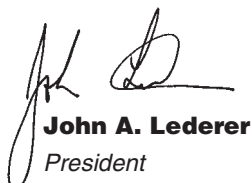



The management of Loblaw Companies Limited is responsible for the preparation, presentation and integrity of the accompanying consolidated financial statements, Management's Discussion and Analysis and all other information in this Annual Report. This responsibility includes the selection and consistent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

To provide reasonable assurance that assets are safeguarded and that relevant and reliable financial information is produced, management maintains a system of internal controls reinforced by the Company's standards of conduct and ethics set out in written policies. Internal auditors, who are employees of the Company, review and evaluate internal controls on management's behalf, coordinating this work with


Toronto, Canada  
March 8, 2005



**John A. Lederer**  
President



**Richard P. Mavrinc**  
Executive Vice President



**Stephen A. Smith**  
Executive Vice President

### Independent Auditors' Report

To the Shareholders of Loblaw Companies Limited:

We have audited the consolidated balance sheets of Loblaw Companies Limited as at January 1, 2005 and January 3, 2004 and the consolidated statements of earnings, retained earnings and cash flow for the 52 week and 53 week years then ended, respectively. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting

the independent auditors. KPMG LLP, whose report follows, were appointed as independent auditors by a vote of the Company's shareholders to audit the consolidated financial statements.

The Board of Directors, acting through an Audit Committee comprised solely of directors who are unrelated to and independent of the Company, is responsible for determining that management fulfills its responsibilities in the preparation of the consolidated financial statements and the financial control of operations. The Audit Committee recommends the independent auditors for appointment by the shareholders. The Audit Committee meets regularly with 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 this Annual Report based on the review and recommendation of the Audit Committee.

the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at January 1, 2005 and January 3, 2004 and the results of its operations and its cash flow for the years then ended in accordance with Canadian generally accepted accounting principles.



Toronto, Canada  
March 8, 2005



Chartered Accountants

## Consolidated Statements of Earnings

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For the years ended January 1, 2005 and January 3, 2004  
(\$ millions except where otherwise indicated)

	<b>2004</b> <b>(52 weeks)</b>	2003 (53 weeks)
<b>Sales</b>	<b>\$ 26,209</b>	\$ 25,220
<b>Operating Expenses</b>		
Cost of sales, selling and administrative expenses (note 1)	<b>24,084</b>	23,360
Depreciation and amortization	<b>473</b>	393
	<b>24,557</b>	23,753
<b>Operating Income</b>	<b>1,652</b>	1,467
Interest Expense (note 3)	<b>239</b>	196
<b>Earnings before Income Taxes</b>	<b>1,413</b>	1,271
Income Taxes (note 7)	<b>445</b>	426
<b>Net Earnings</b>	<b>\$ 968</b>	\$ 845
<b>Net Earnings per Common Share</b> (\$) (note 4)		
Basic	<b>\$ 3.53</b>	\$ 3.07
Diluted	<b>\$ 3.51</b>	\$ 3.05

See accompanying notes to the consolidated financial statements.

## Consolidated Statements of Retained Earnings

For the years ended January 1, 2005 and January 3, 2004  
(\$ millions except where otherwise indicated)

	<b>2004</b> <b>(52 weeks)</b>	2003 (53 weeks)
<b>Retained Earnings, Beginning of Year as Previously Reported</b>	<b>\$ 3,538</b>	\$ 2,929
Impact of implementing new accounting standards (note 1)	<b>(42)</b>	(42)
<b>Retained Earnings, Beginning of Year Restated</b>	<b>3,496</b>	2,887
Net earnings	<b>968</b>	845
Premium on common shares purchased for cancellation (note 15)	<b>(33)</b>	(71)
Dividends declared per common share – 76¢ (2003 – 60¢)	<b>(209)</b>	(165)
<b>Retained Earnings, End of Year</b>	<b>\$ 4,222</b>	\$ 3,496

See accompanying notes to the consolidated financial statements.

# Consolidated Balance Sheets


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As at January 1, 2005 and January 3, 2004  
(\$ millions)

	2004	2003 restated (note 1)
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents (note 5)	\$ 549	\$ 618
Short term investments (note 5)	275	378
Accounts receivable (note 6)	665	588
Inventories	1,821	1,746
Future income taxes (note 7)	109	113
Prepaid expenses and other assets	32	31
<b>Total Current Assets</b>	<b>3,451</b>	3,474
Fixed Assets (note 8)	7,113	6,390
Goodwill (note 9)	1,621	1,607
Future Income Taxes (note 7)	861	7
Other Assets (note 10)	861	706
<b>Total Assets</b>	<b>\$ 13,046</b>	\$ 12,184
<b>Liabilities</b>		
<b>Current Liabilities</b>		
Bank indebtedness	\$ 28	\$ 38
Commercial paper	473	603
Accounts payable and accrued liabilities	2,387	2,271
Income taxes	109	140
Long term debt due within one year (note 12)	216	106
<b>Total Current Liabilities</b>	<b>3,213</b>	3,158
Long Term Debt (note 12)	3,935	3,956
Future Income Taxes (note 7)	212	146
Other Liabilities (note 13)	272	234
<b>Total Liabilities</b>	<b>7,632</b>	7,494
<b>Shareholders' Equity</b>		
Common Share Capital (note 15)	1,192	1,194
Retained Earnings	4,222	3,496
<b>Total Shareholders' Equity</b>	<b>5,414</b>	4,690
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$ 13,046</b>	\$ 12,184

See accompanying notes to the consolidated financial statements.

