

8. LIQUIDITY AND CAPITAL RESOURCES

8.1 MAJOR CASH FLOW COMPONENTS

(\$ millions)	2008	2007	Change
Cash flows from operating activities of continuing operations	\$ 985	\$ 1,368	\$ (383)
Cash flows used in investing activities of continuing operations	\$ (225)	\$ (966)	\$ 741
Cash flows used in financing activities of continuing operations	\$ (792)	\$ (511)	\$ (281)

Cash Flows from Operating Activities of Continuing Operations

In 2008, cash flows from operating activities of continuing operations were \$985 million compared to \$1,368 million in 2007.

The decrease was primarily due to changes in both non-cash working capital and net earnings from continuing operations before minority interest, excluding the impact of the gain on sale of businesses, restructuring and other charges and the fair value adjustment of GWL's forward sale agreement. The change in cash flows in non-cash working capital compared to 2007 was primarily driven by changes in inventories at Loblaw.

- (1) See non-GAAP financial measures beginning on page 46.
- (2) This outlook should be read in conjunction with the Forward-Looking Statements section of this MD&A on page 5.

Cash Flows used in Investing Activities of Continuing Operations

Cash flows used in investing activities of continuing operations in 2008 were \$225 million compared to \$966 million in 2007. The primary reasons for the decrease include the \$467 million of proceeds from the disposition of Weston Foods' dairy and bottling operations, a decrease in the cash flows used in credit card receivables, after securitization and the sale of the Domtar (Canada) Paper Inc. investment, which funded the retirement of the GWL 3% Exchangeable Debentures, which is included in cash flows used in financing activities. Offsetting these changes was an increase in capital spending primarily associated with Loblaw's investment in its infrastructure, and reduced proceeds from asset sales when compared to 2007.

The Company's capital investment amounted to \$807 million (2007 – \$658 million). Weston Foods capital investment in 2008 was \$57 million (2007 – \$45 million). The capital was directed toward the construction of a new plant in Western Canada, as well as facility improvements and upgrades of production lines and distribution assets. Weston Foods capital investment benefited all of its operations to varying degrees and strengthened its processing and distribution capabilities.

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

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

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

At year end 2008, the Company had committed approximately \$51 million (2007 – \$114 million) with respect to capital investment projects such as the construction, expansion and renovation of buildings and the purchase of real property.

During 2008, the Company also generated \$125 million (2007 – \$237 million) from fixed asset sales.

Cash Flows used in Financing Activities of Continuing Operations

Cash flows used in financing activities of continuing operations in 2008 were \$792 million compared to \$511 million in 2007.

During 2008, GWL and Loblaw completed the following financing activities:

- Loblaw issued USD \$300 million of fixed rate unsecured notes in a private placement debt financing;
- Loblaw repaid \$390 million of 6.00% Medium Term Notes ("MTN");
- Loblaw issued 9.0 million Second Preferred Shares, Series A, for total proceeds of \$218 million;
- GWL repaid the remaining outstanding 3% Exchangeable Debentures for an aggregate amount of approximately \$140 million; and
- consolidated commercial paper outstanding was reduced by \$609 million. These cash flows were partially offset by an increase in short term bank loans of \$203 million, which includes GWL's issuance of \$43 million of Series B Debentures.

During 2007, GWL and Loblaw completed the following financing activities:

- consolidated commercial paper outstanding was reduced by \$229 million. These cash flows were partially offset by an increase in short term bank loans of \$72 million, which includes GWL's issuance of \$42 million of Series B Debentures.

See notes 19, 22 and 23 to the consolidated financial statements for the terms and details of the debt and share capital transactions.

Subsequent to year end, Loblaw repaid its \$125 million 5.75% MTN and GWL repaid its \$250 million 5.90% MTN, both of which matured. Also subsequent to year end, GWL provided the holders of its Preferred Shares, Series II with notice that on April 1, 2009 it will redeem for cash the 10.6 million outstanding shares for \$25.00 per share, or \$265 million in aggregate, plus accrued and unpaid dividends to but excluding the date of redemption.

