



Calgary Co-operative Association Limited

Management Discussion and Analysis

Overview

Calgary Co-operative Association Limited (Calgary Co-op) operates as an Alberta co-operative under the *Cooperatives Act* (revised March 6, 2003).

Locally owned and operated, Calgary Co-op was incorporated on July 13, 1955, and opened its first store in November 1956. Today, Calgary Co-op has grown into one of the largest retail co-operatives in North America with over 434,000 members and 4,000 employees, assets of \$374 million and annual sales of \$1.06 billion as at November 1, 2008.

Formed for the benefit of its member-owners Calgary Co-op, currently operates 22 retail food centres, 26 gas bars, 17 liquor stores and seven travel offices located in Calgary, Airdrie, Strathmore, and Okotoks, Alberta.

Vision

The vision for Calgary Co-op is “to be the premier shopping destination in the communities we serve”. Guided by this vision, Calgary Co-op strives to put into action critical initiatives for achieving its vision by focusing on delivering quality products and valued-added services to members/customers at competitive prices.

Calgary Co-op is committed to expanding, upgrading and enhancing overall operations while maintaining a financially strong operation. It seeks sustainable growth and profitability that will provide members with a reasonable annual patronage return, while balancing the need to re-invest in the business.

Calgary Co-op also takes corporate social responsibility seriously. It believes that investing in the community through corporate and store-based initiatives is imperative. As such, Calgary Co-op contributes to a wide variety of organizations including the Alberta Children’s Hospital, Calgary Public Library, Calgary Zoo, local crisis and emergency shelters, food banks, schools, youth programs, recycling and environmental initiatives, and community partnerships.

Responsibility for the environment is also a key priority at Calgary Co-op. Energy management, resource conservation and environmental protection are important to our members/customers and make good business sense.

Strategic Goals

To successfully achieve its vision, Calgary Co-op focuses on achieving four long-term strategic goals that are key to delivering lasting value to members/customers and maintaining a financially healthy co-operative.

The strategic goals are to:

1. Ensure the financial health and sustainability of the organization.
2. Exceed member and customer expectations with exceptional service, selection and value.
3. Implement new and innovative processes and solutions to improve productivity and execution throughout the organization.
4. Implement training, retention and career building programs to develop well-trained, knowledgeable, motivated and empowered employees.

Various operating and financial strategies are in place to support the strategic goals. In the case of operating strategies, these include:

- continuing to focus on our primary lines of business (food, petroleum, pharmacy, liquor and travel) and enter into new lines of business (home care medical supply, etc) if and when it makes sense;
- focusing on fresh food offerings;
- continuing to build our service advantage, including on-shelf availability;
- focusing on operational excellence at store level and throughout the organization;
- offering high quality fresh foods, innovative new products and value-added services;
- owning real estate, when economically feasible;
- improving the shopping experience by investing in new facilities and renovating existing facilities;
- creating customer loyalty through competitive pricing and marketing the “co-op” advantage; and
- building an engaged team through training, recognition, opportunities for growth and development.

The financial strategies for Calgary Co-op include:

- minimizing risks and controlling costs;
- maintaining a strong balance sheet;
- allocating capital to projects that earn a rate of return in excess of the internal rate of return;
- providing a reasonable patronage return to members while retaining sufficient earnings to ensure the ongoing financial health of Calgary Co-op; and
- maximizing utilization and return on assets.

The board and management of Calgary Co-op believe that, by successfully implementing and executing the strategies outlined above, Calgary Co-op will be well-positioned for future growth and be able to best serve its members/customers.

Governance Structure

Members of Calgary Co-op elect its board of directors through a formal democratic voting process. There are nine director positions, which include the three board officer positions of chair, vice chair and board secretary.

The board of directors supervises the management of the business and affairs of Calgary Co-op, subject to the *Cooperatives Act*, regulations, articles, any unanimous agreement, and the by-laws. The board may exercise all of the powers of Calgary Co-op that are not required to be exercised by the membership in a general meeting.