Approved on behalf of the Board

  
**W. Galen Weston**  
Director

  
**T. Iain Ronald**  
Director

# Consolidated Cash Flow Statements

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For the years ended January 1, 2005 and January 3, 2004  
(\$ millions)

	<b>2004</b> <b>(52 Weeks)</b>	2003 (53 weeks)
<b>Operating Activities</b>		
Net earnings	<b>\$ 968</b>	\$ 845
Depreciation and amortization	<b>473</b>	393
Future income taxes	<b>67</b>	50
Change in non-cash working capital	<b>(99)</b>	(250)
Other	<b>34</b>	(6)
<b>Cash Flows from Operating Activities</b>	<b>1,443</b>	1,032
<b>Investing Activities</b>		
Fixed asset purchases	<b>(1,258)</b>	(1,271)
Short term investments	<b>83</b>	(114)
Proceeds from fixed asset sales	<b>110</b>	35
Credit card receivables, after securitization (note 6)	<b>(34)</b>	(16)
Franchise investments and other receivables	<b>(26)</b>	(48)
Other	<b>(52)</b>	(34)
<b>Cash Flows used in Investing Activities</b>	<b>(1,177)</b>	(1,448)
<b>Financing Activities</b>		
Bank indebtedness	<b>(11)</b>	38
Commercial paper	<b>(130)</b>	70
Long term debt (note 12)		
Issued	<b>200</b>	655
Retired	<b>(103)</b>	(102)
Common share capital		
Issued (note 16)		2
Retired (note 15)	<b>(35)</b>	(76)
Dividends	<b>(209)</b>	(198)
Other	<b>(2)</b>	(3)
<b>Cash Flows (used in) from Financing Activities</b>	<b>(290)</b>	386
Effect of foreign currency exchange rate changes on cash and cash equivalents (note 5)	<b>(45)</b>	(175)
Change in Cash and Cash Equivalents	<b>(69)</b>	(205)
Cash and Cash Equivalents, Beginning of Year	<b>618</b>	823
<b>Cash and Cash Equivalents, End of Year</b>	<b>\$ 549</b>	\$ 618

See accompanying notes to the consolidated financial statements.

## Notes to the Consolidated Financial Statements

For the years ended January 1, 2005 and January 3, 2004  
(\$ millions except where otherwise indicated)

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### Note 1. Summary of Significant Accounting Policies

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

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

*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, 2005 and January 3, 2004 contained 52 weeks and 53 weeks, respectively.

*Revenue Recognition* Sales include revenues, net of returns, from customers through corporate stores operated by the Company and sales to and service fees from its franchised stores, associated stores and independent account customers. The Company recognizes revenue at the time the sale is made to its customers.

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

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

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

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

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

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

*Vendor Allowances* Effective the third quarter of 2004, the Company implemented Emerging Issues Committee Abstract 144, “Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor” (“EIC 144”) retroactively with restatement of the prior year. EIC 144 provides that cash consideration received from a vendor is presumed to be a reduction in the cost of the vendor’s products or services and should, therefore, be characterized as a reduction in the cost of sales and the related inventory when recognized in the customer’s income statement and balance sheet. Certain exceptions apply if the consideration is a payment for assets or services delivered to the vendor or for reimbursement of selling costs incurred to promote the vendor’s products, provided that certain conditions are met.

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. As a result of implementing EIC 144, the timing of recognition of certain vendor allowances has changed. Upon retroactive implementation of EIC 144, the Company recorded a decrease to opening retained earnings for 2003 of \$38 (net of current future income taxes recoverable of \$11), a decrease to inventories of \$32 and an increase in accounts payable and accrued liabilities of \$17. Current and prior years' net earnings were not materially impacted.

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

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

Effective January 4, 2004, the Company implemented Section 3063, "*Impairment of Long-lived Assets*", a standard issued by the Canadian Institute of Chartered Accountants ("CICA") which addresses the recognition, measurement and disclosure of impairment of long-lived assets held-for-use. Long-lived assets are reviewed for impairment when events or circumstances indicate that their carrying value exceeds the sum of the undiscounted cash flows expected from their use and eventual disposal. An impairment loss is measured as the amount by which the long-lived assets' carrying value exceeds the fair value. Accordingly, the Company reviews long-lived assets for impairment annually. Asset groups are reviewed for impairment at their lowest level for which identifiable cash flows are largely independent of cash flows of other assets and liabilities. For purposes of annually reviewing store assets for impairment, 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 the Company operates a number of store formats within close proximity to one another. If an indicator of impairment exists, such as sustained negative operating cash flows of the respective asset group, then an estimate of undiscounted future cash flows of each such

store within this group is prepared and compared to its carrying value. For purposes of annually reviewing distribution centre assets for impairment, distribution centre net cash flows are grouped with the respective net cash flows of the stores they service. An impairment in the store network serviced by the distribution centre would indicate an impairment in the distribution centre assets as well. If these assets are determined to be impaired, the impairment loss is measured as the excess of the carrying value over its fair value. In addition, the Company evaluates the carrying value of long-lived assets whenever events or changes in circumstances indicate that the carrying value of long-lived assets may not be recoverable. These events or changes in circumstances include a commitment to close a store or distribution centre or to relocate or convert a store where the carrying value of its assets is greater than the expected future cash flows.

The standard was applied prospectively, with no material impact on the Company's financial condition or results of operations.

*Asset Retirement Obligations* Effective January 4, 2004, the Company implemented Section 3110, "*Asset Retirement Obligations*", issued by the CICA, which establishes standards for the recognition, measurement and disclosure of legal obligations associated with the costs to retire long-lived assets. A liability associated with the retirement of long-lived assets is recorded at its estimated fair value in the period in which the legal obligation is incurred and a corresponding asset is capitalized as part of the related asset and depreciated over its estimated useful life. Subsequent to the initial measurement of the asset retirement obligation, the obligation is adjusted to reflect the passage of time and changes in the estimated future costs underlying the obligation.

Accordingly, the Company has recognized a discounted liability associated with obligations arising from provisions in certain lease agreements regarding the exiting of leased properties at the end of the respective lease terms. The standard was implemented retroactively, with restatement of the prior year's consolidated financial statements. The cumulative effect of implementation was a decrease to opening retained earnings for 2003 of \$4 (net of future income taxes recoverable of \$2), an increase in fixed assets of \$2 and an increase in other liabilities of \$8. The impact on net earnings for each of 2003 and 2004 was not material.

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

*Goodwill* Goodwill represents the excess of the purchase price of a business acquired over the fair value of the underlying net assets acquired at the date of acquisition. Goodwill is not amortized and its carrying value is tested at least annually for impairment. Any impairment in the carrying value of goodwill is recognized in operating income. The Company performed the annual impairment test for goodwill and determined that there was no impairment to the carrying value of goodwill.

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

*Financial Derivative Instruments* The Company uses financial derivative agreements in the form of cross currency basis swaps, interest rate swaps and equity forwards to manage its current and anticipated exposure to fluctuations in foreign currency exchange rates, interest rates and the market price of the Company's common shares. The Company has also entered into an electricity forward contract to minimize price volatility and to maintain a portion of the Company's electricity costs in Ontario, Canada at approximately 2001 rates. The Company does not enter into financial derivative agreements for trading or speculative purposes.

