|--------------------------|
| Canadian GAAP total assets | \$ 15,919 | \$ 14,991 | \$ 13,943 |
| Less: Cash and cash equivalents | 932 | 776 | 243 |
| Short term investments | 735 | 614 | 510 |
| Security deposits | 354 | 250 | 437 |
| Accounts payable and accrued liabilities | 3,416 | 3,279 | 2,823 |
| Net assets | \$ 10,482 | \$ 10,072 | \$ 9,930 |

Equity The following table reconciles equity used in the net debt to equity ratio to Canadian GAAP measures reported in the audited consolidated financial statements as at the years ended.

Equity is calculated as the sum of capital securities and shareholder's equity.

| (\$ millions) | As at January 1, 2011 | As at January 2, 2010 | As at January 3, 2009 |
|----------------------|--------------------------|--------------------------|--------------------------|
| Capital securities | 221 | 220 | 219 |
| Shareholders' equity | 6,880 | 6,273 | 5,803 |
| Equity | 7,101 | 6,493 | 6,022 |

16. Additional Information

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

February 23, 2011
Toronto, Canada

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Management's Statement of Responsibility for Financial Reporting

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

Management is also responsible for establishing and maintaining adequate internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. A dedicated control compliance team reviews and evaluates internal controls, the results of which are shared with management on a quarterly basis. KPMG LLP, whose report follows, were appointed as independent auditors by a vote of the Company's shareholders to audit the consolidated financial statements.

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

Toronto, Canada
February 23, 2011

[signed]
Galen G. Weston
Executive Chairman

[signed]
Allan L. Leighton
Deputy Chairman and President

[signed]
Sarah R. Davis
Chief Financial Officer

Independent Auditors' Report

To the Shareholders:

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

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform an audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

Opinion

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

Toronto, Canada
February 23, 2011



Chartered Accountants, Licensed Public Accountants

Consolidated Statements of Earnings

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

(\$ millions except where otherwise indicated)

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

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Changes in Shareholders' Equity

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

See accompanying notes to the consolidated financial statements.

Consolidated Statements of Comprehensive Income

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

See accompanying notes to the consolidated financial statements.

Consolidated Balance Sheets

As at January 1, 2011 and January 2, 2010

(\$ millions)

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

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

See accompanying notes to the consolidated financial statements.

Approved on Behalf of the Board

[signed]
Galen G. Weston
 Director

[signed]
Thomas C. O'Neill
 Director

Consolidated Cash Flow Statements

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

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

See accompanying notes to the consolidated financial statements.

Notes to the Consolidated Financial Statements

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

Note 1. Summary of Significant Accounting Policies

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

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

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

Fiscal Year The fiscal year of the Company ends on the Saturday closest to December 31. As a result, the Company's fiscal year is usually 52 weeks in duration but includes a 53rd week every 5 to 6 years. The years ended January 1, 2011 and January 2, 2010 both contained 52 weeks.

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

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

Cash, Cash Equivalents and Bank Indebtedness Cash equivalents consist primarily of highly liquid marketable investments with a maturity of 90 days or less from the date of acquisition. Cash equivalents are either designated as held-for-trading financial assets or classified as available-for-sale financial assets which approximates the fair value of these instruments. See note 7 for more information.

Short Term Investments Short term investments consist primarily of government treasury bills, government-sponsored debt securities, corporate commercial paper and bank term deposits. Short term investments are either designated as held-for-trading financial assets or classified as available-for-sale financial assets which approximates the fair value of these instruments.

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

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

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

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

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

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

Notes to the Consolidated Financial Statements

Fixed assets are reviewed for impairment annually and when events or changes in circumstances indicate that the carrying value exceeds the sum of the undiscounted future cash flows expected from use and eventual disposal. These events or changes in circumstances include a commitment to close a store or distribution centre or to relocate or convert a store. For purposes of annually reviewing store assets for impairment, asset groups are reviewed at their lowest level for which identifiable cash flows are largely independent of cash flows of other assets and liabilities. Therefore, store net cash flows are grouped together by primary market areas, where cash flows are largely dependent on each other. Primary markets are regional areas where a number of store formats operate within close proximity to one another. If an indicator of impairment exists, such as sustained negative operating cash flows of the respective asset group, then an estimate of undiscounted future cash flows of each such store within this group is prepared and compared to its carrying value. For purposes of annually reviewing distribution centre assets for impairment, distribution centre net cash flows are grouped with the respective net cash flows of the stores they service. An impairment in the store network serviced by the distribution centre may indicate an impairment in the distribution centre assets as well. If any of these assets are determined to be impaired, the impairment loss is measured as the excess of the carrying value over fair value.

Goodwill Goodwill represents the excess of the purchase price of a business acquired over the fair value of the underlying net assets acquired at the date of acquisition. Goodwill is assessed for impairment at a minimum on an annual basis, at the reporting unit level. Any potential goodwill impairment is identified by comparing the fair value of a reporting unit to its carrying value. If the carrying value of the reporting unit exceeds its fair value, a more detailed goodwill impairment assessment must be undertaken. A goodwill impairment charge is recognized to the extent that the carrying value of goodwill exceeds the implied fair value in operating income.

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

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

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

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

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

Financial Instruments Financial instruments are classified as held-for-trading financial assets or financial liabilities, held-to-maturity investments, loans and receivables, available-for-sale financial assets, or other financial liabilities. Financial instruments are included on the Company's balance sheet and measured at fair value, except for loans and receivables, held-to-maturity financial assets and other financial liabilities which are measured at cost or amortized cost. Financial assets and financial liabilities have been initially remeasured as at January 4, 2009 to take into account the appropriate Company's credit risk and counterparty credit risk (see note 2). Gains and losses on held-for-trading financial assets and financial liabilities are recognized in net earnings in the period in which they arise. Unrealized gains and losses, including changes in foreign exchange rates on available-for-sale financial assets are recognized in other comprehensive income until the financial asset is derecognized or impaired, at which time any unrealized gains or losses are recorded in net earnings. Transaction costs other than those related to financial instruments classified as held-for-trading, which are expensed as incurred, are amortized using the effective interest method.