Each year, Calgary Co-op members elect three directors to the board, each for a three year term or as required to fill additional vacancies. The term of office for each of the nine director positions expires on a staggered yearly basis to ensure that a certain number of experienced directors remain on the board to assist newly elected directors in learning their roles and responsibilities.

The board operates with four standing committees, namely, an Audit Committee, Governance Committee, Member Relations Committee, and Performance and Compensation Committee.

Each year, in collaboration with the executive management team, the board reviews the vision, mission and values for Calgary Co-op, and sets strategic direction for a three year planning period. The board also sets annual goals for itself, which form the basis of the annual work plan for the board.

Key Performance Indicators

Calgary Co-op monitors the success of its operations and implementation of its strategies through the use of key performance indicators that assess financial performance and condition. Some of the key performance indicators are sales, earnings before patronage returns and return on member equity.

Operational Results

Sales

Calgary Co-op will maintain its focus on increasing sales and profitability by focusing on delivering quality products and value-added services to members/customers at competitive prices. In 2008, sales reached \$1,058.6 million, an increase of \$61.0 million or 6.1% from 2007 sales of \$997.6 million. Same store sales, which are sales from the same locations in both the 2008 and 2007 financial years, grew by 6.1%.

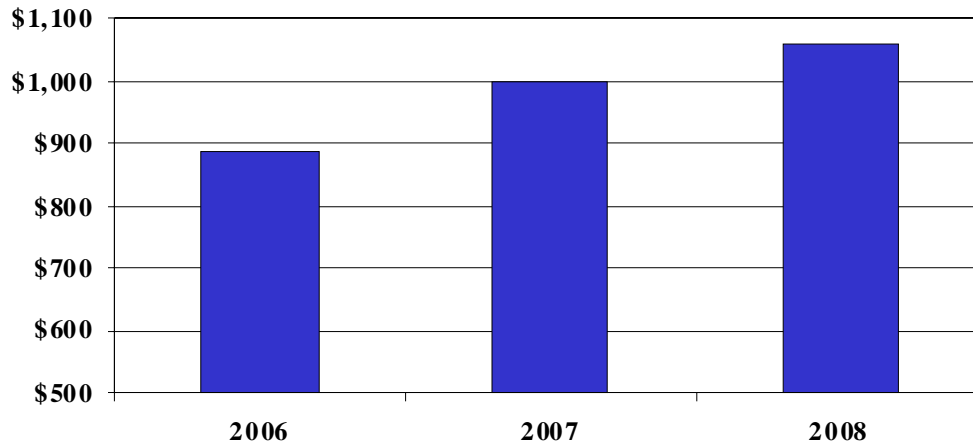
The largest contributing factor to sales growth in 2008 was the rise in gasoline and diesel prices. In the other commodities various levels of inflation and deflation impacted sales. In the case of produce, deflation was a factor for the majority of the year while in bakery dramatic increases in the cost of grain drove price inflation.

As part of its on-going efforts, Calgary Co-op will continue to focus on:

- emphasizing fresh products
- enhancing private label offering
- training employees to better meet customer needs
- strengthening store processes and on-shelf availability of product
- ongoing capital investment in new and existing facilities
- emphasizing merchandising and quality standards at store level

Sales

(in millions)

