Management's Discussion and Analysis

Management's Discussion and Analysis

The following Management's Discussion and Analysis ("MD&A") for George Weston Limited ("Weston") and its subsidiaries (collectively, the "Company") should be read in conjunction with the consolidated financial statements and the accompanying notes on pages 59 to 95 of this Financial Report. The consolidated financial statements and the accompanying notes have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and are reported in Canadian dollars. These consolidated financial statements include the accounts of George Weston Limited and its subsidiaries and variable interest entities ("VIEs") that the Company is required to consolidate in accordance with Accounting Guideline 15, "Consolidation of Variable Interest Entities" ("AcG 15"). A Glossary of terms and ratios used throughout this Financial Report can be found on page 99. The information in this MD&A is current as of March 15, 2007, unless otherwise noted.

FORWARD-LOOKING STATEMENTS

This Annual Report, including the Annual Summary and this MD&A, contains forward-looking statements which reflect management's expectations and are contained in discussions regarding the Company's objectives, plans, goals, aspirations, strategies, potential future growth, results of operations, performance and business prospects and opportunities. Forward-looking statements are typically, though not always, identified by words or phrases such as "anticipates", "expects", "believes", "estimates", "intends" and other similar expressions.

These forward-looking statements are not guarantees, but only predictions. Although the Company believes that these statements are based on information and assumptions, which are current, reasonable and complete, these statements are necessarily subject to a number of factors that could cause actual results to vary significantly from the estimates, projections and intentions. Such differences may be caused by factors which include, but are not limited to, changes in consumer spending, preferences and consumers' nutritional and health related concerns, changes in the competitive environment, including changes in pricing and market strategies of the Company or of its competitors and the entry of new competitors and expansion of current competitors, the availability and cost of raw materials and ingredients, fuels and utilities, the ability to realize anticipated cost savings and efficiencies, including those resulting from restructuring, inventory liquidation and other cost reduction and simplification initiatives, the ability to execute restructuring plans, implement strategies and introduce innovative products successfully and in a timely manner, changes in the markets for the inventory intended for liquidation and changes in the expected realizable value and costs associated with the liquidation, unanticipated, increased or decreased costs associated with the announced initiatives, including those related to compensation costs, the Company's relationship with its employees, results of labour negotiations including the terms of future collective bargaining agreements, changes to the regulatory environment in which the Company operates now or in the future, the inherent uncertainty regarding the outcome of litigation or any dispute resolution initiative, changes in the Company's tax liabilities, either through changes in tax laws or future assessments, performance of third-party service providers, public health events, the ability of the Company to attract and retain key executives, the success rate of the Company in developing and introducing new products and entering new markets and supply and quality control issues with vendors. The calculation of the goodwill impairment charge described in this MD&A involves the estimation of several variables, including but not limited to market multiples, projected future sales and earnings, capital investment, discount rates, terminal growth rates and the fair values of those assets and liabilities being valued. The Company cautions that this list of factors is not exhaustive.

The assumptions applied in making the forward-looking statements contained in this Annual Report, including this MD&A, include the following: economic conditions do not materially change from those expected, patterns of consumer spending and preferences are reasonably consistent with historical trends, no new significant competitors enter the Company's market and neither the Company nor its existing competitors significantly increase their presence or change pricing or market strategies materially, the Company successfully offers new and innovative products and executes its strategies as planned, anticipated cost savings and efficiencies are realized as planned, continuing future restructuring activities are effectively executed in a timely manner, costs associated with the liquidation of inventory are not higher or lower than expected, the Company's assumptions regarding average compensation costs and average years of service for employees affected by the simplification initiatives are materially correct, the Company does not significantly change its approach to its current restructuring activities, there is no material amount of excess inventory in the Company's supply chain, there are no material work stoppages and the performance of third-party service providers is in accordance with expectations.

These estimates and assumptions may change in the future due to uncertain competitive and economic market conditions or changes in business strategies. This list of factors and other risks and uncertainties are discussed in the Company's materials filed with the Canadian securities regulatory authorities from time to time, including the Operating Risks and Risk Management and Financial Risks and Risk Management sections of this MD&A.

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

OVERVIEW

Weston is a Canadian public company, founded in 1882, and is one of North America's largest food processing and distribution companies. Weston has two reportable operating segments: Weston Foods and Loblaw. The Weston Foods operating segment is primarily engaged in the baking and dairy industries within North America. The Loblaw operating segment, which is operated by Loblaw Companies Limited and its subsidiaries, is Canada's largest food distributor and a leading provider of general merchandise, drugstore, and financial products and services.

VISION

Weston's vision has been, and continues to be, centred on three main principles: growth, innovation and flexibility. Weston seeks long term, stable growth in its operating segments, while accepting prudent operating risks through continuous capital investment supported by a strong balance sheet, with the goal of providing sustainable returns to its shareholders through a combination of common share price appreciation and dividends.

The Company believes that to be successful over the long term, it must deliver on what its customers and consumers want, today and in the future. The Company encourages innovation in order to provide consumers with new products and convenient services at competitive prices that meet consumers' everyday household needs.

Looking ahead, the Company plans to achieve these goals by focusing on its long term operating and financial strategies as discussed below.

OPERATING AND FINANCIAL STRATEGIES

In order to be successful in delivering long term value and to fulfill its long term objectives of security and growth, the Company employs various operating and financial strategies in order to achieve its long term vision. Each of the Company's two reportable operating segments has its own risk profile and operating risk management strategies.

Weston Foods' long term operating strategies include:

- customer alignment;
- brand development including innovative new products to meet the nutritional and dietary concerns of consumers;
- plant and distribution optimization including capital investment to strategically position facilities across North America to support growth and enhance productivity and efficiencies;
- ongoing cost reduction initiatives to ensure a low cost operating structure and economies of scale;
- targeting strategic acquisitions and relationships to broaden market penetration and expand geographic presence; and
- building leadership capability.