The following classifications have been applied:

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

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

Derivative Instruments Financial derivative instruments in the form of cross currency swaps, foreign exchange forwards, interest rate swaps and equity forwards partially offset exposure to fluctuations in foreign currency exchange rates, interest rates and the market price of the Company's common shares. Financial and non-financial derivative instruments in the form of futures contracts, option contracts and forward contracts mitigate current and anticipated exposure to fluctuations in commodity prices and foreign currency exchange rates. Policies and guidelines prohibit the use of any derivative instruments for trading or speculative purposes.

All financial derivative instruments are recorded at fair value on the consolidated balance sheet taking into account the appropriate Company's credit risk and counterparty credit risk (see note 24). Non-financial derivative instruments, such as certain contracts that are linked to commodity prices, are recorded at fair value on the consolidated balance sheet unless they are exempt from this treatment based upon expected purchase, sale or usage requirements. Embedded derivative instruments which are not closely related to the host contract are separated from their host contract and recorded on the consolidated balance sheet at fair value. Fair values are based on quoted market prices where available from active markets, otherwise fair values are estimated using valuation methodologies, primarily discounted cash flow analysis (see note 24). Derivative instruments are recorded in current or non-current assets and liabilities based on their remaining terms to maturity. All changes in fair value of the derivative instruments are recorded in net earnings unless cash flow hedge accounting is applied.

The Company formally identifies, designates and documents the relationship between hedging instruments and hedged items including cross currency swaps and interest rate swaps as cash flow hedges against exposure to fluctuations in the foreign currency exchange rate and variable interest rates (see note 23). The Company assesses whether these derivative instruments are highly effective in offsetting the change in the cash flows of hedged items at the inception of the hedging relationship and on an ongoing basis. If and when a derivative instrument is no longer expected to be highly effective, hedge accounting is discontinued. Hedge ineffectiveness, if any, is included in current period net earnings.

Foreign Currency Translation Assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the foreign currency exchange rate in effect at the balance sheet date. Exchange gains or losses arising from the translation of these balances denominated in foreign currencies are recognized in operating income except for items which are designated in a cash flow hedge which are deferred in accumulated other comprehensive income and reclassified to net earnings when realized. Revenues and expenses denominated in foreign currencies are translated into Canadian dollars at the average foreign currency exchange rate for the year.

Notes to the Consolidated Financial Statements

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

Employee Future Benefits The Company sponsors a number of pension plans including registered funded defined benefit pension plans, defined contribution pension plans and supplemental unfunded arrangements providing pension benefits in excess of statutory limits. The Company also offers other employee benefit plans comprised of post-retirement and post-employment benefit plans which are generally unfunded and non-contributory. Post-retirement benefit plans include health care, life insurance and dental benefits during retirement while post-employment benefit plans include long term disability benefits and the continuation of health and dental benefits while on disability. The Company also contributes to various multi-employer pension plans which provide pension benefits.

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

Past service costs arising from plan amendments are amortized over the expected average remaining service period of the active employees. The unamortized net actuarial gain or loss that exceeds 10% of the greater of the accrued benefit plan obligation or the fair value of the benefit plan assets at the beginning of the year is amortized over the expected average remaining service period of the active employees for defined benefit pension and post-retirement benefit plans, unless the plan covers mostly inactive members in which case life expectancy is used. The amortization period for the defined benefit pension plans ranges from 7 to 18 years, with a weighted average of 11 years. The amortization period for the post-retirement benefit plans ranges from 8 to 16 years, with a weighted average of 15 years. The unamortized net actuarial gain or loss for post-employment benefits is amortized over a period not exceeding three years.

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

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

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

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

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

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

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

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

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

Presentation Certain prior year information has been reclassified to conform with current year presentation.

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

Note 2. Implementation of New Accounting Standards

Accounting Standards Implemented in 2009

Goodwill and Intangible Assets In November 2007, the CICA issued amendments to Section 1000 “Financial Statement Concepts”, and AcG 11 “Enterprises in the Development Stage”, issued a new Handbook Section 3064 “Goodwill and Intangible Assets” (“Section 3064”) to replace Section 3062 “Goodwill and Other Intangible Assets”, withdrew Section 3450 “Research and Development Costs” and amended Emerging Issues Committee (“EIC”) Abstract 27 “Revenues and Expenditures During the Pre-operating Period” to not apply to entities that have adopted Section 3064. These amendments, in conjunction with Section 3064, provide guidance for the recognition of intangible assets, including internally developed assets from research and development activities, ensuring consistent treatment of all intangible assets, whether separately acquired or internally developed. The Company implemented these requirements effective 2009, retroactively with restatement.

Notes to the Consolidated Financial Statements

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

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

Note 3. Distribution Network Costs

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

Note 4. Interest Expense and Other Financing Charges

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

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

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

Note 5. Income Taxes

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

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

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

The cumulative effects of changes in Canadian federal and certain provincial statutory income tax rates on future income tax assets and liabilities are included in the consolidated financial statements at the time of substantive enactment. Accordingly, in 2010 a \$nil (2009 – \$3 million) net reduction to the future income tax expense was recognized as a result of the change in the Canadian federal and certain provincial statutory income tax rates.

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

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

Notes to the Consolidated Financial Statements

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

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

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

Note 7. Cash and Cash Equivalents

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

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

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

Note 8. Accounts Receivable

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

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

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

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

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

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

The following table displays the sensitivity of the current fair value of the retained interest to an immediate 10% and 20% adverse change in the 2010 key assumptions. The sensitivity analysis provided in the table is hypothetical and should be used with caution. The sensitivities of each key assumption have been calculated independently of any changes in other key assumptions. Actual experience may result in changes in a number of key assumptions simultaneously. Changes in one factor may result in changes in another, which could amplify or reduce the impact of such assumptions.

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

Notes to the Consolidated Financial Statements

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

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

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

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

Credit Card Receivables

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

Other Receivables

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

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

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

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

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

Note 9. Inventories

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

Note 10. Fixed Assets

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

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

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

Note 11. Goodwill and Intangible Assets

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

Notes to the Consolidated Financial Statements

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

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

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

Note 12. Other Assets

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

Note 13. Employee Future Benefits

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

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

The Company also offers other employee benefit plans comprised of post-retirement and post-employment benefit plans which are generally unfunded and non-contributory. Post retirement benefit plans include health care, life insurance and dental benefits during retirement while post-employment benefit plans include long term disability benefits and the continuation of health and dental benefits while on disability. Employees eligible for post-retirement benefits are those who retire at certain retirement ages having met certain service requirements and employees eligible for post-employment benefits are those on long term disability leave. The majority of post-retirement health care plans for current and future retirees include a limit on the total benefits payable by the Company.