Effective January 4, 2004, the Company implemented Accounting Guideline 13, "*Hedging Relationships*" ("AcG 13") issued by the CICA which addresses the identification, designation, documentation and effectiveness of hedging relationships for the purposes of applying hedge accounting and provides guidance with respect to the discontinuance of hedge accounting. Financial derivative instruments not designated within an AcG 13 compliant hedging relationship are measured at fair value with changes in fair value recorded in the consolidated statement of earnings in accordance with the Emerging Issues Committee Abstract 128, "*Accounting for Trading, Speculative or Non-Hedging Derivative Financial Instruments*".

Pursuant to the requirements of AcG 13, the Company has formally identified, designated and documented the following hedging relationships: cross currency basis swaps and interest rate swaps as cash flow hedges against its exposure to fluctuations in the foreign currency exchange rate and variable interest rates on a portion of its United States dollar denominated assets, principally cash equivalents

and short term investments; the electricity forward contract as a cash flow hedge of price volatility of the Company's electricity costs in Ontario, Canada; and interest rate swaps as a cash flow hedge of the variable interest rate exposure on commercial paper. Effectiveness tests are performed to evaluate hedge effectiveness at inception and on an ongoing basis, both retrospectively and prospectively.

Realized and unrealized foreign currency exchange rate adjustments on cross currency basis swaps are offset by realized and unrealized foreign currency exchange rate adjustments on a portion of the Company's United States dollar denominated assets and are recognized in operating income. The cumulative unrealized foreign currency exchange rate receivable or payable is recorded in other assets or other liabilities, respectively. The exchange of interest payments on the cross currency basis swaps and interest rate swaps is recognized on an accrual basis in interest expense. Unrealized gains or losses on the interest rate swaps designated within a compliant AcG 13 relationship are not recognized.

Hedging relationships that ceased to be eligible for hedge accounting under AcG 13 were discontinued as of January 4, 2004. The financial derivative instruments in these hedging relationships which were previously recorded on an accrual basis were fair valued as of January 4, 2004 and the resulting fair value loss was deferred and is being amortized over the original hedge term of approximately three years. The impact on the Company's financial condition and results of operations was not material. Subsequent changes in the fair value of these financial derivative instruments are recognized in interest expense.

Gains and losses on the electricity forward contract which is designated as a hedge of a portion of electricity costs are recognized in operating income as actual electricity costs are recognized.

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

*Income Taxes* The Company uses the asset and liability method of accounting for income taxes. Under the asset and liability method, future income tax assets and liabilities are recognized for the future income tax consequences attributable to differences between the financial statement carrying values of existing assets and liabilities

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

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

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

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

The accrued benefit plan asset or liability represents the cumulative difference between the cost and the funding contributions and is recorded in accounts payable and accrued liabilities, other assets and other liabilities in the consolidated balance sheets. The amount recorded in accounts payable and accrued liabilities represents the estimated defined benefit pension plans and other benefit plans funding contributions for the following year.

In March 2004, the CICA issued amendments to Section 3461, "*Employee Future Benefits*" to enhance disclosure requirements relating to pension, post-retirement and post-employment benefit plans. The new annual and interim disclosures are effective for fiscal years and interim periods ending on or after June 30, 2004. Accordingly, the Company implemented the additional interim disclosures in the second quarter of 2004 and the additional annual disclosures are provided in Notes 1 and 11.

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

The Company accounts for stock options issued prior to December 30, 2001 that will be settled by issuing common shares as capital transactions. Consideration paid by employees on the exercise of this type of stock option is credited to common share capital. This type of option was last issued in 2001 and represents approximately 3.5% of all options outstanding at year end.

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 15% of each employee's contribution to the plan, which is recognized in operating income as a compensation cost when the contribution is made.

Members of the Company's Board of Directors may elect annually to receive all or a portion of their annual retainer(s) and fees in the form of deferred share units which are accounted for using the intrinsic value method. The year-over-year change in the deferred share units liability is recognized in operating income as a compensation cost.

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

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

*Comparative Information* Certain prior year's information was reclassified to conform with the current year's presentation and was restated due to the retroactive implementation of Section 3110 and EIC 144, as described above. The cumulative impact to opening retained earnings for 2003 upon retroactive implementation of Section 3110 and EIC 144 was a decrease of \$4 and \$38, respectively, for a total of \$42.

### Note 3. Interest Expense

	2004	2003
Interest on long term debt	\$ 290	\$ 269
Interest on financial derivative instruments	(30)	(45)
Net short term interest		5
Capitalized to fixed assets	(21)	(33)
Interest expense	\$ 239	\$ 196

Net interest paid in 2004 was \$254 (2003 – \$211).

### Note 4. Basic and Diluted Net Earnings per Common Share

	2004	2003
Net earnings	\$ 968	\$ 845
Weighted average common shares outstanding (in millions)	274.3	275.4
Dilutive effect of stock-based compensation (in millions)	1.6	1.7
Diluted weighted average common shares outstanding (in millions)	275.9	277.1
Basic net earnings per common share (\$)	\$ 3.53	\$ 3.07
Dilutive effect of stock-based compensation per common share (\$)	(0.02)	(0.02)
Diluted net earnings per common share (\$)	\$ 3.51	\$ 3.05

### Note 5. Cash, Cash Equivalents and Short Term Investments

At year end, the Company had \$819 (2003 – \$991) in cash, cash equivalents and short term investments held by Glenhuron Bank Limited ("Glenhuron"), a wholly owned subsidiary of the Company in Barbados. The \$14 (2003 – \$14) of income from cash, cash equivalents and short term investments was recognized in net short term interest.

The Company recognized an unrealized foreign currency exchange rate loss of \$65 (2003 – \$215) as a result of translating its United

### Note 2. Special Voluntary Early Retirement Program

In connection with the labour arrangement for *The Real Canadian Superstore* in Ontario, Canada, the Company recognized a charge of \$25 in operating income during 2003 relating to the voluntary early retirement offers accepted by certain employees of Locals 1000A and 1977 of the United Food and Commercial Workers ("UFCW") union. During 2004, a net charge of \$1 was recognized in operating income, representing an adjustment to the 2003 charge net of an additional amount associated with the acceptance of a voluntary early retirement offer by certain employees of Local 175 of the UFCW union. Approximately \$5 of this accrual was paid by the end of 2003 and \$19 was paid during 2004. At year end 2004, \$2 remains outstanding.

States dollar denominated cash, cash equivalents and short term investments, of which \$45 (2003 – \$175) related to cash and cash equivalents. The resulting loss on cash, cash equivalents and short term investments is offset in operating income by the unrealized foreign currency exchange rate gain on the cross currency basis swaps. A cumulative unrealized foreign currency exchange rate receivable of \$155 (2003 – \$96) relating to these swaps is recorded in other assets on the balance sheet.