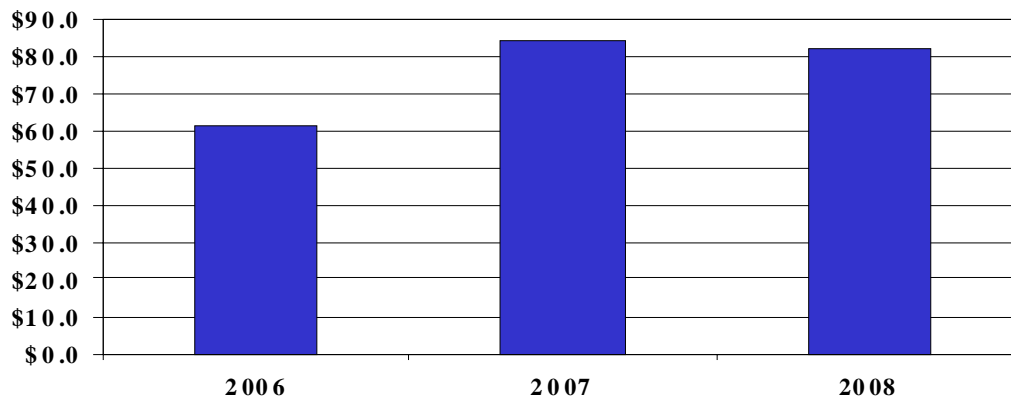


Earnings Before Interest, Taxes, Depreciation and Amortization

In 2008, earnings before interest expense, taxes, depreciation, amortization, loss on disposal & write-off of property & equipment and patronage returns (EBITDA; see Non-GAAP Financial Measures) reached \$83.1 million - a slight reduction, \$0.8 million, from the 2007 financial year. As a percentage of sales, EBITDA stands at 7.9% versus 8.4% in 2007.

EBITDA

(in millions)

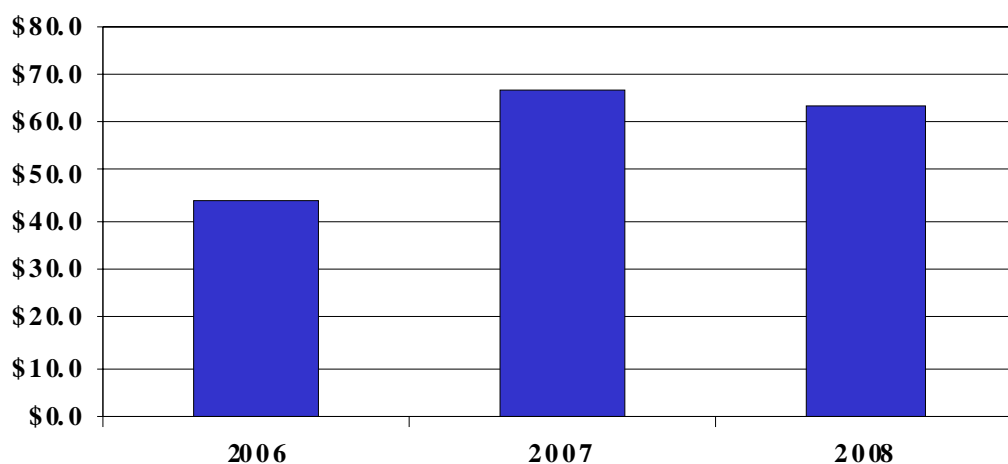


Earnings Before Patronage Return and Income Taxes

Earnings before patronage return and income taxes declined from \$67.3 million in 2007 to \$64.3 million in the current year. The net decline is a combination of various positive and negative factors including:

- increased patronage return from Federated Co-operatives Limited (FCL) is a combination of higher FCL earnings and increased purchase volumes by Calgary Co-op of food and petroleum from FCL;
- on a same store basis, fewer labour hours were used at store level than the prior year as a consequence of the tight labor market;
- increased rental income as additional commercial rental units were leased during the year;
- increased rental expense as a result of the new food centres, gas bar and liquor store that were open for the full year in 2008;
- increased loss on disposal and/or write-off of capital assets related primarily to the disposal of food store equipment and write-down of obsolete assets in renovated shopping centres;
- increased interest income resulting from stronger cash flows that provided additional cash for investment during the year;
- lower interest expense in 2008 is due to reduced long term debt levels;
- however, the impact of reduced food sales and lower margins overall was greater than the positive factors previously listed and resulted in the net decline in earnings.