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

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

Funding of Pension and Other Benefit Plans The most recent actuarial valuations of the defined benefit pension plans for funding purposes (“funding valuations”) were performed as at December 31, 2007 and December 31, 2009. The Company is required to file funding valuations at least every three years; accordingly, the next funding valuations will be performed as at December 31, 2010 and 2012, respectively.

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

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

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

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

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

Notes to the Consolidated Financial Statements

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

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

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

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

| Percentage of Plan Assets | 2010 | | 2009 | |
|---------------------------|-----------------------|------------------------------------|-----------------------|------------------------------------|
| | Pension Benefit Plans | Other Benefit Plans ⁽¹⁾ | Pension Benefit Plans | Other Benefit Plans ⁽¹⁾ |
| Asset Category | | | | |
| Equity securities | 58% | –% | 55% | –% |
| Debt securities | 40% | –% | 43% | 98% |
| Cash and cash equivalents | 2% | 100% | 2% | 2% |
| Total | 100% | 100% | 100% | 100% |

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

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

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

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

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

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

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

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

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

Notes to the Consolidated Financial Statements

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

Sensitivity of Key Assumptions The following table outlines the key assumptions for 2010 and the sensitivity of a 1% change in each of these assumptions on the accrued benefit plan obligations and on the benefit plan cost for defined benefit pension plans and other benefit plans. The table reflects the impact on the current service and interest cost components for the discount rate and expected growth rate of health care costs assumptions.

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

| | Pension Benefits Plans | | Other Benefit Plans ⁽¹⁾ | |
|--|----------------------------------|----------------------------------|------------------------------------|----------------------------------|
| | Accrued Benefit Plan Obligations | Benefit Plan Cost ⁽²⁾ | Accrued Benefit Plan Obligations | Benefit Plan Cost ⁽²⁾ |
| Expected long term rate of return on plan assets | | 6.75% | | 5.0% |
| Impact of: 1% increase | n/a | \$ (11) | n/a | – |
| 1% decrease | n/a | \$ 11 | n/a | – |
| Discount rate | 5.00% | 5.75% | 4.8% | 5.5% |
| Impact of: 1% increase | \$ (194) | \$ (7) | \$ (40) | \$ (2) |
| 1% decrease | \$ 225 | \$ 7 | \$ 45 | \$ 2 |
| Expected growth rate of health care costs ⁽³⁾ | | | 8.0% | 9.0% |
| Impact of: 1% increase | n/a | n/a | \$ 35 | \$ 4 |
| 1% decrease | n/a | n/a | \$ (31) | \$ (4) |

n/a – not applicable

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

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

(3) Gradually decreasing to 5.0% by 2015 (2009 – 5.0% by 2015) for the accrued benefit plan obligation and the benefit plan cost, and remaining at that level thereafter.

Note 14. Short Term Debt

The Company has an \$800 million committed credit facility expiring in March of 2013 provided by a syndicate of third party lenders which contains certain financial covenants (see note 20). This facility is a potential source of the Company's short term funding requirements and permits borrowings having up to a 180-day term. Interest is based on a floating rate, primarily the bankers' acceptance rate and an applicable margin based on the Company's credit rating. As at January 1, 2011 and January 2, 2010, the Company had not drawn on the committed credit facility.

Note 15. Long Term Debt

| (\$ millions) | January 1, 2011 | January 2, 2010 |
|--|-----------------|-----------------|
| Loblaw Companies Limited Notes | | |
| 7.10%, due 2010 | \$ – | \$ 300 |
| 6.50%, due 2011 | 350 | 350 |
| 5.40%, due 2013 | 200 | 200 |
| 6.00%, due 2014 | 100 | 100 |
| 4.85%, due 2014 | 350 | 350 |
| 7.10%, due 2016 | 300 | 300 |
| 5.22%, due 2020 | 350 | – |
| 6.65%, due 2027 | 100 | 100 |
| 6.45%, due 2028 | 200 | 200 |
| 6.50%, due 2029 | 175 | 175 |
| 11.40%, due 2031 | | |
| – principal | 151 | 151 |
| – effect of coupon repurchase | (81) | (67) |
| 6.85%, due 2032 | 200 | 200 |
| 6.54%, due 2033 | 200 | 200 |
| 8.75%, due 2033 | 200 | 200 |
| 6.05%, due 2034 | 200 | 200 |
| 6.15%, due 2035 | 200 | 200 |
| 5.90%, due 2036 | 300 | 300 |
| 6.45%, due 2039 | 200 | 200 |
| 7.00%, due 2040 | 150 | 150 |
| 5.86%, due 2043 | 55 | 55 |
| Private Placement Notes | | |
| 6.48%, due 2013 (US \$150 million) | 150 | 158 |
| 6.86%, due 2015 (US \$150 million) | 150 | 158 |
| Long Term Debt Secured by Mortgage | | |
| 5.49%, due 2018 (see note 10) | 93 | 96 |
| Guaranteed investment certificates due 2011 – 2015 (1.55% - 3.15%) | 18 | – |
| VIE loans payable ⁽¹⁾ (see note 26) | 202 | 163 |
| Capital lease obligations ⁽¹⁾ (see note 17) | 132 | 64 |
| Other | 1 | 2 |
| Total long term debt | 4,646 | 4,505 |
| Less amount due within one year | 433 | 343 |
| | \$ 4,213 | \$ 4,162 |

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

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

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

Notes to the Consolidated Financial Statements

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

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

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

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

Note 16. Other Liabilities

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

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

Note 17. Leases

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

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

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

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

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

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

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

Note 19. Common Share Capital (authorized – unlimited)

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

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

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

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

Common Share Dividends (\$) The declaration and payment of dividends and the amount thereof are at the discretion of the Board which takes into account the Company's financial results, capital requirements, available cash flow and other factors the Board considers relevant from time to time. Over the long term, the Company's objective is for its dividend payment ratio to be in the range of 20% to 25% of the prior year's basic net earnings per common share adjusted as appropriate for items which are not regarded to be reflective of ongoing operations giving consideration to the year-end cash position, future cash flow requirements and investment opportunities. During 2010, the Board declared common share dividends of \$0.84 (2009 – \$0.84) per common share. Subsequent to year end, the Board declared a quarterly dividend of \$0.21 per common share payable April 1, 2011.