### Note 6. Credit Card Receivables

During 2004, the Company through PC Bank securitized \$227 (2003 – \$202) of credit card receivables, yielding nominal net gain (2003 – loss) on the initial sale inclusive of a \$1 (2003 – \$2) servicing liability. Servicing liabilities expensed during the year

were \$11 (2003 – \$9) and the fair value at year end of recognized servicing liabilities was \$7 (2003 – \$6). The trust's recourse to PC Bank's assets is limited to PC Bank's retained interests and is further supported by the Company through a standby letter of credit for 15% of the securitized amount.

	2004	2003
Credit card receivables	<b>\$ 968</b>	\$ 711
Amount securitized	<b>(785)</b>	(558)
Net credit card receivables	<b>\$ 183</b>	\$ 153
Net credit loss experience	<b>\$ 4</b>	\$ 9

The net credit loss experience of \$4 (2003 – \$9) includes \$23 (2003 – \$22) of credit losses on the total portfolio of credit card receivables net of credit losses of \$19 (2003 – \$13) relating to securitized credit card receivables.

The following table outlines the key economic assumptions used in measuring the retained interests at the date of securitization for securitizations completed in 2004. The table also displays the sensitivity of the current fair value of retained interests to an immediate

10% and 20% adverse change in the 2004 key economic assumptions. The sensitivity analysis provided in the table is hypothetical and should be used with caution. The sensitivities of each key assumption have been calculated independently of any changes in other key assumptions. Actual experience may result in changes in a number of key assumptions simultaneously. Changes in one factor may result in changes in another, which could amplify or reduce the impact of such assumptions.

	2004	Change in Assumptions	
		10%	20%
Carrying value of retained interests	<b>\$ 12</b>		
Payment rate (monthly)	<b>47.0%</b>		
Weighted average life (years)	<b>0.6</b>		
Expected credit losses (annual)	<b>3.0%</b>	\$ (0.4)	\$ (0.8)
Discount rate applied to residual cash flows (annual)	<b>14.0%</b>	\$ (1.6)	\$ (3.3)

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

	2004	2003
Proceeds from new securitizations	<b>\$ 227</b>	\$ 202
Net cash flows received on retained interests	<b>\$ 83</b>	\$ 53

### Note 7. Income Taxes

The Company's effective income tax rate in the consolidated statements of earnings is reported at a rate less than the weighted

average basic Canadian federal and provincial statutory income tax rate for the following reasons:

	2004	2003
Weighted average basic Canadian federal and provincial statutory income tax rate	<b>34.9%</b>	36.5%
Net increase (decrease) resulting from:		
Earnings in jurisdictions taxed at rates different from the Canadian statutory income tax rates	<b>(2.0)</b>	(3.8)
Non-taxable amounts	<b>(0.7)</b>	(0.6)
Large corporation tax	<b>0.7</b>	0.6
Impact of successful resolution of certain income tax matters from a previous year and other	<b>(1.4)</b>	0.3
Enacted changes in income tax rates		0.5
Effective income tax rate	<b>31.5%</b>	33.5%

Net income taxes paid in 2004 were \$400 (2003 – \$399).

In 2004, the Company recognized a \$14 reduction to the income tax expense as a result of the successful resolution of certain income tax matters from a previous year.

In 2003, the Ontario government enacted both the repeal of the income tax rate reductions of 1.5% scheduled for each of 2004, 2005 and 2006 and the increase in the provincial income tax rate to 14% in 2004 from 12.5% in 2003. Future income tax balances were therefore adjusted, resulting in a \$7 charge to future income tax expense in 2003.

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

	2004	2003
Accounts payable and accrued liabilities	<b>\$ 84</b>	\$ 88
Other liabilities	<b>86</b>	74
Losses carried forward		3
Fixed assets	<b>(222)</b>	(173)
Other assets	<b>(79)</b>	(51)
Other	<b>28</b>	33
Net future income tax liabilities	<b>\$ (103)</b>	\$ (26)

	2004	2003
<b>Presented on the Consolidated Balance Sheets as:</b>		
Future income tax assets		
Current	<b>\$ 109</b>	\$ 113
Non-current		7
	<b>109</b>	120
Future income tax liabilities		
Non-current	<b>(212)</b>	(146)
Net future income tax liabilities	<b>\$ (103)</b>	\$ (26)

### Note 8. Fixed Assets

	2004			2003		
	Cost	Accumulated Depreciation	Net Book Value	Cost	Accumulated Depreciation	Net Book Value
Properties held for development	<b>\$ 378</b>		<b>\$ 378</b>	\$ 361		\$ 361
Properties under development	<b>290</b>		<b>290</b>	320		320
Land	<b>1,530</b>		<b>1,530</b>	1,370		1,370
Buildings	<b>4,040</b>	<b>\$ 731</b>	<b>3,309</b>	3,467	\$ 638	2,829
Equipment and fixtures	<b>3,057</b>	<b>1,835</b>	<b>1,222</b>	2,725	1,612	1,113
Building and leasehold improvements	<b>656</b>	<b>276</b>	<b>380</b>	655	267	388
	<b>9,951</b>	<b>2,842</b>	<b>7,109</b>	8,898	2,517	6,381
Capital leases – buildings and equipment	<b>95</b>	<b>91</b>	<b>4</b>	83	74	9
	<b>\$ 10,046</b>	<b>\$ 2,933</b>	<b>\$ 7,113</b>	\$ 8,981	\$ 2,591	\$ 6,390

Fixed asset impairment and accelerated depreciation charges of \$22 (2003 – \$4) were recognized in operating income. These charges were primarily a result of an evaluation of the carrying value of fixed assets upon the occurrence of a change in circumstances including a commitment to close, relocate or convert a store. The majority of

the charges in 2004 resulted from the repositioning of the Ontario, Canada banner portfolio. The fair values were determined using quoted market prices where available, independent offers to purchase where available or prices for similar assets.

### Note 9. Business Acquisitions

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

In the normal course of business, the Company may acquire from time to time franchisee stores and convert them to corporate stores. In 2004,

the Company acquired 5 franchisee businesses (2003 – 15 franchisee businesses). The acquisitions were accounted for using the purchase method of accounting with the results of the businesses acquired included in the Company's consolidated financial statements from the date of acquisition. The fair value of the net assets acquired consisted of a nominal amount of fixed assets (2003 – \$7), other assets principally inventory of \$2 (2003 – \$6) and goodwill of \$6 (2003 – \$8) for cash consideration of \$6 (2003 – \$11), net of accounts receivable due from the franchisees of \$2 (2003 – \$10).