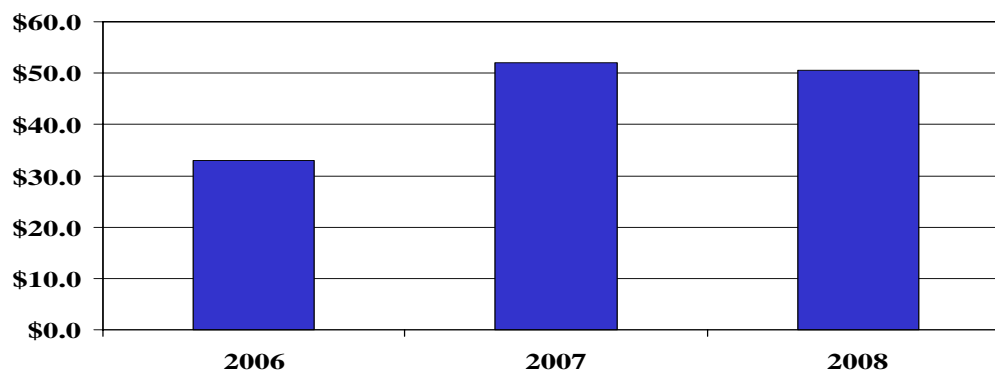
Earnings Before Patronage Returns and Income Taxes (in million s)



Patronage Returns

For fiscal 2008, the board of directors approved payment of patronage returns totaling \$50.5 million, a decrease of \$1.4 million from the amount paid in 2007. The cash portion of the patronage return is \$32.8 million, a \$1.0 million increase over the \$31.8 million cash portion in 2007. The share portion of the patronage return is \$17.7 million versus \$20.2 million in 2007.

Patronage Returns (in millions)

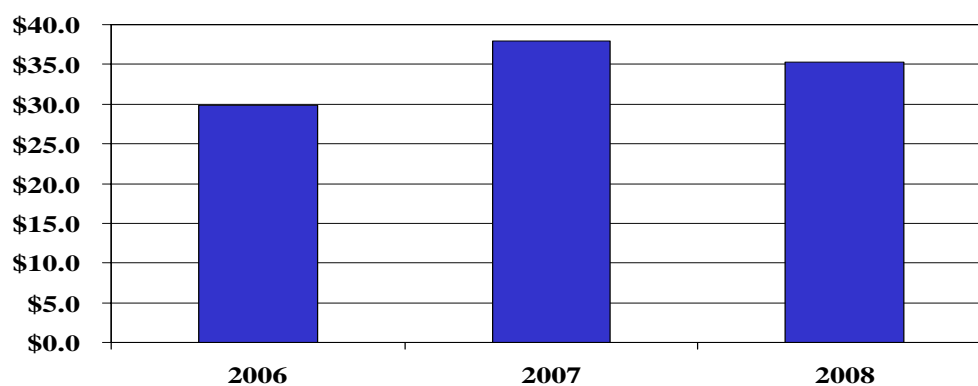


Financial Condition

Cash flows from operations before changes in non-cash working capital decreased slightly to \$35.3 million from \$38.0 million last year. Cash flows used in financing activities in 2008 were \$5.5 million compared to \$8.1 million in 2007. Cash flows used in investing were \$6.5 million versus \$34.8 million last year.

Expenditures on property and equipment were lower than the previous year (\$11.2 million in 2008 compared to \$38.9 million in 2007). Delays in receiving development approval resulted in a number of projects being delayed, with start dates now scheduled for 2009.

Cash Flow From Operations (before changes in non-cash working capital)