Notes to the Consolidated Financial Statements

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

Normal Course Issuer Bids (“NCIB”) In the second quarter of 2010, the Company renewed its NCIB to purchase on the Toronto Stock Exchange, or enter into equity derivatives to purchase, up to 13,865,435 of Company’s common shares, representing approximately 5% of the common shares outstanding. In accordance with the rules and by-laws of the Toronto Stock Exchange, the Company may purchase its shares at the then market price of such shares. During 2010, the Company did not purchase any common shares for cancellation (2009 – 1,698,400) at a price of nil (2009 – \$33.14).

Note 20. Capital Management

The Company defines capital as net debt⁽¹⁾ capital securities and shareholders’ equity. The Company’s objectives when managing capital are to:

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

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

| | As at January 1, 2011 | As at January 2, 2010 |
|--|-----------------------|-----------------------|
| Interest coverage | 4.3x | 4.2x |
| Net debt ⁽¹⁾ to equity ⁽¹⁾ | 0.4:1 | 0.4:1 |
| Net debt ⁽¹⁾ to EBITDA ⁽¹⁾ | 1.3:1 | 1.6:1 |

The Company manages debt on a net basis as outlined below. The net debt⁽¹⁾ to equity⁽¹⁾ ratio is consistent with the Company’s internal guideline of less than 1:1. This ratio is useful in assessing the amount of leverage employed. These ratios are also calculated from time-to-time on an alternative basis by management to approximate the methodology of debt rating agencies and other market participants.

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

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

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

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

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

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

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

Notes to the Consolidated Financial Statements

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

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

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

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

Covenants and Regulatory Requirements The committed credit facility which the Company entered into during 2008, the USD \$300 million fixed-rate private placement notes which the Company issued during 2008, the Company's Medium Term Notes and certain of the Company's letters of credit contain certain financial and non-financial covenants. Certain agreements include maintaining an interest coverage ratio as well as a leverage ratio, which the Company measures on a quarterly basis. These ratios are defined in the respective agreements. As at January 1, 2011, the Company was in compliance with the covenants under these agreements.

The Company is also subject to externally imposed capital requirements from the Office of the Superintendent of Financial Institutions ("OSFI"), as the primary regulator of PC Bank, and the Central Bank of Barbados, as the primary regulator of Glenhuron, both wholly owned subsidiaries of the Company. PC Bank's capital management objectives are to maintain a consistently strong capital position while considering the Bank's economic risks generated by its credit card loan portfolio and to meet all regulatory capital requirements as defined by OSFI. PC Bank is subject to the Basel II regulatory capital management framework which includes a Tier 1 capital ratio of 7% and a total capital ratio of 10%. PC Bank has met all applicable capital targets as at the end of 2010. Glenhuron is currently regulated under Basel I. Under Basel I, Glenhuron's assets are risk weighted and the minimum ratio of capital to risk weighted assets is 8.0%. Glenhuron's ratio of capital to risk weighted assets met the minimum requirements under Basel I as at January 1, 2011.

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

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

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

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

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

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

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

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

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

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

Notes to the Consolidated Financial Statements

The RSU activity during the year is as follows:

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

Employee Share Ownership Plan The Company maintains an ESOP which allows employees to acquire the Company's common shares through regular payroll deductions of up to 5% of their gross regular earnings. The Company contributes an additional 25% (2009 – 25%) of each employee's contribution to the plan. The ESOP is administered through a trust which purchases the Company's common shares on the open market on behalf of employees. A compensation cost of \$6 million (2009 – \$6 million) related to this plan was recognized in operating income.

Director Deferred Share Unit Plan Members of the Board, who are not management of the Company, may elect annually to receive all or a portion of their annual retainer(s) and fees in the form of DSUs, the value of which is determined by the market price of the Company's common shares at the time the director's annual retainer(s) or fees are earned. Upon termination of Board service, the common shares due to the director, as represented by the DSUs, will be purchased on the open market on the director's behalf. At year end, 147,358 (2009 – 110,303) DSUs were outstanding. The year-over-year change in the deferred share unit compensation liability was \$2 million (2009 – \$1 million) and was recognized in operating income.

Executive Deferred Share Unit Plan Under this plan, executives may elect to defer up to 100% of the STIP earned by the executive in any year into the EDSU Plan, subject to an overall cap of three times the executive's base salary. All EDSUs held by an executive will be paid out in cash by December 15 of the year following the year in which the executive's employment ceases for any reason. An election to participate in the plan in any year must be made before the beginning of the year and is irrevocable. The number of EDSUs granted in respect of any year will be determined by dividing the STIP bonus that is subject to the EDSU plan election by the value of the Company's common shares on the date the STIP bonus would otherwise be payable. For this purpose, and for purposes of determining the value of an EDSU upon conversion of the EDSUs into cash, the value of the EDSUs will be calculated by using the weighted average of the trading prices of the Company's common shares on the Toronto Stock Exchange for the five trading days prior to the valuation date. As at the end of 2010 and 2009, there were 29,143 and nil EDSUs outstanding, respectively. A compensation cost of \$1 million (2009 – nil) related to this plan was recognized in operating income.

Note 22. Accumulated Other Comprehensive Income

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

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

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

Note 23. Financial Derivative Instruments

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

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

Notes to the Consolidated Financial Statements

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

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

In 2008, the Company entered into fixed cross currency swaps to exchange \$296 million Canadian dollars for \$300 million USD, which mature by 2015. A portion of these cross currency swaps are designated in a cash flow hedge to manage the foreign exchange related to a part of the Company's fixed rate USD private placement notes (see note 15). As at January 1, 2011, a cumulative unrealized foreign currency exchange rate receivable of \$11 million (2009 – \$19 million) was recorded in other assets (see note 12).