Under the principles of Simplify, Innovate, Grow, Loblaw employs various operating and financial strategies which guide Loblaw over the long term and represent a philosophy for the way in which it conducts its business. The new management team developed its Formula for Growth to define priorities for a three year renewal plan. In order to provide an integrated offering of food, general merchandise and drugstore, Loblaw's Formula for Growth focuses on the following:

- best format: truly distinctive formats meeting customers' different needs;
- fresh first: best fresh food offering;
- control label advantage: leading in the development of unique, high quality control label products and services;
- *Joe Fresh Style*: ensuring great style at an affordable price;
- health, home and wholesome: making healthy living affordable;
- priced right: providing best value;
- always available: best in-stock positions; and
- friendly colleagues motivated to serve.

Loblaw's long term operating strategies are consistent with its Formula for Growth and continue to be as follows:

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

The Company's financial strategies include:

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

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

The Company believes that if it successfully implements and executes its various strategic imperatives in support of its long term operating and financial strategies, it will be well positioned to fulfill its vision of providing sustainable returns to its shareholders over the long term.

KEY PERFORMANCE INDICATORS

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

Key Financial Performance Indicators	**2006**	2005[2]
Sales growth	**3.1%**	5.3%
Sales growth excluding the impact of VIEs[1]	**3.3%**	3.9%
Basic net earnings per common share from continuing operations (decline) growth	**(91.8%)**	16.9%
Adjusted basic net earnings per common share from continuing operations (decline) growth[1]	**(11.7%)**	2.5%
Net debt (excluding exchangeable debentures)[1] to equity ratio	**0:96:1**	1.02:1
Return on average common shareholders' equity	**1.3%**	16.7%

(1) See Non-GAAP Financial Measures beginning on page 51.

(2) During 2006, the Company implemented Emerging Issues Committee Abstract 156, "Accounting by a Vendor for Consideration Given to a Customer (Including a Reseller of the Vendor's Products)" ("EIC 156") on a retroactive basis. Accordingly certain sales incentives paid by Loblaw to independent franchisees, associates and independent accounts for prior years have been reclassified between sales and cost of sales, selling and administrative expenses. For a further discussion, see the Accounting Standards Implemented in 2006 section included in this MD&A.

In addition, other operating performance indicators include but are not limited to: same-store sales growth, operating and administrative cost management, new product development, customer service ratings, product return rates, production waste, production efficiencies and market share.

OVERALL FINANCIAL PERFORMANCE

CONSOLIDATED RESULTS OF OPERATIONS

($ millions except where otherwise indicated)	2006	2005[2]	2004[2]
Sales	$ 32,167	$ 31,189	$ 29,619
Sales excluding the impact of VIEs[1]	$ 31,784	$ 30,774	$ 29,619
Operating income	$ 537	$ 1,634	$ 1,782
Adjusted operating income[1]	$ 1,643	$ 1,894	$ 1,901
Interest expense and other financing charges	$ 253	$ 187	$ 438
Net earnings from continuing operations	$ 110	$ 716	$ 606
Net earnings	$ 121	$ 698	$ 428
Basic net earnings per common share from continuing operations ($)	$ 0.43	$ 5.25	$ 4.49
Adjusted basic net earnings per common share from continuing operations ($)[1]	$ 4.98	$ 5.64	$ 5.50
Basic net earnings per common share ($)	$ 0.52	$ 5.11	$ 3.11

(1) See Non-GAAP Financial Measures beginning on page 51.
(2) During 2006, the Company implemented EIC 156 on a retroactive basis. Accordingly certain sales incentives paid by Loblaw to independent franchisees, associates and independent accounts for prior years have been reclassified between sales and cost of sales, selling and administrative expenses. For a further discussion, see the Accounting Standards Implemented in 2006 section included in this MD&A.

Sales and Sales Growth Excluding the Impact of VIEs[1]

($ millions except where otherwise indicated)	2006	2005[2]	2004[2]
Total sales	$ 32,167	$ 31,189	$ 29,619
Less: Sales attributable to the consolidation of VIEs	383	415	
Sales excluding the impact of VIEs[1]	$ 31,784	$ 30,774	$ 29,619
Total sales growth	3.1%	5.3%	
Less: Impact on sales growth attributable to the consolidation of VIEs	(0.2%)	1.4%	
Sales growth excluding the impact of VIEs[1]	3.3%	3.9%	

(1) See Non-GAAP Financial Measures beginning on page 51.
(2) During 2006, the Company implemented EIC 156 on a retroactive basis. Accordingly certain sales incentives paid by Loblaw to independent franchisees, associates and independent accounts for prior years have been reclassified between sales and cost of sales, selling and administrative expenses. For a further discussion, see the Accounting Standards Implemented in 2006 section included in this MD&A.

Adjusted Operating Income[1]

($ millions)	2006	2005	2004
Operating income	$ 537	$ 1,634	$ 1,782
Add (deduct) impact of the following:			
Loblaw goodwill impairment charge	800		
Restructuring and other charges	90	118	122
Ontario collective labour agreement	84		
Inventory liquidation	68		
Departure entitlement charge	12		
Direct costs associated with supply chain disruptions		30	
Goods and Services Tax and provincial sales taxes		40	
Net effect of stock-based compensation and the associated equity derivatives	60	72	(3)
VIEs	(8)		
Adjusted operating income[1]	$ 1,643	$ 1,894	$ 1,901

(1) See Non-GAAP Financial Measures beginning on page 51.

Adjusted EBITDA[1]

($ millions)	2006	2005	2004
Adjusted operating income[1]	$ 1,643	$ 1,894	$ 1,901
Add (deduct) impact of the following:			
Depreciation and amortization	705	684	618
VIE depreciation and amortization	(24)	(26)	
Adjusted EBITDA[1]	$ 2,324	$ 2,552	$ 2,519

(1) See Non-GAAP Financial Measures beginning on page 51.