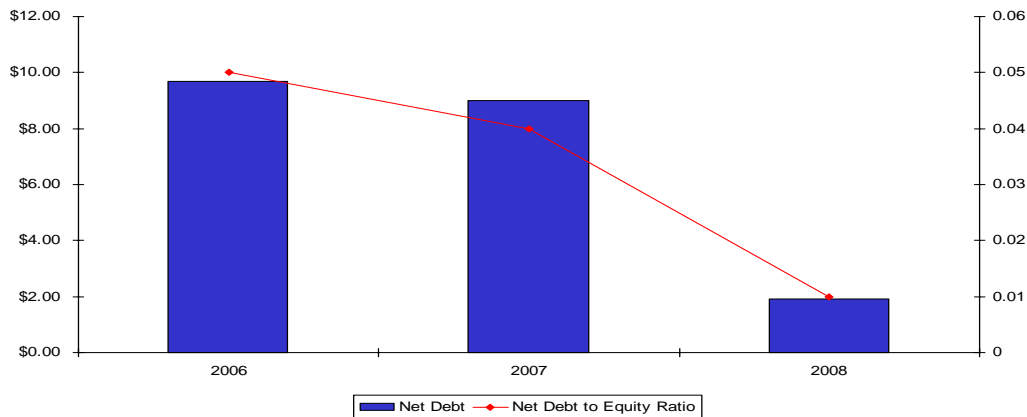


Calgary Co-op employs a combination of financing options from both internal and external sources. Profit retention is the primary source of internal financing. This is accomplished through additions to member shares and retained earnings. Members' equity in Calgary Co-op at the end of the 2008 fiscal year totaled \$256.2 million compared to \$229.9 million in 2007.

Credit Union Central Alberta (CUCA) provides the majority of Calgary Co-op's external financing. CUCA provided \$6.5 million of long-term financing in 2008. In addition, CUCA provides an \$8 million line of credit and a \$10 million evergreen loan facility to Calgary Co-op. As of November 1, 2008, outstanding letters of credit totaled \$3.1 million while the evergreen loan facility had no outstanding balance. Federated Co-operatives Limited provides various financing options including interest-free loans and non-interest bearing capital leases. At the end of fiscal 2008, \$2.1 million of interest-free loans and \$2.7 million in capital leases were outstanding with Federated Co-operatives Limited.

The net debt to equity ratio (see Non-GAAP Financial Measures) for Calgary Co-op improved over the prior year. In 2008, the net debt to equity ratio was 0.01:1 compared to 0.04:1 in 2007.

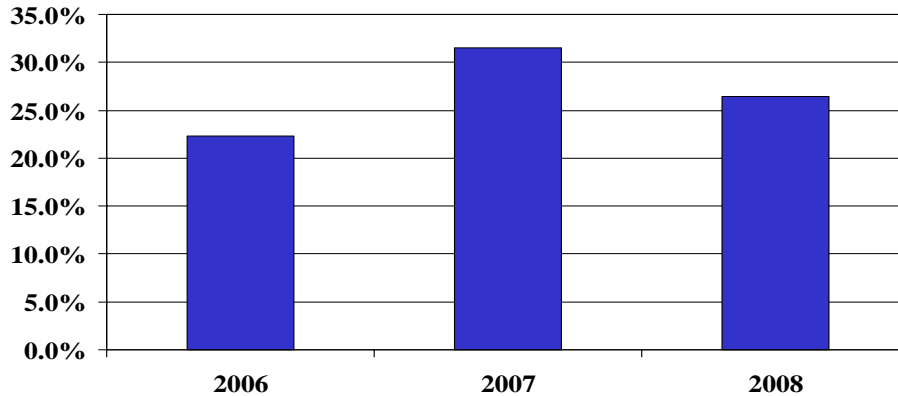
Net Debt to Equity



Return on member equity is based on after-tax earnings before patronage returns divided by opening member equity. For 2008, return on member equity was 26.4% compared to 31.5% in 2007. The three-year average return on member equity is 26.7%.

Return on Equity

(based on earnings before patronage return and opening equity)



Non-GAAP Financial Measures

Calgary Co-op reports its financial results in accordance with Canadian GAAP. Included within this MD&A are certain non-GAAP financial measures that Calgary Co-op believes may be useful information to readers of the financial statements. Because these measures do not have a standardized definition, they may or may not be comparable to similarly titled measures presented by other entities.

One of the non-GAAP measures used in assessing Calgary Co-op operating performance is EBITDA, defined as “earnings before interest expense, income tax, depreciation and amortization, loss on disposal of property and equipment, and patronage return”. EBITDA is used as an indicator of the company’s operational performance, ability to generate cash flows to fund cash requirements, investment and development projects.