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

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

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

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

Electricity Forward Contract The Company entered into an electricity forward contract to minimize price volatility and to maintain a portion of the Company's electricity costs at approximately 2006 rates. This electricity forward contract has an initial term of five years and expires in December 2011. As at January 1, 2011, the fair value of this forward contract of \$1 million (2009 – \$3 million) was recorded in other liabilities. During 2010, a gain in value of \$2 million (2009 – loss of \$10 million) was recorded in operating income.

Fuel Exchange Traded Futures and Options The Company from time to time enters into exchange traded futures contracts and options contracts to minimize cost volatility on fuel prices. Futures contracts establish a fixed cost on a portion of the Company's fuel exposure and option contracts typically provide protection against a range of cost outcomes. As at January 1, 2011, the Company did not hold any outstanding fuel exchange traded future or option contracts (2009 – nil). During 2010, a gain in value of \$1 million (2009 –\$4 million) was recorded in operating income.

Note 24. Fair Values of Financial Instruments

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

The following tables provide a comparison of carrying and fair values for each classification of financial instruments as at January 1, 2011 and January 2, 2010, and an analysis of financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

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

The following describes the fair value determinations of financial instruments:

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

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

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

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

Notes to the Consolidated Financial Statements

As at January 1, 2011

| (\$ millions) | Financial derivatives designated in a cash flow hedge | Financial instruments required to be classified as held-for-trading | Financial instruments designated as held-for-trading | Available-for-sale instruments measured at fair value | Loans and receivables | Other financial liabilities | Total carrying amount | Total fair value |
|--|---|---|--|---|-----------------------|-----------------------------|-----------------------|------------------|
| Cash and cash equivalents, short term investments and security deposits | \$ - | \$ - | \$ 1,874 | \$ 147 | \$ - | \$ - | \$ 2,021 | \$ 2,021 |
| Accounts receivable | - | - | 21 | - | 703 | - | 724 | 724 |
| Derivatives | 64 | 133 | - | - | - | - | 197 | 197 |
| Total financial assets | \$ 64 | \$ 133 | \$ 1,895 | \$ 147 | \$ 703 | \$ - | \$ 2,942 | \$ 2,942 |
| Fair value level 1 | \$ - | \$ - | \$ - | \$ - | n/a | n/a | n/a | \$ - |
| Fair value level 2 | 64 | 130 | 1,874 | 147 | n/a | n/a | n/a | 2,215 |
| Fair value level 3 | - | 3 | 21 | - | n/a | n/a | n/a | 24 |
| Fair Value Total | \$ 64 | \$ 133 | \$ 1,895 | \$ 147 | n/a | n/a | n/a | \$ 2,239 |
| Short term borrowings | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 3 | \$ 3 | \$ 3 |
| Accounts payable and accrued liabilities | - | 24 | - | - | - | 3,392 | 3,416 | 3,416 |
| Long term debt | - | - | - | - | - | 4,646 | 4,646 | 5,142 |
| Certain other liabilities | - | - | - | - | - | 35 | 35 | 35 |
| Capital Securities | - | - | - | - | - | 221 | 221 | 252 |
| Derivatives (see note 23) | - | 26 | - | - | - | 7 | 33 | 33 |
| Total financial liabilities | \$ - | \$ 50 | \$ - | \$ - | \$ - | \$ 8,304 | \$ 8,354 | \$ 8,881 |
| Fair value level 1 | \$ - | \$ - | \$ - | \$ - | n/a | n/a | n/a | \$ - |
| Fair value level 2 | - | 50 | - | - | n/a | n/a | n/a | 50 |
| Fair value level 3 | - | - | - | - | n/a | n/a | n/a | - |
| Fair Value Total | \$ - | \$ 50 | \$ - | \$ - | n/a | n/a | n/a | \$ 50 |

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

As at January 2, 2010

| (\$ millions) | Financial derivatives designated in a cash flow hedge | Financial instruments required to be classified as held-for-trading | Financial instruments designated as held-for-trading | Available-for-sale instruments measured at fair value | Loans and receivables | Other financial liabilities | Total carrying amount | Total fair value |
|---|---|---|--|---|-----------------------|-----------------------------|-----------------------|------------------|
| Cash and cash equivalents, short term investments and security deposits | \$ - | \$ - | \$ 1,448 | \$ 192 | \$ - | \$ - | \$ 1,640 | \$ 1,640 |
| Accounts receivable | - | - | 13 | - | 761 | - | 774 | 774 |
| Derivatives | 83 | 116 | - | - | - | - | 199 | 199 |
| Total financial assets | \$ 83 | \$ 116 | \$ 1,461 | \$ 192 | \$ 761 | \$ - | 2,613 | \$ 2,613 |
| Fair value level 1 | \$ - | \$ - | \$ - | \$ - | n/a | n/a | n/a | \$ - |
| Fair value level 2 | 83 | 115 | 1,448 | 192 | n/a | n/a | n/a | 1,838 |
| Fair value level 3 | - | 1 | 13 | - | n/a | n/a | n/a | 14 |
| Fair Value Total | \$ 83 | \$ 116 | \$ 1,461 | \$ 192 | n/a | n/a | n/a | \$ 1,852 |
| Short term borrowings | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 2 | \$ 2 | \$ 2 |
| Accounts payable and accrued liabilities | - | 48 | - | - | - | 3,231 | 3,279 | 3,279 |
| Long term debt | - | - | - | - | - | 4,505 | 4,505 | 4,801 |
| Certain other liabilities | - | - | - | - | - | 36 | 36 | 36 |
| Capital Securities | - | - | - | - | - | 220 | 220 | 244 |
| Derivatives (see note 23) | - | 34 | - | - | - | 7 | 41 | 41 |
| Total financial liabilities | \$ - | \$ 82 | \$ - | \$ - | \$ - | \$ 8,001 | \$ 8,083 | \$ 8,403 |
| Fair value level 1 | \$ - | \$ - | \$ - | \$ - | n/a | n/a | n/a | \$ - |
| Fair value level 2 | - | 82 | - | - | n/a | n/a | n/a | 82 |
| Fair value level 3 | - | - | - | - | n/a | n/a | n/a | - |
| Fair Value Total | \$ - | \$ 82 | \$ - | \$ - | n/a | n/a | n/a | \$ 82 |

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

The financial instruments classified as level 3 are as follows:

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

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

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

Notes to the Consolidated Financial Statements

Note 25. Financial Instrument Risk Management

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

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

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

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

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

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

(2) Based on the average cost base as at January 1, 2011.