### Note 10. Other Assets

	2004	2003
Franchise investments and other receivables	\$ 323	\$ 315
Accrued benefit plan asset (note 11)	175	137
Unrealized equity forwards receivable (note 17)	109	92
Deferred charges	99	66
Unrealized cross currency basis swaps receivable (notes 5 and 17)	155	96
	<b>\$ 861</b>	<b>\$ 706</b>

### Note 11. Employee Future Benefits

The Company offers a number of pension plans, which include registered funded defined benefit pension plans, supplemental unfunded arrangements which provide pension benefits in excess of statutory limits and defined contribution pension plans. Its defined benefit pension plans are predominantly non-contributory and these benefits are, in general, based on career average earnings.

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

The majority of post-retirement health care plans for current and future retirees include a limit on the total benefits payable by the Company.

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

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

The most recent actuarial valuation of the defined benefit pension plans for funding purposes ("funding valuation") was as of December 31, 2003. The Company is required to file funding valuations at least every three years; therefore, the next required funding valuation will be as of December 31, 2006.

Total cash payments made by the Company during 2004, consisting of contributions to funded defined benefit pension plans, defined contribution pension plans, multi-employer pension plans, long term disability benefit plan and benefits paid directly to beneficiaries of the unfunded defined benefit pension plans and unfunded other benefit plans, were \$105 (2003 – \$156).

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

	2004			2003		
	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>	Total	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>	Total
<b>Benefit Plan Assets</b>						
Fair value, beginning of year	\$ 771	\$ 30	\$ 801	\$ 628	\$ 23	\$ 651
Actual return on plan assets	74	1	75	94	1	95
Employer contributions	42	18	60	93	20	113
Voluntary employee contributions	2		2	2		2
Benefits paid	(49)	(14)	(63)	(45)	(14)	(59)
Other	(2)		(2)	(1)		(1)
Fair value, end of year	\$ 838	\$ 35	\$ 873	\$ 771	\$ 30	\$ 801
<b>Accrued Benefit Plan Obligations</b>						
Balance, beginning of year	\$ 887	\$ 190	\$ 1,077	\$ 817	\$ 166	\$ 983
Current service cost	33	4	37	30	5	35
Interest cost	56	11	67	54	10	64
Benefits paid	(49)	(14)	(63)	(45)	(14)	(59)
Actuarial loss	11	1	12	28	23	51
Plan amendments	1	(11)	(10)	4		4
Other	(2)		(2)	(1)		(1)
Balance, end of year	\$ 937	\$ 181	\$ 1,118	\$ 887	\$ 190	\$ 1,077
<b>Deficit of plan assets versus plan obligations</b>	\$ (99)	\$ (146)	\$ (245)	\$ (116)	\$ (160)	\$ (276)
Unamortized cost of plan amendments	6	(9)	(3)	6		6
Unamortized net actuarial loss	137	70	207	143	75	218
<b>Net accrued benefit plan asset (liability)</b>	\$ 44	\$ (85)	\$ (41)	\$ 33	\$ (85)	\$ (52)
Recognized in the consolidated balance sheets as follows:						
Accounts payable and accrued liabilities	\$ (60)	\$ (20)	\$ (80)	\$ (42)	\$ (19)	\$ (61)
Other assets (note 10)	136	39	175	108	29	137
Other liabilities (note 13)	(32)	(104)	(136)	(33)	(95)	(128)
<b>Net accrued benefit plan asset (liability)</b>	\$ 44	\$ (85)	\$ (41)	\$ 33	\$ (85)	\$ (52)

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

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:

	2004		2003	
	Pension Benefit Plans	Other Benefit Plans	Pension Benefit Plans	Other Benefit Plans
Accrued Benefit Plan Obligations				
Unfunded plans	\$ 47	\$ 151	\$ 49	\$ 162
Funded plans	826		775	
	873	151	824	162
Fair Value of Benefit Plan Assets	773		706	
Deficit	\$ 100	\$ 151	\$ 118	\$ 162

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:

	2004		2003	
	Pension Benefit Plans	Other Benefit Plans	Pension Benefit Plans	Other Benefit Plans
<b>Accrued Benefit Plan Obligations</b>				
Discount rate	6.25%	6.1%	6.25%	6.0%
Rate of compensation increase	3.5%		3.5%	
<b>Net Defined Benefit Plan Cost</b>				
Discount rate	6.25%	6.0%	6.5%	6.2%
Expected long term rate of return on plan assets	8.0%	4.5%	8.0%	5.0%
Rate of compensation increase	3.5%		3.5%	

The Company's growth rate of health care costs, primarily drug costs, was estimated at 9.0% (2003 – 9.0%) and is assumed to decrease to 5.0% in 2008 (2003 – 5.0% in 2011) and remain at that level thereafter.

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

Asset Category	2004		2003	
	Pension Benefit Plans	Other Benefit Plans	Pension Benefit Plans	Other Benefit Plans
Equity securities	<b>64%</b>		62%	
Debt securities	<b>34%</b>	<b>95%</b>	35%	92%
Cash and cash equivalents	<b>2%</b>	<b>5%</b>	3%	8%
<b>Total</b>	<b>100%</b>	<b>100%</b>	100%	100%

Pension benefit plan assets include securities issued by the Company's majority shareholder, George Weston Limited ("Weston"), and by Loblaw having a fair value of \$3.7 and nil (2003 – \$4.1 and

\$0.6), respectively, as at September 30. Other benefit plan assets do not include any Weston or Loblaw securities.