Adjusted Basic Net Earnings per Common Share from Continuing Operations[1]

Per common share ($)	2006	2005	2004
Basic net earnings per common share from continuing operations	$ 0.43	$ 5.25	$ 4.49
Add (deduct) impact of the following:			
Loblaw goodwill impairment charge	3.84		
Restructuring and other charges	0.36	0.42	0.58
Ontario collective labour agreement	0.26		
Inventory liquidation	0.21		
Departure entitlement charge	0.04		
Direct costs associated with supply chain disruptions		0.09	
Goods and Services Tax and provincial sales taxes		0.14	
Net effect of stock-based compensation and the associated equity derivatives	0.38	0.46	(0.01)
Accounting for Loblaw forward sale agreement	(0.40)	(0.77)	0.51
Changes in statutory income tax rates	(0.14)	0.02	
Resolution of certain income tax matters			(0.07)
VIEs		0.03	
Adjusted basic net earnings per common share from continuing operations[1]	$ 4.98	$ 5.64	$ 5.50

(1) See Non-GAAP Financial Measures beginning on page 51.

Management's Discussion and Analysis

Consolidated 2006 results reflect the transformational changes being undertaken by both the Weston Foods and Loblaw operating segments in order to position the businesses for strong growth in the future.

Baking industry conditions have changed significantly over the past several years and the Company's North American baking operations have faced a challenging marketplace impacted by changing consumer eating preferences and food shopping patterns, as well as continued inflationary cost pressures. The Company continued to respond to these challenging conditions and execute on opportunities to improve the long term competitive position of its North American baking operations, which has resulted in further restructuring and other charges taken by the Company during 2006.

Results for the Loblaw operating segment in 2006 were affected by the short term costs associated with one of the largest transformations in Loblaw's history. The past year saw a number of significant changes in the leadership of Loblaw with the appointment of a new senior leadership team in the offices of Executive Chairman, Chief Merchandising Officer, Chief Operating Officer and Chief Financial Officer. The need for this transformative process was driven by Loblaw's recent uncharacteristically poor financial performance, its assessment of a fast-changing retail environment and a strategic review, undertaken by the new senior leadership of Loblaw, of processes, structure and key drivers of its operations. This strategic review highlighted both core strengths and issues to be addressed. The core strengths include a strong market share, control label products and a strong store network. A number of issues facing Loblaw included unacceptable levels of on-shelf availability, the need to strengthen price positioning, insufficiently distinctive formats, a complex organizational structure with inconsistent procedures and standards which lacked clear accountabilities and insufficient focus on the customer. In response to these findings, Loblaw embarked on planning and developing an organizational transition which focuses on redesigning processes, a leaner administrative structure and a comprehensive strategy designed to fortify its competitive position and maintain its leadership role in meeting the food and everyday household needs of Canadian consumers. In pursuit of this strategy, Loblaw is refocusing the business around the three principles of Simplify, Innovate, Grow and took decisive action in 2006 to initiate tangible change. These steps include: (i) simplifying the organization by more clearly defining accountabilities, eliminating duplication and establishing consistent, simple and efficient processes; (ii) supporting innovation based on the belief that providing customers with new products and convenient services at competitive prices and stimulating shopping environments is critical to its success; and (iii) developing a Formula for Growth as previously described. Additional steps taken in 2006 include the negotiation of a new four-year collective agreement with members of certain Ontario locals of the United Food and Commercial Workers union ("UFCW"), the liquidation of certain general merchandise inventory and the closure of certain underperforming stores. Changes in 2005 included the restructuring of Loblaw's supply chain network, the reorganizations involving its merchandising, procurement and operations groups, the establishment of a new National Head Office and Store Support Centre in Brampton, Ontario, which opened in 2005, and the relocation of general merchandise operations from Calgary, Alberta to the new National Head Office. During 2005, Loblaw encountered challenges during the execution of planned changes to its systems, supply chain and general merchandise areas, including certain supply chain systems conversions which were initiated as part of the creation of a national information technology platform and the start-up of a new third-party owned and operated general merchandise warehouse and distribution centre for eastern Canada which handles general merchandise and certain drugstore products, primarily health and beauty care products. These challenges disrupted the flow of inventory to Loblaw's stores and caused Loblaw to incur additional operating costs and reduced overall sales as product availability impacted consumers at the store level. During 2006, Loblaw continued to feel the effects from these changes. However, progress continued to be made in reducing the impact of the supply chain disruptions as follows:

- the third-party owned and operated general merchandise warehouse and distribution centre for eastern Canada posted slight productivity improvements and achieved improved service levels;
- six additional systems conversions were completed during the year with minimal disruption to continuing operations as part of the move to a national systems platform;
- food service levels continued at expected levels during 2006 and service levels for drugstore improved; and
- service levels for general merchandise showed signs of stability and improvement, and while slower than anticipated, progress has been made.

The following discussion summarizes the factors and trends that have impacted the Company's financial performance over the past two fiscal years.

In 2006, consolidated sales increased 3.1% to $32.2 billion from $31.2 billion in 2005. Sales growth for 2006 included a negative impact of approximately 0.2% from the consolidation of certain Loblaw independent franchisees as required by AcG 15. Sales excluding the impact of VIEs[1] increased 3.3% or $1.0 billion over the prior year. In 2005, consolidated sales increased 5.3% from $29.6 billion in 2004. Sales growth for 2005 included a positive impact of approximately 1.4% from the consolidation of certain Loblaw independent franchisees. The 2006 consolidated net earnings from continuing operations decreased $606 million, or 84.6%, to $110 million from $716 million in 2005. In 2005, consolidated net earnings from continuing operations increased $110 million, or 18.2%, from $606 million in 2004. Consolidated net earnings decreased $577 million, or 82.7%, to $121 million in 2006 from $698 million in 2005. In 2005, consolidated net earnings increased $270 million, or 63.1%, from $428 million in 2004.

The 2006 basic net earnings per common share from continuing operations of $0.43 decreased 91.8% in line with the decrease in consolidated net earnings from continuing operations. The 2006 basic net earnings per common share of $0.52 also decreased by 89.8% compared to $5.11 in 2005. Both decreases were primarily due to a non-cash Loblaw goodwill impairment charge recorded in 2006 related to the goodwill established on the Loblaw acquisition of Provigo Inc. in 1998.