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

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

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

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

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

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

Credit risk associated with cash equivalents, short term investments and security deposits results from the possibility that a counterparty may default on the repayment of a security. Policies and guidelines that require issuers of permissible investments to have a minimum long term "A" credit rating from a recognized credit rating agency and that specify minimum and maximum exposures to specific industries, issuers and types of investment instruments mitigate credit risk. These investments are purchased and held directly in custody accounts, and have limited exposure to third party money market portfolios and funds.

Credit risk from PC Bank's credit card receivables and receivables from independent franchisees, associated stores and independent accounts results from the possibility that customers may default on their payment obligation. PC Bank manages the credit card receivable risk by employing stringent credit scoring techniques, actively monitoring the credit card portfolio, and reviewing techniques and technology that can improve the effectiveness of the collection process. In addition, these receivables are dispersed among a large, diversified group of credit card customers. Accounts receivable from independent franchisees, associated stores and independent accounts are actively monitored on an ongoing basis and settled on a frequent basis in accordance with the terms specified in the applicable agreements.

The Company's maximum exposure to credit risk as it relates to derivative instruments is approximated by the positive fair market value of the derivatives on the balance sheet (see note 24).

Refer to note 8 for additional information on the credit quality performance of credit card receivables and other receivables from independent franchisees, associated stores and independent accounts.

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

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

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

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

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

Notes to the Consolidated Financial Statements

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

During 2010, the Company recognized in operating income an unrealized foreign currency exchange gain of \$16 million (2009 – \$45 million) related to the USD \$300 million fixed-rate private placement notes. This was partially offset by both the effective portion of the designated cross currency swaps that was reclassified from other comprehensive income to operating income and the fair value gain of the cross currency swaps that are not designated in a hedging relationship. At the inception of the cash flow hedge, a nominal amount of ineffectiveness was recognized in operating income.

Commodity Price Risk The Company is exposed to increases in the prices of commodities in operating its stores and distribution centres, as well as the indirect link of commodities to its consumer products. To manage a portion of this exposure, the Company uses purchase commitments for a portion of its needs for certain consumer products that may be commodities based and the Company expects to take delivery of these consumer products in the normal course of business. A non-financial derivative contract with a notional value of \$8 million (2009 – \$17 million) is used to hedge electricity price risk for a portion of the Company's expected electricity consumption in Alberta. The Company also enters into exchange traded futures contracts and option contracts to minimize cost volatility on fuel prices. The Company estimates that a 10% increase (decrease) in relevant commodity prices, with all other variables held constant, would result in a gain (loss) of \$1 million on earnings before income taxes and minority interest.

Common Share Price Risk The Company issues stock-based compensation to its employees in the form of stock options and RSU's based on its common shares. Consequently, operating income is negatively impacted when the common share price increases and positively when the share price declines. Glenhuron's equity forwards provide a partial offset to fluctuations in stock-based compensation cost. The equity forwards allow for settlement in cash, common shares or net settlement. These forwards change in value as the market price of the Company's common shares changes and provide a partial offset to fluctuations in the Company's stock-based compensation cost, including RSU plan expense. The partial offset between the Company's stock-based compensation costs, including RSU plan expense, and the equity forwards is more effective when the market price of the Company's common shares exceeds the exercise price of the employee stock options. When the market price of the common shares is lower than the exercise price of the employee stock options, only RSUs will provide a partial offset to these equity forwards. The amount of net stock-based compensation cost recorded in operating income is mainly dependent upon the number of unexercised stock options and RSUs, their vesting schedules relative to the number of underlying common shares on the equity forwards, and the level of fluctuations in the market price of the underlying common shares. The impact on the equity forwards of a one dollar increase (decrease) of the market value in the Company's underlying common shares, with all other variables held constant, would result in a gain (loss) of \$1 million in earnings before income taxes and minority interest.

Note 26. Contingencies, Commitments and Guarantees

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

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

At year end, the Company has committed approximately \$95 million (2009 – \$76 million) with respect to capital investment projects such as the construction, expansion and renovation of buildings and the purchase of real property.

The Company establishes letters of credit used in connection with certain obligations mainly related to real estate transactions, benefit programs, purchase orders and performance guarantees. The aggregate gross potential liability related to these letters of credit is approximately \$325 million (2009 – \$277 million). Additionally, the Company has a guarantee on behalf of PC Bank in the amount of US \$180 million. Other letters of credit related to the financing program for the Company's independent franchisees and securitization of PC Bank's credit card receivables have been identified as guarantees and are discussed further in the Guarantees section below.

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

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

The gross principal amount of loans issued to the Company's independent franchisees by the independent funding trusts as at January 1, 2011 was \$405 million (2009 – \$390 million) including \$202 million (2009 – \$163 million) of loans payable by VIEs consolidated by the Company. The Company has agreed to provide credit enhancement in the form of a standby letter of credit for the benefit of the independent funding trust representing not less than 15% (2009 – 15%) of the principal amount of the loans outstanding. This standby letter of credit has never been drawn upon. This credit enhancement allows the independent funding trust to provide financing to the Company's independent franchisees. As well, each independent franchisee provides security to the independent funding trust for its obligations by way of a general security agreement. In the event that an independent franchisee defaults on its loan and the Company has not, within a specified time period, assumed the loan, or the default is not otherwise remedied, the independent funding trust would assign the loan to the Company and draw upon this standby letter of credit. The Company has agreed to reimburse the issuing bank for any amount drawn on the standby letter of credit.

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

Letters of Credit Letters of credit for the benefit of independent trusts with respect to credit card receivables securitization programs of PC Bank have been issued by major Canadian chartered banks. These standby letters of credit could be drawn upon in the event of a major decline in the income flow from or in the value of the securitized credit card receivables. The Company has agreed to reimburse the issuing banks for any amount drawn on the standby letters of credit. The aggregate gross potential liability under these arrangements, which represents 9% (2009 – 9%) on a portion of the securitized credit card receivables amount, is approximately \$48 million (2009 – \$116 million) (see note 8).

Lease Obligations In connection with historical dispositions of certain of its assets, the Company has assigned leases to third parties. The Company remains contingently liable for these lease obligations in the event any of the assignees are in default of their lease obligations. The estimated amount for minimum rent, which does not include other lease related expenses such as property tax and common area maintenance charges, is in aggregate \$26 million (2009 – \$41 million).