Management's Discussion and Analysis

In 2008, GWL renewed its Normal Course Issuer Bid ("NCIB") to purchase on the Toronto Stock Exchange ("TSX") or enter into equity derivatives to purchase up to 5% of its common shares outstanding. GWL did not purchase any shares under its NCIB during 2008 or 2007. GWL intends to file a NCIB in 2009 to purchase on the TSX or enter into equity derivatives to purchase up to 5% of its outstanding common shares.

Net Debt (excluding Exchangeable Debentures)⁽¹⁾

The Company's net debt (excluding Exchangeable Debentures)⁽¹⁾ at December 31, 2008 was \$3,569 million compared to \$4,732 million at the end of 2007. Of the \$1,163 million reduction, the proceeds from the sale of Weston Foods' dairy and bottling operations accounted for \$467 million, the proceeds from the issuance of preferred shares by Loblaw accounted for \$218 million and all other factors accounted for \$478 million.

8.2 SOURCES OF LIQUIDITY

The Company obtains its short term financing through a combination of cash generated from operating activities, cash, cash equivalents, short term investments, bank indebtedness and amounts available to be drawn against Loblaw's credit facility.

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

During the second quarter of 2008, GWL entered into a \$300 million, 5-year committed credit facility provided by a syndicate of banks. As at December 31, 2008, nil was drawn on the 5-year committed credit facility. Following the sale of the U.S. fresh bakery business in 2009, GWL terminated this facility.

Securitization of credit card receivables provides PC Bank with an additional source of funds for the operation of its business. In 2008, PC Bank securitized an aggregate \$300 million (2007 – \$225 million) of credit card receivables. Under these securitization programs, a portion of the total interest in the credit card receivables is sold to independent trusts, one of which has a term of 364 days, subject to annual renewal. If the term of this facility is not renewed, collections will be accumulated prior to the expiry and the amount of that portion of the securitized receivables will be repaid to that trust. In the absence of securitization, Loblaw would be required to raise alternative financing by issuing additional debt or equity instruments. Subsequent to year end, Eagle Credit Card Trust ("Eagle") filed a base shelf prospectus which permits it to issue up to \$1.5 billion of notes over a 25 month period, subject to the availability of credit markets. Further information about PC Bank's credit card receivables and securitization is provided in notes 1 and 12 to the consolidated financial statements and in the Off-Balance Sheet Arrangements section of this MD&A.

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

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

GWL has traditionally obtained its long term financing primarily through MTN and preferred share programs. Given its significant holdings of cash and short term investments, GWL currently does not plan to refinance maturing MTN or the redemption of its Preferred Shares, Series II.

In the normal course of business, the Company enters into certain arrangements, such as providing comfort letters to third-party lenders in connection with financing activities of certain franchisees, with no recourse liability to the Company. In addition, the Company establishes standby letters of credit used in connection with certain obligations related to the financing program for Loblaw's independent franchisees, securitization of PC Bank's credit card receivables, real estate transactions and benefit programs. At year end, the aggregate gross potential liability related to the Company's standby letters of credit was approximately \$595 million (2007 – \$531 million), against which the Company had \$616 million (2007 – \$628 million) in credit facilities available to draw on.

(1) See non-GAAP financial measures beginning on page 46.

Loblaw's existing cash and cash equivalents, short term investments, future operating cash flows and the amounts available to be drawn against its credit facility are expected to enable Loblaw to finance its capital investment program and fund its ongoing business requirements including working capital and pension plan funding. Loblaw believes it has sufficient funding available to meet these requirements over the next 12 months. Given reasonable access to capital markets, Loblaw does not foresee any difficulty in securing financing to satisfy its long term obligations.

The Company's (excluding Loblaw's) existing cash and cash equivalents, short term investments, proceeds from the sale of Weston Foods' U.S. fresh bakery business and future operating cash flows are expected to be sufficient to satisfy its current intention to redeem its Preferred Shares, Series II, finance its capital investment program and fund the ongoing business requirements of its continuing operations, including working capital and pension plan funding, over the next 12 months. The Company (excluding Loblaw) does not foresee any difficulty in satisfying its long term obligations at this time.