The Company's consolidated financial statements are expressed in Canadian dollars but a significant portion of its Weston Foods business occurs in United States dollars through its investment in self-sustaining foreign operations in the United States ("U.S. net investment"). Changes in the exchange rate for the United States dollar affect the Company's sales, net earnings and the value of the Company's assets and liabilities on its consolidated balance sheet, either positively or negatively, as a result of translating the U.S. net investment into Canadian dollars. In 2006 and 2005, due to the appreciation in the Canadian dollar relative to the United States dollar during the year on a weighted average basis, sales and net earnings growth were negatively impacted as a result of foreign currency translation. At year end 2006, due to the slight decline of the Canadian dollar relative to the United States dollar from year end 2005, the value of the Company's net assets was positively impacted as a result of foreign currency translation. At year end 2005, due to the strengthening of the Canadian dollar relative to the United States dollar from year end 2004, the value of the Company's net assets was negatively impacted as a result of foreign currency translation.

Over the past two years, the Weston Foods baking operations have operated in a challenging marketplace impacted by changing consumer eating preferences and food shopping patterns as well as continued inflationary cost pressures. Changing consumer eating preferences, including a focus on health and diet, challenged Weston Foods sales growth of traditional white flour based products, in particular white bread and fresh-baked sweet goods. In addition, consumer shopping patterns and Weston Foods sales growth continue to shift toward alternate format retail channels over traditional, conventional supermarket formats. Product rationalization and the planned exit of certain less profitable products have negatively impacted sales with competitive activity remaining strong across all categories, particularly in biscuit and frozen bakery sales. These continuing trends are more fully discussed under Weston Foods operating results in the Results of Reportable Operating Segments section of this MD&A.

During this two-year period, Weston Foods sales have been positively impacted by its focus on:

- penetrating new sales channels, particularly with alternate format retail channels;
- strong sales growth in the whole grain and higher-priced premium product categories;
- new private label business; and
- the development and introduction of new and expanded convenience and health related product offerings, including "on-the-go" individual portioned products, enhanced whole grain and whole wheat offerings as well as Omega-3, no cholesterol, reduced fat, no trans fat and organic products.

In 2006, Weston Foods achieved sales price increases across many of its product categories. These increases helped to partially mitigate the impact of the continued cost inflation experienced across the baking industry. Over the last two years, Weston Foods has continued to restructure its asset base to reduce costs and operate more efficiently. Management continues to evaluate strategic and cost reduction initiatives related to its manufacturing assets, distribution networks and administrative infrastructure with the objective of ensuring a low cost operating structure.

(1) See Non-GAAP Financial Measures beginning on page 51.

Management's Discussion and Analysis

Loblaw has been undergoing a significant amount of change over the past two years. As discussed previously, a number of significant changes in the operations of Loblaw occurred in 2006, including the change in senior leadership. The new management team commenced a review of Loblaw in the latter half of 2006 which focused on key drivers of the business such as fresh food presentation, the value proposition of banners, maximizing employee engagement, the performance of retailing basics and customer satisfaction. Loblaw also continued to feel the effects in 2006 of certain of its 2005 initiatives which included restructuring of the supply chain operations, supply chain systems conversions which were initiated as part of the creation of a national information technology platform, the reorganization of its merchandising, procurement and operations groups and the move of personnel to the Store Support Centre in Brampton, Ontario.

Loblaw sales in 2006 increased 3.7% to $28.6 billion from $27.6 billion in 2005. Excluding the impact of VIEs, sales were $28.3 billion or 3.8% higher than 2005. Same-store sales increased 0.8% in 2006 and 0.2% in 2005. National food price inflation as measured by "The Consumer Price Index for Food Purchased from Stores" ("CPI") was approximately 2.3% for 2006 compared to approximately 2.0% for 2005. Loblaw's calculation of food price inflation, which considers Loblaw-specific product mix and pricing strategy, was reasonably consistent with that of CPI. Sales and same-store sales in 2006 were adversely impacted by a decrease in tobacco sales caused by a general market decline and the loss of tobacco sales through its wholesale club network due to the decision of a major tobacco supplier to sell directly to certain customers of Loblaw. In 2005, and to a lesser extent 2006, sales and same-store sales were also adversely impacted as the flow of inventory to Loblaw's stores was disrupted by the effects of systems conversions and the start-up of a third-party warehouse. Sales were also influenced by a number of other factors, including changes in net retail square footage, expansion into new services and/or departments and the activities of competitors. Over the past two years, an average of $1.0 billion annually in capital was invested, resulting in an increase in net retail square footage of approximately 4.0 million square feet or 8.8%. Corporate store sales per average square foot decreased from $592 in 2004 to $585 in 2006. The amount of new net retail square footage and the timing of the store openings and closures within any given year may vary. The increase in weighted average net retail square footage was 4.5% in 2006 and 7.5% in 2005. In pursuit of improving its value proposition, Loblaw has invested in pricing in specific markets by adopting everyday low pricing strategies. Consistent with its strategy of focusing on food but serving the consumer's everyday household needs, Loblaw has expanded its general merchandise and drugstore offerings over this period and the retail sales growth realized in those categories continued to surpass retail sales growth of food. Competitor activity varied by market. During the past two years, unprecedented levels of retail square footage, mainly associated with food offerings, have been introduced into certain markets, resulting in pressure on prices and customer retention.

The following analysis details factors that have impacted the Company's consolidated sales and net earnings over the past two years.

Sales

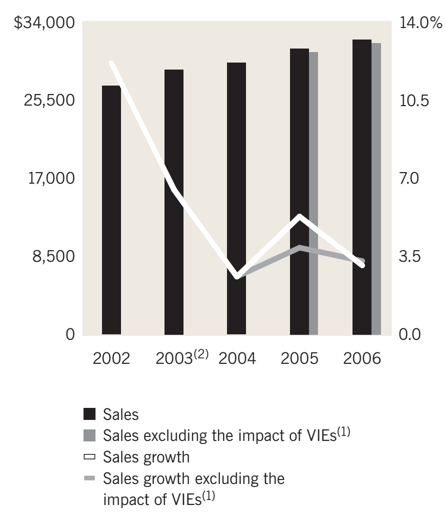
The Company's 2006 consolidated sales increased 3.1% to $32.2 billion from $31.2 billion in 2005, including a negative impact of approximately 0.2% from the consolidation of certain Loblaw independent franchisees as required by AcG 15 and a negative impact of approximately 0.7% from the foreign currency translation of the Weston Foods operating segment.