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

Notes to the Consolidated Financial Statements

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

Note 27. Variable Interest Entities

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

Franchisees The Company enters into various forms of franchise agreements that generally require the franchisee to purchase inventory from the Company and pay certain fees in exchange for services provided by the Company and for the right to use certain trademarks and licenses owned by the Company. Franchisees generally lease the land and building from the Company, and when eligible, may obtain financing through a structure involving independent trusts to facilitate the purchase of the majority of their inventory and fixed assets, consisting mainly of fixtures and equipment (see note 26). These trusts are administered by a major Canadian chartered bank. Under the terms of certain franchise agreements, the Company may also lease equipment to franchisees. Franchisees may also obtain financing through operating lines of credit with traditional financial institutions or through issuing preferred shares or notes payable to the Company. The Company monitors the financial condition of its franchisees and provides for estimated losses or write-downs on its accounts and notes receivable or investments when appropriate.

As at January 1, 2011, 214 (2009 – 166) of the Company's franchised stores met the criteria for a VIE and were consolidated pursuant to AcG 15.

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

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

Independent Trusts The Company has also identified that it holds variable interests, by way of standby letters of credit in independent trusts which are used to securitize credit card receivables for PC Bank. In these securitizations, PC Bank sells a portion of its credit card receivables to the independent trusts in exchange for cash. Although these independent trusts have been identified as VIEs, it was determined that the Company is not the primary beneficiary and therefore these VIEs are not subject to consolidation by the Company. The Company's maximum exposure to loss as a result of its involvement with these independent trusts is disclosed in note 26.

Note 28. Related Party Transactions

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

Inventory Purchases Purchases of inventory from related parties for resale in the distribution network represented approximately 3% (2009 – 3%) of the cost of merchandise inventories sold.

Cost Sharing Agreements Weston has entered into certain contracts with third parties for administrative and corporate services, including telecommunication services and information technology related matters on behalf of the Company. Through cost sharing agreements that have been established between the Company and Weston concerning these costs, the Company has agreed to be responsible to Weston for its proportionate share of the costs incurred on its behalf. Payments by the Company pursuant to these cost sharing agreements in 2010 were approximately \$9 million (2009 – \$10 million).

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

Borrowings/Lending The Company, from time to time, may borrow funds from or may lend funds to Weston on a short term basis at short term market borrowing rates. There were no amounts outstanding as at January 1, 2011 and January 2, 2010.

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

Management Agreements The Company has an agreement with Weston to provide certain administrative services by each company to the other. The services to be provided under this agreement include those related to commodity management, pension and benefits, tax, medical, travel, information system, risk management, treasury and legal. Payments are made quarterly based on the actual costs of providing these services. Where services are provided on a joint basis for the benefit of the Company and Weston together, each party pays the appropriate proportion of such costs. Net payments under this agreement in 2010 were \$16 million (2009 – \$16 million). Fees paid under this agreement are reviewed each year by the Audit Committee.

Glenhuron manages certain United States cash, cash equivalents and short term investments for wholly owned non-Canadian subsidiaries of Weston and management fees earned are based on market rates.

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

Note 29. Business Acquisitions and Dispositions

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

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

Notes to the Consolidated Financial Statements

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

Net assets acquired (\$ millions):

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

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

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

Note 30. Other Information

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

Three Year Summary⁽¹⁾

| Year ⁽²⁾ (\$ millions except where otherwise indicated) | 2010 | 2009 | 2008 ⁽²⁾ |
|--|--------|--------|---------------------|
| Operating Results | | | |
| Sales | 30,997 | 30,735 | 30,802 |
| Operating income | 1,269 | 1,205 | 1,052 |
| Interest expense and other financing charges | 273 | 269 | 263 |
| Net earnings | 681 | 656 | 550 |
| Financial Position | | | |
| Working capital | 774 | 741 | 730 |
| Fixed assets | 9,123 | 8,559 | 8,045 |
| Goodwill and intangible assets | 1,029 | 1,026 | 818 |
| Total assets | 15,919 | 14,991 | 13,943 |
| Net debt ⁽³⁾ | 2,513 | 2,783 | 3,293 |
| Shareholders' equity | 6,880 | 6,273 | 5,803 |
| Cash Flow | | | |
| Cash flows from operating activities | 1,594 | 1,945 | 960 |
| Capital investment | 1,280 | 1,067 | 750 |
| Per Common Share (\$) | | | |
| Basic net earnings | 2.45 | 2.39 | 2.01 |
| Dividend rate at year end | 0.84 | 0.84 | 0.84 |
| Cash flows from operating activities ⁽¹⁾ | 5.74 | 7.07 | 3.50 |
| Fixed asset purchases | 4.61 | 3.53 | 2.74 |
| Book value | 24.52 | 22.71 | 21.16 |
| Market price at year end | 40.37 | 33.88 | 35.23 |
| Financial Measures and Ratios | | | |
| Operating margin (%) | 4.1 | 3.9 | 3.4 |
| EBITDA ⁽³⁾ | 1,924 | 1,794 | 1,602 |
| EBITDA margin ⁽³⁾ (%) | 6.2 | 5.8 | 5.2 |
| Net debt ⁽³⁾ to EBITDA ⁽³⁾ | 1.3x | 1.6x | 2.1x |
| Net debt ⁽³⁾ to equity ⁽³⁾ | 0.4:1 | 0.4:1 | 0.5:1 |
| Interest coverage ⁽¹⁾ | 4.3x | 4.2x | 3.7x |
| Return on average net assets (%) ⁽³⁾ | 12.4 | 12.0 | 10.7 |
| Return on average shareholders' equity (%) | 10.4 | 10.9 | 9.7 |
| Cash flows from operating activities activities to net debt ⁽³⁾ | 0.63 | 0.70 | 0.29 |
| Price/net earnings ratio at year end | 16.5 | 14.2 | 17.5 |
| Market/book ratio at year end | 1.6 | 1.5 | 1.7 |
| Operating Statistics | | | |
| Retail square footage (in millions) | 50.7 | 50.6 | 49.8 |
| Average corporate store size (square feet) | 64,800 | 62,300 | 61,900 |
| Average franchise store size (square feet) | 29,500 | 29,700 | 28,400 |
| Corporate stores sales per average square foot (\$) | 601 | 597 | 624 |
| Same-store sales (decline) growth (%) | (0.6) | (1.1) | 4.2 |
| Number of corporate stores | 576 | 613 | 609 |
| Number of franchised stores | 451 | 416 | 427 |

(1) For financial definitions and ratios refer to the Glossary of Terms on page 87.