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

	2004		2003	
	Pension Benefit Plans	Other Benefit Plans	Pension Benefit Plans	Other Benefit Plans
Current service cost, net of employee contributions	<b>\$ 31</b>	<b>\$ 4</b>	\$ 28	\$ 5
Interest cost on plan obligations	<b>56</b>	<b>11</b>	54	10
Actual return on plan assets	<b>(74)</b>	<b>(1)</b>	(94)	(1)
Actuarial loss	<b>11</b>	<b>1</b>	28	23
Plan amendments	<b>1</b>	<b>(11)</b>	4	
Benefit plan cost, before adjustments to recognize the long term nature of employee future benefit costs	<b>25</b>	<b>4</b>	20	37
Difference between cost arising in the year and cost recognized in the year in respect of:				
Return on plan assets	<b>13</b>		44	
Actuarial loss	<b>(7)</b>	<b>5</b>	(20)	(19)
Plan amendments		<b>9</b>	(3)	
Net defined benefit plan cost	<b>31</b>	<b>18</b>	41	18
Defined contribution plan cost	<b>6</b>		6	
Multi-employer pension plan cost	<b>39</b>		37	
<b>Net benefit plan cost</b>	<b>\$ 76</b>	<b>\$ 18</b>	\$ 84	\$ 18

*Sensitivity of Key Assumptions* The following table outlines the key assumptions for 2004 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. Actuarial gains or losses are amortized in accordance with Canadian GAAP, further reducing the volatility associated with these changes.

	Pension Benefit Plans		Other Benefit Plans	
	Accrued Benefit Plan Obligations	Benefit Plan Cost	Accrued Benefit Plan Obligations	Benefit Plan Cost
Expected long term rate of return on plan assets		8.0%		
Impact of: 1% increase	n/a	\$ (8)	n/a	
1% decrease	n/a	8	n/a	
Discount rate	6.25%	6.25%	6.1%	6.0%
Impact of: 1% increase	\$ (128)	\$ (7)	\$ (20)	\$ (1)
1% decrease	\$ 149	\$ 8	\$ 23	\$ 1
Expected growth rate of health care costs <sup>(1)</sup>			9.0%	9.0%
Impact of: 1% increase	n/a	n/a	\$ 19	\$ 3
1% decrease	n/a	n/a	\$ (17)	\$ (3)

n/a not applicable

(1) Gradually decreasing to 5.0% in 2008 and remaining at that level thereafter.

## Note 12. Long Term Debt

	2004	2003
<b>Provigo Inc. Debentures</b>		
Series 1997, 6.35%, due 2004 <sup>(ii)</sup>		\$ 100
Series 1996, 8.70%, due 2006	<b>\$ 125</b>	125
Other <sup>(i)</sup>	<b>5</b>	9
<b>Loblaw Companies Limited Notes</b>		
6.95%, due 2005	<b>200</b>	200
6.00%, due 2008	<b>390</b>	390
5.75%, due 2009	<b>125</b>	125
7.10%, due 2010	<b>300</b>	300
6.50%, due 2011	<b>350</b>	350
5.40%, due 2013	<b>200</b>	200
6.00%, due 2014	<b>100</b>	100
7.10%, due 2016	<b>300</b>	300
6.65%, due 2027	<b>100</b>	100
6.45%, due 2028	<b>200</b>	200
6.50%, due 2029	<b>175</b>	175
11.40%, due 2031		
– principal	<b>151</b>	151
– effect of coupon repurchase	<b>(18)</b>	(11)
6.85%, due 2032	<b>200</b>	200
6.54%, due 2033	<b>200</b>	200
8.75%, due 2033	<b>200</b>	200
6.05%, due 2034	<b>200</b>	200
6.15%, due 2035 <sup>(ii)</sup>	<b>200</b>	
6.45%, due 2039	<b>200</b>	200
7.00%, due 2040	<b>150</b>	150
5.86%, due 2043	<b>55</b>	55
Other at a weighted average interest rate of 9.78%, due 2005 to 2043	<b>43</b>	43
Total long term debt	<b>4,151</b>	4,062
Less amount due within one year	<b>216</b>	106
	<b>\$ 3,935</b>	\$ 3,956

The five year schedule of repayment of long term debt based on maturity is as follows: 2005 – \$216; 2006 – \$128; 2007 – \$5; 2008 – \$392; 2009 – \$128.

(i) Other of \$5 (2003 – \$9) represents the unamortized portion of the adjustment to fair value the Provigo Inc. Debentures. This adjustment was recorded as part of the Provigo purchase equation and was calculated using the Company's average credit spread applicable at that time to the remaining life of the Provigo Inc.

Debentures. The adjustment is being amortized over the remaining term of the Provigo Inc. Debentures.

- (ii) During 2004, the Company issued \$200 of 6.15% MTN due 2035. The Company also repaid its \$100 of 6.35% Series 1997 Provigo Inc. Debenture as it matured.
- (iii) Subsequent to year end 2004, the Company issued \$300 of 5.90% MTN due 2036 and the \$200 of 6.95% MTN matured and was repaid.

### Note 13. Other Liabilities

	2004	2003
Accrued benefit plan liability (note 11)	<b>\$ 136</b>	\$ 128
Stock-based compensation	<b>76</b>	82
Other	<b>60</b>	24
	<b>\$ 272</b>	\$ 234

### Note 14. Sale-Leaseback Transactions

In 2004, the Company completed two sale-leaseback transactions involving two of its warehouses. Under these transactions, the land, buildings and building improvements at the locations were sold for total cash consideration of \$44 and leased back for initial terms

of 5 years, with specified renewal options for up to 15 years. These leasebacks are accounted for as operating leases. The \$14 gain on the sale-leaseback transactions was deferred and is being amortized over the initial lease terms.

### Note 15. Common Share Capital (authorized – unlimited)

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

	2004		2003	
	Number of Common Shares	Common Share Capital	Number of Common Shares	Common Share Capital
Issued and outstanding, beginning of year	<b>274,829,014</b>	<b>\$ 1,194</b>	276,018,714	\$ 1,195
Issued for stock options exercised (note 16)	<b>3,000</b>		93,200	4
Purchased for cancellation	<b>(576,100)</b>	<b>(2)</b>	(1,282,900)	(5)
Issued and outstanding, end of year	<b>274,255,914</b>	<b>\$ 1,192</b>	274,829,014	\$ 1,194
Weighted average outstanding	<b>274,253,178</b>		275,405,585	

*Normal Course Issuer Bids ("NCIB")* During 2004, the Company purchased for cancellation 576,100 (2003 – 1,282,900) of its common shares for \$35 (2003 – \$76). In 2003, the Company entered into equity forwards to buy 1,103,500 of its common shares, pursuant to its NCIB. The Company did not enter into any additional equity forwards in 2004.

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

**Note 16. Stock-Based Compensation** (\$)

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

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

During 2004, the Company granted 45,000 (2003 – 2,387,746) stock options with a weighted average exercise price of \$65.453 (2003 – \$53.670) per common share under its existing stock option plan, which

allows for settlement in shares or in the share appreciation value in cash at the option of the employee.