Consolidated sales growth for 2006 was impacted by each reportable operating segment as follows:

- Negatively by 0.1% due to the sales decrease of 0.6% at Weston Foods, which included the negative impact of foreign currency translation of approximately 4.4%.
- Positively by 3.2% due to the sales increase of 3.7% at Loblaw. Sales increases were realized across all regions of the country and in all areas of food, general merchandise and drugstore. However, sales and same-store sales growth were negatively impacted by a decline in tobacco sales.

The Company's 2005 consolidated sales increased 5.3% to $31.2 billion from $29.6 billion in 2004, including a positive impact of approximately 1.4% from the consolidation of certain Loblaw independent franchisees as required by AcG 15 and a negative impact of approximately 0.7% from the foreign currency translation of the Weston Foods operating segment.

Sales and Sales Growth
($ millions)



(1) See Non-GAAP Financial Measures beginning on page 51.
(2) 2003 was a 53-week year.

Consolidated sales growth for 2005 was impacted by each reportable operating segment as follows:

- Positively by 0.1% due to the sales increase of 0.9% at Weston Foods, which included the negative impact of foreign currency translation of approximately 5.1%.
- Positively by 5.4% due to the sales increase of 6.1% at Loblaw, which included the positive impact of approximately 1.6% from the consolidation of certain Loblaw independent franchisees as required by AcG 15. Sales and same-store sales were adversely affected by supply chain disruptions experienced during 2005.

Operating Income

The Company's 2006 consolidated operating income decreased $1,097 million, or 67.1%, to $537 million. 2006 consolidated operating income included the net negative impact of $1,106 million as a result of the following:

- a charge of $800 million related to the non-cash Loblaw goodwill impairment charge;
- a charge of $90 million related to restructuring and other charges for restructuring plans undertaken by both Weston Foods and Loblaw;
- a charge of $84 million related to the Ontario collective labour agreement at Loblaw;
- a charge of $68 million related to the inventory liquidation at Loblaw;
- a charge of $12 million related to a departure entitlement payment at Loblaw;
- a charge of $60 million for the net effect of stock-based compensation and the associated equity derivatives. The amount of net stock-based compensation cost recorded in operating income is dependent upon the number of unexercised, vested stock options and restricted share units, the number of underlying common shares associated with the equity derivatives and the fluctuations in the market price of the underlying common shares; and
- income of $8 million related to the consolidation of VIEs by Loblaw.

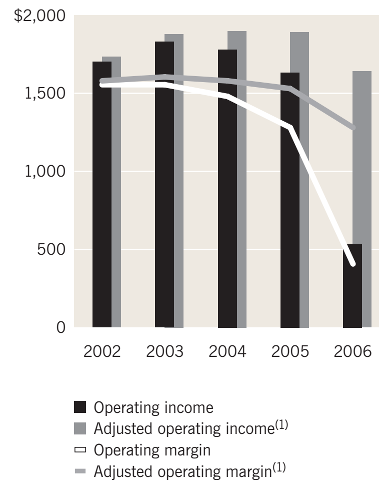
After adjusting for the negative impact of the items described above, consolidated adjusted operating income(1) for 2006 was $1,643 million compared to $1,894 million in 2005, a decline of 13.3%.

The Company's 2006 consolidated adjusted operating income(1) was impacted by each of its reportable operating segments as follows:

- Positively by 1.2% due to an increase of 7.6% in adjusted operating income(1) at Weston Foods, including the negative impact of foreign currency translation as a result of the appreciation of the Canadian dollar relative to the United States dollar. In addition, Weston Foods adjusted operating income(1) was positively impacted by sales growth, including price increases in key product categories combined with changes in sales mix, and by the benefits being realized from restructuring and other cost reduction activities initiated over the last few years.
- Negatively by 14.5% due to a decrease of 17.2% in adjusted operating income(1) at Loblaw. Adjusted operating income(1) in 2006 was adversely impacted by the effects of product supply issues, resulting from the implementation challenges arising from the 2005 conversions, and delays in program activities resulted in foregone sales and lost cost leverage on fixed components of operating and administrative expenses. In addition, the continued investment in lower food prices to drive sales growth had a negative impact on adjusted operating income(1). Higher information technology investments in addition to store and distribution centre operational costs, principally labour and higher third-party storage costs, were also incurred. Fixed assets impairment charges were recorded, due in part to a decision to suspend plans for a number of sites scheduled for future development as well as higher general merchandise mark downs taken to clear inventory through normal channels.

Operating Income and Margin, Adjusted Operating Income(1) and Margin(1)

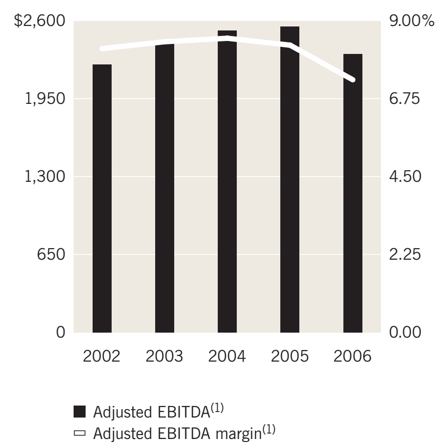
($ millions)



(1) See Non-GAAP Financial Measures beginning on page 51.

Analysis of Adjusted EBITDA(1) and Margin(1)

($ millions)



(1) See Non-GAAP Financial Measures beginning on page 51.

(1) See Non-GAAP Financial Measures beginning on page 51.