(2) 2008 was a 53 week year.

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

Earnings Coverage Exhibit to the Audited Consolidated Financial Statements

The following is the Company's updated earnings coverage ratio for the rolling 52 week period ended January 1, 2011 in connection with the Company's Short Form Base Shelf Prospectus dated November 25, 2010.

| | |
|--|------------|
| Earnings Coverage on long term debt obligations and capital securities | 4.21 times |
|--|------------|

The earnings coverage ratio on long term debt (including any current portion) and capital securities is equal to net earnings before interest on long term debt, dividends on capital securities, income taxes and minority interest divided by interest on long term debt and dividends on capital securities as shown in the notes to the consolidated financial statements of the Company for the period.

Glossary of Terms

| Term | Definition | Term | Definition |
|--|---|---|---|
| Annual Report | For 2010, the Annual Report consists of a Business Review and a Financial Review. | Net debt | Bank indebtedness, short term debt, long term debt due within one year, certain other liabilities, long term debt, and the fair value of certain financial derivative liabilities less cash and cash equivalents, short term investments, security deposits and the fair value of certain financial derivative assets (see Non-GAAP Financial Measures on page 38 of the Company's Management's Discussion & Analysis). |
| 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. | Net debt to EBITDA | Net debt divided by EBITDA. |
| Book value per common share | Shareholders' equity divided by the number of common shares outstanding at year end. | Net debt to equity | Net debt divided by total shareholders' equity and capital securities. |
| 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. | New store | A newly constructed store, conversion or major expansion. |
| Cash flows from operating activities to net debt | Cash flows from operating activities divided by net debt. | Operating income | Earnings before interest expense, income taxes and minority interest. |
| Control label | A brand and associated trademark that is owned by the Company for use in connection with its own products and services. | Operating margin | Operating income divided by sales. |
| Conversion | A store that changes from one Company banner to another Company banner. | 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. |
| Corporate stores sales per average square foot | Sales by corporate stores divided by the average corporate stores' square footage at year end. | Renovation | A capital investment in a store resulting in no change to the store square footage. |
| 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, certain other liabilities and capital securities at period end. | Retail sales | Combined sales of stores owned by the Company and those owned by the Company's independent franchisees. |
| Dividend rate per common share at year end | Dividend per common share declared in the fourth quarter multiplied by four. | Retail square footage | Retail square footage includes corporate and independent franchised stores. |
| DRIP | Dividend Reinvestment Plan. | Return on average net assets | Operating income divided by average total assets excluding cash and cash equivalents, short term investments, security deposits and accounts payable and accrued liabilities (see Non-GAAP Financial Measures on page 38 of the Company's Management's Discussion & Analysis). |
| EBITDA | Operating income before depreciation and amortization (see Non-GAAP Financial Measures on page 38 of the Company's Management's Discussion & Analysis). | Return on average shareholders' equity | Net earnings available to common shareholders divided by average total common shareholders' equity. |
| EBITDA margin | EBITDA divided by sales (see Non-GAAP Financial Measures on page 38 of the Company's Management's Discussion & Analysis). | Same-store sales | Retail sales from the same physical location for stores in operation in that location in both periods being compared by excluding sales from a store that has undergone a conversion or major expansion in the period. |
| Fixed asset purchases per common share | Fixed asset purchases divided by the weighted average number of common shares outstanding during the year. | 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 27 to the consolidated financial statements). |
| Gross margin | Sales less cost of merchandise inventories sold including inventory shrinkage divided by sales. | 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. |
| Interest coverage | Operating income divided by interest expense and other financing charges adding back interest capitalized to fixed assets. | Working capital | Total current assets less total current liabilities. |
| 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. | Year | The Company's fiscal year ends on the Saturday closest to December 31 and is usually 52 weeks in duration, but includes 53 weeks every 5 to 6 years. The years ended January 1, 2011 and January 2, 2010 both contained 52 weeks, while the year ended January 3, 2009 contained 53 weeks. |
| 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. | | |

National Head Office and Store Support Centre

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

Stock Exchange Listing and Symbol

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

Common Shares

W. Galen Weston, directly and indirectly, including through his controlling interest in Weston, owns approximately 64% of the Company's common shares.

At year end 2010 there were 280,578,130 common shares Issued and outstanding and 100,476,181 common shares available for public trading.

The average daily trading volume of the Company's common shares for 2010 was 359,460.

Preferred Shares

At year end 2010 there were 9,000,000 second preferred shares issued and outstanding and available for public trading.

The average daily trading volume of the Company's second preferred shares for 2010 was 8,387.

Trademarks

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

Common Dividend Policy

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

Common Dividend Dates

The declaration and payment of quarterly dividends are made subject to approval by the Board of Directors. The anticipated record and payment dates for 2011 are:

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

Investor Relations

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

Preferred Share Dividend Dates

The declaration and payment of quarterly dividends are made subject to approval by the Board of Directors. The anticipated payment dates for 2011 are: January 31, April 30, July 31 and October 31.

Normal Course Issuer Bid

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

Value of Common Shares

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

Registrar and Transfer Agent

Computershare Investor Services Inc.
100 University Avenue
Toronto, Canada
M5J 2Y1
Toll free: 1-800-564-6253
(Canada and U.S.)
Fax: (416) 263-9394
Toll free fax: 1-888-453-0330
International direct dial:
(514) 982-7555

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

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

Independent Auditors

KPMG LLP
Chartered Accountants
Toronto, Canada

Annual Meeting

The 2011 Annual Meeting of Shareholders of Loblaw Companies Limited will be held on Thursday May 5, 2011 at 11:00am (EST), at the Metro Toronto Convention Centre, South Building, Meeting Room 701, 222 Bremner Boulevard, Toronto, Ontario, Canada.

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 (www.loblaw.ca).

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Loblaws

COMPANIES LIMITED

Ce rapport est disponible en français.