Another non-GAAP measure employed at Calgary Co-op is Net Debt, defined as long and short-term debt less cash, cash equivalents, and short-term investments. This measure is an important component in identifying the amount of financial leverage employed by Calgary Co-op.

Another useful non-GAAP measure is net debt to total equity ratio, which highlights how Calgary Co-op finances operations. It also provides for an overall impression of its debt situation.

Risk Management

In the normal course of business, Calgary Co-op is exposed to various risks that have the potential to impact upon its profitability. As a result, Calgary Co-op has risk management strategies in place to assist in minimizing risk exposure.

Industry and Competitive Environment

Given the challenging economic times, the Canadian retail industry will remain highly competitive. Like all retailers in Canada, Calgary Co-op will be faced with challenges in the next year. As the economy and consumer spending slows, potential concerns include:

- difficulty in passing on commodity price increases to consumers
- a weak Canadian dollar impacts pricing for certain commodities such as produce
- demonstrating value to the customer
- more promotional pricing in the market which impacts margins

Calgary Co-op will continue to face stiff competition from other retailers including traditional and non-traditional grocery competitors, such as drug stores, mass merchandisers, warehouse clubs, discount stores and assorted other competitors. The potential arrival of new competitors, expansion of existing competitors, ethnic diversity, changing consumer expectations and demographics are all challenges to be faced. Various strategies employed by Calgary Co-op to face these challenges include: training and talent management initiatives, growing the private-label product line, providing products at competitive prices, enhancing customer service, continuous improvement of store level processes, being market driven, having cost effective operations, reviewing product pricing, encouraging innovation, and adjusting operating strategies as necessary.

Interest rate risk

Calgary Co-op's interest rate risk is limited to certain cash and short-term investments and long-term debt. Long-term debt has continued to decline over the last several years and along with it has declined Calgary Co-op's sensitivity to fluctuations in interest rates. This is illustrated by the fact that if interest rates had increased during 2008 by 100 basis points the impact on net earning would be a reduction of \$74,000.

Credit risk

Calgary Co-op's credit risk exposure is normal for the businesses it operates. The exposure is limited due to the fact there is a broad base of customers with no significant concentration of credit risk. In addition, various policies and guidelines, active account monitoring and credit scoring techniques are all employed to manage customer accounts.

Food Safety

Calgary Co-op has food safety policies and programs that address safe food handling and preparation standards, and rigorously applies these food safety procedures, practices and programs within the business. In addition, procedures are in place to effectively manage public health concerns related to specific food products or a major occurrence of a food-borne illness.

A comprehensive food safety program is in place, which includes employee certification upon completion of the program. Program attendance is mandatory for employees who handle fresh products and successful completion of the program is expected. Employees who successfully complete the initial training program must then take re-certification training on a regular basis.

Human Resources

The majority of the Calgary Co-op workforce is unionized. On October 24, 2005, unionized employees ratified a new five-year collective agreement with Calgary Co-op that will conclude in October 2009. Calgary Co-op endeavours to maintain good relations with all employees, both unionized and non-unionized.

In the current labour market it is a challenge to recruit, develop, and retain employees. Calgary Co-op is utilizing a variety of initiatives to retain existing employees and attract new employees. Some examples include: the bonus incentive program for all employees, significant investment in training, and career development plans.

Information Technology

As is the case with almost all companies today, Calgary Co-op relies on information technology to support its current and future operations. These systems are an important enabler in meeting the organizations business objectives. Various risks can arise if upgrades to existing systems or the introduction of new systems are not properly implemented to allow effective management of the business going forward.

Real Estate

The availability of sites for acquisition and development or leasing of new facilities may impact the ability for Calgary Co-op to meet its longer-term sales goals. Calgary Co-op maintains a reasonably large portfolio of owned real estate and, where possible, prefers to purchase sites for future facilities rather than lease.