In 2004, the Company recognized in operating income a compensation cost related to its stock option plan of \$24 million (2003 – \$62 million) and a gain on the fair value impact of the equity forwards of \$24 million (2003 – \$66 million). The share appreciation value of \$33 million (2003 – \$28 million) was paid on the exercise of 985,395 (2003 – 802,701) stock options. In 2004, the Company issued 3,000 (2003 – 93,200) common shares on the exercise of stock options for cash consideration of \$0.1 million (2003 – \$2 million) for which it had recorded a nominal stock-based compensation liability (2003 – \$4 million).

At year end, a total of 4,365,958 (2003 – 5,407,026) stock options were outstanding, and represented approximately 1.6% (2003 – 2.0%) of the Company's issued and outstanding common shares, which was within the Company's guideline of 5%. Of the 4,365,958 outstanding options, 4,212,218 relate to stock option grants that allow for settlement in shares or in the share appreciation value in cash at the option of the employee and 153,740 relate to stock option grants, issued prior to December 30, 2001 that will be settled by issuing common shares.

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

	2004		2003	
	Options (number of shares)	Weighted Average Exercise Price/Share	Options (number of shares)	Weighted Average Exercise Price/Share
Outstanding options, beginning of year	<b>5,407,026</b>	<b>\$ 42.533</b>	4,055,237	\$ 32.029
Granted	<b>45,000</b>	<b>\$ 65.453</b>	2,387,746	\$ 53.670
Exercised	<b>(988,395)</b>	<b>\$ 32.440</b>	(895,901)	\$ 24.570
Forfeited/cancelled	<b>(97,673)</b>	<b>\$ 43.201</b>	(140,056)	\$ 43.173
Outstanding options, end of year	<b>4,365,958</b>	<b>\$ 45.039</b>	5,407,026	\$ 42.533
Options exercisable, end of year	<b>1,736,769</b>	<b>\$ 39.268</b>	2,016,552	\$ 37.527

Range of Exercise Prices	2004 Outstanding Options			2004 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
\$ 32.000 – \$ 43.800	<b>1,713,405</b>	<b>2</b>	<b>\$ 32.315</b>	<b>1,130,285</b>	<b>\$ 32.415</b>
\$ 48.500 – \$ 55.400	<b>2,587,553</b>	<b>5</b>	<b>\$ 52.979</b>	<b>602,484</b>	<b>\$ 51.974</b>
\$ 61.950 – \$ 67.110	<b>65,000</b>	<b>6</b>	<b>\$ 64.375</b>	<b>4,000</b>	<b>\$ 61.950</b>

Subsequent to year end 2004, the Company granted 2,152,252 stock options under its current stock option plan, that allow for settlement in shares or in the share appreciation value in cash at the option of the employee, to 231 employees with an exercise price of \$69.63 per common share. Including stock option grants issued subsequent to year end, total stock options outstanding represent approximately 2.4% of the Company's issued and outstanding common shares.

*Employee Share Ownership Plan ("ESOP")* The Company maintains an ESOP which allows employees to acquire the Company's common shares through regular payroll deductions of up to 5% of their gross regular earnings. The Company contributes an additional 15% of each employee's contribution to the plan. Effective February 1, 2005 the Company will increase its contribution to 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 \$2 million (2003 – \$2 million) related to this plan was recognized in operating income.

*Deferred Share Units ("DSUs") Plan* Members of the Company's Board of Directors may elect annually to receive all or a portion of their annual retainer(s) and fees in the form of DSUs, the value of which is determined by the market price of the Company's common shares at the time of payment of the director's annual retainer(s) or fees. 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, 30,908 (2003 – 21,489) DSUs were outstanding. The year-over-year change in the deferred share units liability was minimal and was recognized in operating income.

*Restricted Share Unit ("RSU") Plan* The Company adopted a RSU plan for certain employees. Under the RSU plan, performance periods of three years in duration are designated and commence on the date on which RSUs are awarded to each participant ("Award Date"). In respect of each such designated performance period, a participant is granted a number of RSUs, where each unit has a value equal to one Loblaw common share at the time of grant. Each RSU entitles the participant to receive a cash payment in the third calendar year following the applicable Award Date and in the amount calculated with reference to the trading price of a Loblaw common share on the Toronto Stock Exchange. Each RSU will be paid out no later than December 30 of that year.

Based on further review, the Company has determined that the compensation cost related to the RSUs will be recognized in operating income over the term of the performance period based on the expected total compensation to be paid out at the end of the performance period.

Subsequent to year end 2004, the Company awarded 376,645 RSUs to 231 employees.

## Note 17. Financial Instruments

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

	Notional Amounts Maturing in						2004	2003
	2005	2006	2007	2008	2009	Thereafter	Total	Total
Cross currency basis swaps		\$ 11	\$ 107	\$ 210	\$ 31	\$ 755	\$ 1,114	\$ 1,214
Interest rate swaps	\$ 161	\$ (43)		\$ 240	\$ 140	\$ 100	\$ 598	\$ 680
Equity forwards						\$ 236	\$ 236	\$ 233
Electricity forward contract	\$ 16						\$ 16	\$ 63

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

The Company entered into cross currency basis swaps to exchange United States dollars for \$1.1 billion (2003 – \$1.2 billion) Canadian dollars, which mature by 2016. Currency adjustments receivable or payable arising from these swaps are settled in cash on maturity. At year end, a cumulative unrealized foreign currency exchange rate receivable of \$155 (2003 – \$96) was recorded in other assets.

*Interest Rate Swaps* The Company enters into interest rate swaps to hedge a portion of its exposure to fluctuations in interest rates.

The Company entered into interest rate swaps converting a net notional \$598 (2003 – \$680) of its floating rate investments to fixed rate investments at 5.80% (2003 – 6.72%), which mature by 2013.

*Equity Forwards (\$)* The Company enters into equity forwards to manage its exposure to fluctuations in its stock-based compensation cost as a result of changes in the market price of its common shares.

In 2003, the Company entered into equity forwards to buy 1,103,500 of its common shares at an average forward price of \$56.39 per common share, with an average initial term of 10 years. At year end 2004, the Company had cumulative equity forwards to buy 4.8 million (2003 – 4.8 million) of its common shares at an average forward price of \$49.25 (2003 – \$48.56) including \$4.38 (2003 – \$3.69) per common share of interest expense net of dividends that will be paid at redemption. The equity forwards allow for settlement in cash, common shares or net settlement. The Company has included a cumulative unrealized market gain of \$109 million (2003 – \$92 million) in other assets relating to these equity forwards.