The Company's 2006 consolidated adjusted operating margin(1) declined to 5.2% from 6.2% in 2005, and consolidated adjusted EBITDA margin(1) declined to 7.3% from 8.3% in 2005. Consolidated adjusted operating margin(1) declined in 2006 primarily due to the lower adjusted operating margin(1) at Loblaw, partially offset by the higher adjusted operating margin(1) at Weston Foods.

The Company's 2005 consolidated operating income decreased $148 million, or 8.3%, to $1,634 million. 2005 consolidated operating income included the negative impact of $260 million as a result of the following:

- a charge of $118 million related to restructuring and other charges for restructuring plans undertaken by both Weston Foods and Loblaw;
- a charge of $30 million related to Loblaw's estimated impact of direct costs associated with supply chain disruptions;
- a charge of $40 million related to Loblaw's estimate of Goods and Services Tax ("GST") and provincial sales taxes ("PST") charges; and
- a charge of $72 million for the net effect of stock-based compensation and the associated equity derivatives.

After adjusting for the negative impact of the items described above, consolidated adjusted operating income(1) for 2005 declined 0.4% to $1,894 million from $1,901 million in 2004, which excluded a $119 million net charge mainly composed of restructuring and other charges.

The Company's 2005 consolidated adjusted operating income(1) was impacted by each of its reportable operating segments as follows:

- Positively by 2.4% due to an increase of 18.0% in adjusted operating income(1) at Weston Foods, including the negative impact of foreign currency translation as a result of the appreciation of the Canadian dollar relative to the United States dollar. In addition, Weston Foods operating income was positively impacted by sales growth, including volume, price and sales mix improvements, and by the benefits being realized from restructuring and other cost reduction activities initiated in 2004 and 2005.
- Negatively by 2.8% due to a decrease of 3.2% in adjusted operating income(1) at Loblaw. Softening sales from product supply issues and deliberate delays in program activity in 2005 resulted in lost leverage on the fixed components of operating and administrative expenses.

The Company's 2005 consolidated adjusted operating margin(1) declined to 6.2% from 6.4% in 2004, and consolidated adjusted EBITDA margin(1) declined to 8.3% from 8.5% in 2004. Consolidated adjusted operating margin(1) declined in 2005 primarily due to the lower adjusted operating margin(1) at Loblaw, partially offset by the higher adjusted operating margin(1) at Weston Foods.

Interest Expense and Other Financing Charges

Interest expense and other financing charges consist primarily of interest on short and long term debt, the amortization of deferred financing costs, interest and other financing charges on financial derivative instruments, net of interest earned on short term investments and interest capitalized to fixed assets.

In 2006, interest expense and other financing charges increased $66 million, or 35.3%, to $253 million from $187 million in 2005. The change is explained as follows:

- Interest expense on long term debt decreased $11 million, or 2.7%, to $393 million from $404 million in 2005 primarily as a result of lower average debt levels.
- Interest on financial derivative instruments, which includes the net effect of the Company's interest rate swaps, cross currency basis swaps and equity derivatives, resulted in a charge of $15 million (2005 – income of $1 million). The change in interest on financial derivative instruments was due mainly to an increase in Canadian short term interest rates.
- Non-cash income of $73 million (2005 – $150 million) was recorded in other financing charges representing the fair value adjustment of Weston's 2001 forward sale agreement for 9.6 million Loblaw common shares (the "underlying Loblaw shares"). The fair value adjustment is based on the fluctuations in the market price of the underlying Loblaw shares and is a non-cash item that will ultimately be offset by the recognition of any gain on Weston's disposition of the underlying Loblaw shares (see notes 7 and 22 to the consolidated financial statements for additional information).
- Net short term interest income increased to $38 million (2005 – $25 million) primarily due to higher interest rates on United States dollar denominated cash, cash equivalents and short term investments partially offset by higher average short term debt and increased Canadian short term interest rates.
- Interest expense capitalized to fixed assets remained unchanged at $21 million as compared to 2005. Loblaw capitalizes interest incurred on debt related to real estate properties under development.

The 2006 weighted average fixed interest rate on long term debt (excluding capital lease obligations and the Exchangeable Debentures) was 6.6% (2005 – 6.6%) and the weighted average term to maturity was 16 years (2005 – 16 years).

(1) See Non-GAAP Financial Measures beginning on page 51.

In 2005, interest expense and other financing charges decreased $251 million, or 57.3%, to $187 million from $438 million in 2004. The change is explained as follows:

- Interest expense on long term debt decreased $8 million, or 1.9%, to $404 million from $412 million in 2004 primarily as a result of lower weighted average interest rates.
- Interest on financial derivative instruments, which includes the net positive effect of the Company's interest rate swaps, cross currency basis swaps and equity derivatives, amounted to income of $1 million (2004 – $28 million). The decrease in net interest income was due mainly to the maturity of interest rate swaps during the year and an increase in United States short term interest rates.
- Non-cash income of $150 million (2004 – non-cash charge of $101 million) was recorded in other financing charges representing the fair value adjustment of Weston's 2001 forward sale agreement for 9.6 million Loblaw common shares.
- Net short term interest income increased to $25 million (2004 – $7 million) primarily due to higher interest rates on United States dollar denominated cash, cash equivalents and short term investments and lower average short term debt partially offset by an increase in Canadian short term interest rates.
- Interest expense capitalized to fixed assets remained unchanged at $21 million as compared to 2004.

Income Taxes

The Company's 2006 effective income tax rate increased to 90.1% from 30.6% in 2005. The increase was mainly the result of the non-deductible Loblaw goodwill impairment charge, which increased the 2006 effective income tax rate by 66.5%. The effective income tax rate before the impact of the non-deductible Loblaw goodwill impairment charge as calculated in note 9 to the consolidated financial statements decreased to 23.6% in 2006 from 30.6% in 2005 as a result of the following factors:

- changes in the Canadian federal and certain provincial statutory income tax rates;
- a change in the proportion of taxable income earned across different tax jurisdictions, including the jurisdictions in which the income tax impacts of restructuring and other charges and stock-based compensation and the associated equity derivatives occurred; and
- a $24 million reduction to future income tax expense was recognized as a result of changes in the Canadian federal and certain provincial statutory income tax rates, the cumulative effect of which was included in the consolidated financial statements at the time of substantive enactment.