During 2008, Loblaw's MTN, other notes and debentures and commercial paper ratings were downgraded twice by Dominion Bond Rating Service ("DBRS") and once by Standard & Poor's ("S&P"). On March 11, 2009, DBRS revised the trend on Loblaw's commercial paper rating to "Stable" from "Negative". The following table sets out the current credit ratings of Loblaw.

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	Negative
Medium term notes	BBB	Negative	BBB	Negative
Preferred shares	Pfd-3	Negative	P-3 (high)	
Other notes and debentures	BBB	Negative	BBB	Negative

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

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

On February 12, 2008, DBRS downgraded GWL's MTN and debentures to "BBB" from "BBB (high)", the short term credit rating to "R-2 (high)" from "R-1 (low)", Exchangeable Debentures to "BBB (low)" from "BBB" and the preferred shares to "Pfd-3" from "Pfd-3 (high)", all with a Stable trend. These ratings remained the same until December 12, 2008, when DBRS placed GWL's ratings "Under Review with Developing Implications" following the announcement that a subsidiary of GWL, Dunedin Holdings S.à r.l., had entered into an agreement with Grupo Bimbo, S.A.B. de C.V. to sell the U.S. fresh bakery business. On March 11, 2009, DBRS revised the trend on GWL's commercial paper, notes and debentures, and preferred shares ratings to "Stable" from "Under Review with Developing Implications".

During the second quarter of 2008, S&P affirmed GWL's long term corporate credit, commercial paper and preferred share ratings at "BBB", "A-2" and "P-3 (high)", respectively. GWL was removed from "CreditWatch with Negative Implications" and the ratings outlook was changed to "Negative". GWL was subsequently placed back on "CreditWatch with Negative Implications" by S&P on December 5, 2008, following the announcement that Dunedin Holdings S.à r.l. was in discussions with Grupo Bimbo, S.A.B. de C.V. about the possible sale of the U.S. fresh bakery business.

Management's Discussion and Analysis

The following table sets out the current credit ratings of GWL.

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

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

GWL's ability to obtain funding from external sources may be restricted by further downgrades in its credit ratings, should its financial performance and condition deteriorate. In addition, credit and capital markets are subject to inherent global risks that may negatively affect GWL's access and ability to fund its short term and long term debt requirements. The Company (excluding Loblaw) mitigates these risks by maintaining appropriate levels of cash and cash equivalents and short term investments, actively monitoring market conditions and diversifying its sources of funding and maturity profile. Given its significant holdings of cash and short term investments following the sale of the dairy and bottling operations and the U.S. fresh bakery business, the Company (excluding Loblaw) currently does not foresee any difficulty in funding its short term and long term debt requirements.

Independent Funding Trust

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

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

The gross principal amount of loans issued to Loblaw's independent franchisees outstanding at the end of 2008 was \$388 million (2007 – \$418 million), including \$152 million (2007 – \$153 million) of loans payable by VIEs consolidated by the Company. Based on a formula, Loblaw has agreed to provide credit enhancement in the form of a standby letter of credit for the benefit of the independent funding trust equal to approximately 15% (2007 – 10%) of the principal amount of the loans outstanding at any point in time, \$66 million (2007 – \$44 million) as of the end of 2008. The standby letter of credit has never been drawn upon. This credit enhancement allows the independent funding trust to provide favourable financing terms to Loblaw'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 Loblaw 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 Loblaw and draw upon this standby letter of credit. Loblaw has agreed to reimburse the issuing bank for any amount drawn on the standby letter of credit. This alternative financing arrangement will result in a higher relative financing cost to the franchisees, which in turn could adversely affect operating results. The alternative financing arrangement has been reviewed and Loblaw determined there were no material implications with respect to the consolidation of VIEs.