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

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

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

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

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

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

The fair value of the equity forwards, which approximated carrying value, was estimated by multiplying the number of the Company's common shares outstanding under the equity forwards by the

difference between the market price of its common shares and the average forward price of the outstanding forwards at year end.

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

	2004		2003	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Long term debt liability	\$ 4,151	\$ 4,665	\$ 4,062	\$ 4,457
Interest rate swaps net asset	\$ (2)	\$ 5		\$ 12
Electricity forward contract net asset		\$ 3		\$ 2

*Counterparty Risk* The Company may be exposed to losses should any counterparty to its financial derivative agreements fail to fulfill its obligations. The Company has sought to minimize potential counterparty risk and losses by conducting transactions for its derivative agreements with counterparties that have at minimum a long term A credit rating and by placing risk adjusted limits on its exposure to any single counterparty for its financial derivative agreements. The Company has internal policies, controls and reporting processes which require ongoing assessment and corrective action, if necessary, with respect to its derivative transactions. In addition, principal amounts on cross currency basis swaps and equity forwards are each netted by agreement and there is no exposure to loss of the original notional principal amounts on the interest rate swaps and equity forwards.

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

#### **Note 18. 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.

Credit risk associated with the Company's cash equivalents and short term investments results from the possibility that a counterparty may default on the repayment of a security. This risk is mitigated by established policies and guidelines that require issuers of permissible investments to have a minimum A credit rating from a recognized credit rating agency and that specify minimum and maximum exposures to specific issuers.

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

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.

The Company is committed to various operating leases. Future minimum lease payments relating to these operating leases are as follows:

	Amounts Maturing in						2004 Total	2003 Total
	2005	2006	2007	2008	2009	Thereafter to 2054		
Operating lease payments	\$ 178	\$ 167	\$ 151	\$ 136	\$ 121	\$ 647	\$ 1,400	\$ 1,284
Expected sub-lease income	(64)	(52)	(45)	(36)	(27)	(72)	(296)	(205)
Net operating lease payments	\$ 114	\$ 115	\$ 106	\$ 100	\$ 94	\$ 575	\$ 1,104	\$ 1,079

At year end, the Company has committed approximately \$354 (2003 – \$370) with respect to capital investment projects such as the construction, expansion and renovation of buildings and the purchase of real property.

The Company establishes standby letters of credit used in connection with certain obligations mainly related to real estate transactions and benefit and insurance programs. The aggregate gross potential liability related to these standby letters of credit is approximately \$104 (2003 – \$82). Other standby letters of credit related to the financing program for the Company's franchisees and securitization of PC Bank's credit card receivables have been identified as guarantees and are discussed further in the Guarantees section below.

In connection with the purchase of Provigo, the Company committed to support Quebec small business and farming communities as follows: for a period of seven years commencing in 1999 and, subject to business dispositions, the aggregate amount of goods and services purchased from Quebec suppliers in the normal course of business will not fall below those of 1998. The Company has fulfilled its commitment in each year from 1999 to and including 2004.

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

*Standby Letters of Credit* A standby letter of credit for the benefit of an independent trust with respect to the credit card receivables securitization program of PC Bank has been provided by a major Canadian bank. This standby letter of credit could be drawn upon in the event of a major decline in the income flow from or in the value of the securitized credit card receivables after the cash reserve account established pursuant to the securitization agreement has been

depleted. The Company has agreed to reimburse the issuing bank for any amount drawn on the standby letter of credit. The Company believes that the likelihood of this occurrence is remote. The aggregate gross potential liability under this arrangement, which represents 15% of the securitized credit card receivables amount, is approximately \$118 (2003 – \$84).

A standby letter of credit has been provided by a major Canadian bank in the amount of \$42 (2003 – \$35) for the benefit of an independent funding trust which provides loans to the Company's franchisees for their purchase of inventory and fixed assets, mainly fixturing and equipment. The amount of the standby letter of credit is based on a defined formula and is equal to approximately 10% of the principal amount of the loans outstanding at any point in time. In the event that a franchisee defaults on its loan and the Company has not, within a specified time period, assumed the loan or the default is not otherwise remedied, the independent funding trust may assign the loan to the Company and draw upon this standby letter of credit. The Company has agreed to reimburse the issuing bank for any amount drawn on the standby letter of credit.

*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 \$143 (2003 – \$173).

*Indemnification Provisions* The Company from time to time enters into agreements in the normal course of its business, such as service and outsourcing arrangements and leases, in connection with business or asset acquisitions or dispositions. These agreements by their nature

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

#### **Note 19. Related Party Transactions**

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

*Inventory Purchases* Purchases of inventory from related parties for resale in the Company's distribution network represented approximately 3% (2003 – 3%) of the cost of sales, selling and administrative expenses.

*Cost Sharing Agreements* George Weston Limited has entered into certain contracts with third parties for administrative services, mainly for telecommunication services and information technology related matters on behalf of the Company. Through cost sharing agreements that have been established between the Company and George Weston Limited concerning these costs, the Company has agreed to be responsible to George Weston Limited for its proportionate share of the costs incurred on its behalf. Payments by the Company to George Weston Limited pursuant to these cost sharing agreements were approximately \$13 in 2004. In addition, the Company and George Weston Limited also share costs associated with certain corporate services used by both companies.

*Electricity Forward Contract* The Company entered into an electricity forward contract to maintain a portion of the Company's electricity costs in Ontario, Canada at 2001 market rates. Approximately 8% of the total volume commitment in the contract was designated for use by George Weston Limited. Pursuant to an agreement between the Company and George Weston Limited, George Weston Limited has agreed to remain responsible for its proportionate share of all cost and liability associated with its usage.

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

*Borrowings/Lendings* The Company, from time to time, may borrow from or may lend to George Weston Limited on a short term basis at commercial paper rates. There were no such amounts outstanding as at year end. The Company also has a deposit of U.S. \$24 in the George Weston Limited United States dollar central cash system.

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

*Management Agreements* Pursuant to various agreements, the Company, through Glenhuron, a wholly owned subsidiary of the Company in Barbados, manages certain United States cash, cash equivalents and short term investments and other assets for wholly owned non-Canadian subsidiaries of George Weston Limited. Management fees were based on market rates and were included in interest expense.

#### **Note 20. Other Information**

*Segment Information* The Company's only reportable operating segment is merchandising, primarily food distribution. All sales to external parties were generated in Canada and all fixed assets and goodwill were attributable to Canadian operations.