The Company's 2005 effective income tax rate increased to 30.6% from 27.4% in 2004. The increase was the result of the following factors:

- a change in the proportion of taxable income earned across different tax jurisdictions, including the jurisdictions in which the income tax impacts of restructuring and other charges and stock-based compensation and the associated equity derivatives occurred;
- Loblaw's successful resolution in 2004 of certain income tax matters from a previous year; and
- a $3 million charge to future income tax expense was recognized as a result of a change in certain Canadian provincial statutory income tax rates, the cumulative effect of which was included in the consolidated financial statements at the time of substantive enactment.

Net Earnings from Continuing Operations

Net earnings from continuing operations for 2006 decreased $606 million, or 84.6%, to $110 million from $716 million in 2005. Basic net earnings per common share from continuing operations for 2006 decreased $4.82, or 91.8%, to $0.43 from $5.25 in 2005. The 2006 basic net earnings per common share from continuing operations of $0.43 included the net negative impact of $4.55 per common share as a result of the following factors:

- a $3.84 per common share charge related to the non-cash Loblaw goodwill impairment;
- a $0.36 per common share charge related to restructuring and other charges for restructuring plans undertaken by both Weston Foods and Loblaw;
- a $0.26 per common share charge related to the Ontario collective labour agreement at Loblaw;
- a $0.21 per common share charge related to the inventory liquidation at Loblaw;
- a $0.04 per common share charge related to a departure entitlement payment at Loblaw;
- a $0.38 per common share charge for the net effect of stock-based compensation and the associated equity derivatives;
- $0.40 per common share non-cash income related to the accounting for Weston's 2001 forward sale agreement for 9.6 million Loblaw common shares which is offset on an economic basis; and
- $0.14 per common share income related to the adjustment to future income tax balances resulting from changes in the Canadian federal and certain provincial statutory income tax rates.

After adjusting for the above noted items, Weston's 2006 adjusted basic net earnings per common share from continuing operations[1] decreased 11.7% to $4.98 when compared to $5.64 in 2005, which is adjusted as outlined below.

Net earnings from continuing operations for 2005 increased $110 million, or 18.2%, to $716 million from $606 million in 2004. Basic net earnings per common share from continuing operations for 2005 increased $0.76, or 16.9%, to $5.25 from $4.49 in 2004. The 2005 basic net earnings per common share from continuing operations of $5.25 included the net negative impact of $0.39 per common share as a result of the following factors:

- a $0.42 per common share charge related to restructuring and other charges for restructuring plans undertaken by both Weston Foods and Loblaw;
- a $0.09 per common share charge related to Loblaw's estimated impact of direct costs associated with supply chain disruptions;
- a $0.14 per common share charge related to Loblaw's estimate of GST and PST charges;
- a $0.46 per common share charge for the net effect of stock-based compensation and the associated equity derivatives;
- $0.77 per common share non-cash income related to the accounting for Weston's 2001 forward sale agreement for 9.6 million Loblaw common shares;
- a $0.02 per common share charge related to the adjustment to future income tax balances resulting from changes in statutory income tax rates in certain Canadian provinces; and
- a $0.03 per common share charge related to the consolidation of VIEs by Loblaw.

After adjusting for the above noted items, Weston's 2005 adjusted basic net earnings per common share from continuing operations[1] was $5.64. This result compares to 2004 adjusted basic net earnings per common share from continuing operations[1] of $5.50 which was adjusted for the net negative impact of the impairment of fixed assets and intangible assets associated with the Weston Foods *Entenmann's* operation in the United States, restructuring and other charges, stock-based compensation and the associated equity derivatives, accounting for Weston's 2001 forward sale agreement for 9.6 million Loblaw common shares and the Loblaw resolution of certain income tax matters from a previous year. Adjusted basic net earnings per common share from continuing operations[1] for 2005 increased 2.5% compared to 2004.

Discontinued Operations

The gain from discontinued operations in 2006 was $11 million compared to a loss of $18 million in 2005. The gain from discontinued operations in 2006 is primarily related to the final adjustment to the proceeds associated with the previously completed sale of the remaining discontinued Fisheries operations.

In 2006, the Company reached an agreement to settle claims against it relating to certain alleged misrepresentations and warranties arising from the sale of the Company's forest products business in 1998, including tax related representations and warranties dealing with years prior to 1998. The Company did not admit any wrongdoing or liability in connection with the settlement. The net impact of this settlement agreement was reflected in the 2005 loss from discontinued operations.

The loss from discontinued operations in 2005 was $18 million compared to a loss of $178 million in 2004. During 2005, the Company completed the sales of the remaining discontinued Fisheries operations. As a result of these sales, the Company recorded an after-tax loss of $24 million as a loss from discontinued operations during 2005. The loss from discontinued operations in 2004 of $178 million related to the impairment of assets and the loss on the sale of the operations in Chile in 2004.

For additional information, see note 11 to the consolidated financial statements.

Net Earnings

Changes in the Company's net earnings over the past two years were impacted by the factors described above. The new accounting standards implemented in 2006 and the resulting impact on the financial position and results of operations are outlined in the Accounting Standards Implemented in 2006 section of this MD&A. The following standards were implemented in 2005:

- AcG 15, "Consolidation of Variable Interest Entities";
- EIC Abstract 150, "Determining Whether an Arrangement Contains a Lease"; and
- EIC Abstract 154, "Accounting for Pre-Existing Relationships Between the Parties of a Business Combination".

Changes in minority interest did not have a significant impact on the Company's net earnings growth rates over the past two years as Weston's ownership of Loblaw has not changed significantly over this period.

(1) See Non-GAAP Financial Measures beginning on page 51.