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

8.3 CONTRACTUAL OBLIGATIONS

The following illustrates certain of the Company's significant contractual obligations and discusses other obligations as at December 31, 2008:

Summary of Contractual Obligations

(\$ millions)	Payments due by year						Total
	2009	2010	2011	2012	2013	Thereafter	
Long term debt ⁽¹⁾	\$ 415	\$ 333	\$ 681	\$ 25	\$ 409	\$ 3,860	\$ 5,723
Capital securities ⁽²⁾	265						265
Operating leases ⁽³⁾	216	196	172	149	131	810	1,674
Contracts for purchase of real property and capital investment projects ⁽⁴⁾	50	1					51
Purchase obligations ⁽⁵⁾	733	578	573	423	3		2,310
Total contractual obligations	\$ 1,679	\$ 1,108	\$ 1,426	\$ 597	\$ 543	\$ 4,670	\$ 10,023

(1) Long term debt includes capital lease obligations.

(2) GWL's capital securities are included as subsequent to year end the Company provided notice to the holders that such securities will be redeemed on April 1, 2009. Loblaw's capital securities have been excluded as Loblaw is not currently contractually obligated to pay these amounts.

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

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

(5) 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. The purchase obligations do not include purchase orders issued or agreements made in the ordinary course of business which are solely for goods that are meant for resale, nor do they include any contracts which may be terminated on relatively short notice or with insignificant cost or liability to the Company. Also excluded are purchase obligations related to commodities or commodity-like goods for which a market for resale exists.

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

- future payments of accrued benefit plan liability, principally post-retirement benefits, depend on when and if retirees submit claims;
- future payments of income taxes depend on the levels of taxable earnings 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 GWL or Loblaw common shares on the exercise date and the manner in which the employees exercise those stock options;
- future payments of restricted share units depend on the market prices of GWL and Loblaw common shares;
- future payments related to equity derivatives depend on the market price of GWL and Loblaw 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

8.4 OFF-BALANCE SHEET ARRANGEMENTS

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

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

Guarantees

The Company has entered into various guarantee agreements including standby letters of credit in relation to the securitization of *PC* Bank's credit card receivables, third-party financing made available to Loblaw's independent franchisees, and obligations to indemnify third parties in connection with leases, business dispositions and other transactions in the normal course of the Company's business. For a detailed description of the Company's guarantees, see note 30 to the consolidated financial statements.

Securitization of Credit Card Receivables

Loblaw, through *PC* Bank, securitizes credit card receivables through independent trusts administered by major Canadian chartered banks and through Eagle, also an independent trust. In these securitizations, *PC* Bank sells a portion of its credit card receivables to the trusts in exchange for cash. The trusts fund these purchases by issuing debt securities in the form of asset-backed commercial paper and asset-backed term notes to third-party investors. The securitizations are accounted for as asset sales only when *PC* Bank transfers control of the transferred assets and receives consideration other than beneficial interests in the transferred assets.

All transactions between the trusts and *PC* Bank have been, and are expected to continue to be, accounted for as sales as contemplated by Canadian GAAP, specifically AcG 12, "Transfers of Receivables". As *PC* Bank does not control or exercise any measure of influence over the trusts, the financial results of the trusts have not been included in the Company's consolidated financial statements.

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

As at year end 2008, the total amount of securitized credit card receivables outstanding which *PC* Bank continues to service was \$1.8 billion (2007 – \$1.5 billion) and the associated retained interests amounted to \$14 million (2007 – \$8 million). The standby letters of credit supporting a portion of these securitized receivables amounted to approximately \$116 million (2007 – \$89 million). During 2008, *PC* Bank received income of \$176 million (2007 – \$141 million) in securitization revenue from the independent trusts relating to the securitized credit card receivables. In the absence of securitization, Loblaw would be required to raise alternative financing by issuing debt or equity instruments. Further disclosure regarding this arrangement is provided in notes 12 and 30 to the consolidated financial statements.

Independent Funding Trust

Certain independent franchisees of Loblaw 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 8.2, "Independent Funding Trust" and in note 30 to the consolidated financial statements.