Utility Prices

Calgary Co-op consumes significant amounts of electricity and natural gas at its facilities. The organization has entered into a fixed price supply contract for a large portion of its future electricity and natural gas requirements.

Environmental

Calgary Co-op has formal policies relating to the environment and energy management. Environmental audits are conducted annually by internal resources and tri-annually by certified independent external resources. Site remediation is also done in compliance with relevant legislation and using appropriate, qualified resources.

Energy management initiatives are important from the perspective of conserving resources and providing significant operating cost savings. An important component of the environmental and energy management programs is raising awareness among employees about energy usage and ways they can contribute to reducing energy consumption, as well as other conservation and environmental protection initiatives and practices.

Health and Safety

Calgary Co-op continues to invest in health and safety initiatives. A number of health and workplace safety programs are currently in place with others in development. Calgary Co-op has established policies and procedures to assist in ensuring compliance with applicable legislative requirements. In addition, audits and assessments are completed using internal and external resources. Raising employee awareness about health and safety issues is a focus.

Ethical Business Conduct

Calgary Co-op has adopted a Code of Business Conduct, which assists in ensuring that Calgary Co-op conducts its business in an ethical manner. All employees are responsible for knowing, understanding and operating within the Code of Business Conduct. Management employees and directors are required to complete a signed acknowledgement every three years.

Insurance

In order to limit exposure to certain risks, Calgary Co-op has an insurance program that utilizes various lines and limits of coverage.

Internal Control

Calgary Co-op has established and maintains various internal controls and procedures over financial reporting. The systems of internal control are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements. There are no changes in internal controls that have materially affected Calgary Co-op's internal control over financial reporting.

Compensation Objectives

The overall goal of Calgary Co-op's compensation program is to provide market competitive, as opposed to market leading, performance-based compensation. The annual incentive plans and long term incentive arrangements ("Plans") are cash-based award plans under which no payment is triggered unless certain performance objectives are attained. The Plans are administered by the Performance and Compensation Committee of the Board of Directors ("Board").

The compensation programs described below are designed to retain and attract key employees, recognize the contribution of employees to the growth of Calgary Co-op, provide an additional incentive for employees to improve their skills and assume managerial responsibilities, provide an annual incentive element in an overall compensation package that is competitive with the compensation offered by comparable retail companies in Calgary, promote profitability and enhance the value of Calgary Co-op.

Elements of the Employee Compensation Program

Base Salary

Wage rates for unionized positions are negotiated to remain competitive with a market comparable group and are subject to the terms and conditions of a collective agreement. With respect to professional, technical and management positions, Calgary Co-op's compensation policy is to establish end point salaries at the fiftieth (50th) percentile of a market comparator group. Base salaries are reviewed annually to ensure that they reflect comparable base salaries, general market conditions, level of responsibility and accountability, experience, individual performance and overall contribution to Calgary Co-op's success.

Annual Incentive Plans

Unionized employees are eligible to participate in Calgary Co-op's Gainshare Plan, which provides an opportunity for such individuals to earn an annual bonus payment based on the achievement of targets approved by the Board. Potential bonuses are expressed as a percentage of annual regular paid hours. No bonus is payable until threshold performance targets are achieved.

Professional, technical and management positions at Calgary Co-op participate in a Short-Term Incentive Plan which provides an opportunity for such individuals to earn an annual bonus payment based on the achievement of targets approved by the Board. Potential bonuses are expressed as a percentage of annual base salary. No bonus is payable until threshold performance targets are achieved.

Long Term Incentive Plan

Eligible management positions participate in a Long Term Incentive Plan that provides an opportunity for such individuals to earn a bonus payment based on the achievement of an average ROE target approved by the Board over a three year consecutive performance period. Performance periods are established annually at the beginning of each financial year. Potential bonus awards are expressed as a percentage of the average annual base salary over the performance period. No bonus is payable unless threshold targets and performance hurdles are achieved over the performance period.