CONSOLIDATED FINANCIAL CONDITION

($ millions except where otherwise indicated)	**2006**	2005	2004
Total assets	**$ 18,595**	$ 18,593	$ 17,769
Total long term debt (excluding amount due within one year)	**$ 5,918**	$ 5,913	$ 6,004
Dividends declared per share ($) – Common share	**$ 1.44**	$ 1.44	$ 1.44
– Preferred share:			
Series I	**$ 1.45**	$ 1.45	$ 1.45
Series II	**$ 1.29**	$ 1.29	$ 1.29
Series III	**$ 1.30**	$ 0.92	
Series IV	**$ 1.30**	$ 0.54	
Series V	**$ 0.83**		

The Company's total assets in 2006 were approximately equal to 2005 but higher than 2004. Goodwill in 2006 decreased as a result of the non-cash Loblaw goodwill impairment charge. Fixed assets have grown as a result of the capital investment program net of annual depreciation of both the Weston Foods and Loblaw operating segments and the impairment and accelerated depreciation charges taken within both operating segments. Loblaw inventory at the end of 2006 remained relatively flat to 2005 but was still greater than that of two years ago due to an investment in general merchandise. Loblaw's inventory turns of general merchandise categories are lower than those of food categories, resulting in higher aggregate levels of investment in general merchandise inventory as that business developed. A substantial portion of credit card receivables of *President's Choice* Bank ("*PC* Bank"), a wholly owned subsidiary of Loblaw, is sold to independent trusts and the unsecuritized balance net of the allowance for credit losses increased by $156 million since 2004. The increase in other assets resulted from an increase in the accrued benefit plan asset and in the unrealized equity derivative receivable as a result of the non-cash income representing the fair value adjustment of Weston's 2001 forward sale agreement for 9.6 million Loblaw shares. This increase was offset by a reduction in the Domtar Inc. investment due to exchanges of the 3% Exchangeable Debentures for Domtar Inc. common shares predominantly in 2005. As a result of the translation of the Company's U.S. net investment in self-sustaining operations, total assets in 2006 were marginally higher than 2005 due to the slight decline of the Canadian dollar relative to the United States dollar year-over-year. In 2005, the Company's total assets were reduced by the translation of the Company's U.S. net investment in self-sustaining operations due to the strengthening of the Canadian dollar relative to the United States dollar.

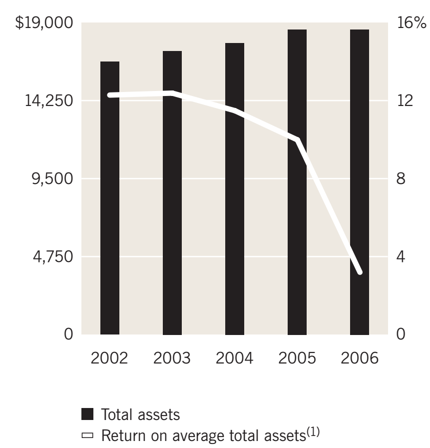
Cash flows from operating activities have covered a large portion of the funding requirements for the Company over the past two years. While Weston and Loblaw issued long term debt net of amounts retired in 2005, long term debt was repaid in 2006. In addition, long term debt increased in 2005 as a result of consolidating the long term debt of VIEs pursuant to AcG 15. Cash flows from operating activities in 2006 exceeded the Company's capital investment program of $1.1 billion.

Over the past two years, the Company's funding requirements resulted primarily from:

- the capital investment program;
- dividends paid on common and preferred shares;
- defined benefit pension plan contributions; and
- non-cash working capital requirements.

In 2006, as a result of the slight decline of the Canadian dollar relative to the United States dollar, the change in the cumulative foreign currency translation adjustment increased shareholders' equity by $15 million. This net change was due to the positive impact of translating the Company's U.S. net investment. In 2005, as a result of the strengthening of the Canadian dollar relative to the United States dollar, the change in the cumulative foreign currency translation adjustment decreased shareholders' equity by $114 million.

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



(1) See Non-GAAP Financial Measures beginning on page 51.

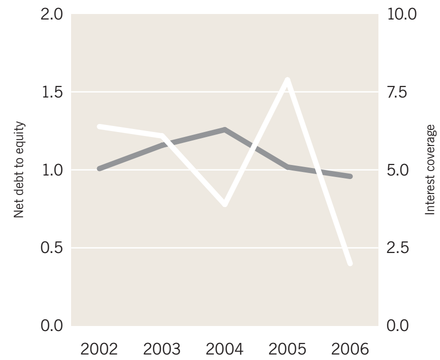
Management's Discussion and Analysis

Financial Ratios

The Company's 2006 return on average total assets[1] of 3.2% was lower than the 2005 return of 10.0%. The return was negatively impacted in 2006 by the non-cash Loblaw goodwill impairment charge and incremental costs and charges recorded in operating income as outlined above. The Company's 2005 return on average total assets[1] of 10.0% was lower than the 2004 return of 11.5%. This return was negatively impacted in 2005 by the incremental costs and charges recorded in operating income as outlined above.

The Company's 2006 return on average common shareholders' equity of 1.3% decreased compared to the 2005 return of 16.7%, primarily due to the non-cash Loblaw goodwill impairment charge, incremental costs and charges recorded in operating income as outlined previously and higher interest expense and other financing charges due to the decline in non-cash income to $73 million in 2006 (2005 – $150 million) related to the fair value adjustment of Weston's 2001 forward sale agreement for 9.6 million Loblaw common shares. The Company's 2005 return on average common shareholders' equity of 16.7% was higher than the 2004 return of 14.8%. This increase in 2005 was mainly due to lower interest expense and other financing charges including the $150 million non-cash income (2004 – non-cash charge of $101 million) related to the fair value adjustment of Weston's 2001 forward sale agreement for 9.6 million Loblaw common shares, partially offset by the incremental costs and charges recorded in operating income. The five year average annual return on common shareholders' equity was 14.3%.

Net Debt[1] to Equity
and Interest Coverage



Net debt (excluding exchangeable debentures)[1] to equity
Interest coverage

(1) See Non-GAAP Financial Measures beginning on page 51.

The Company's 2006 net debt (excluding exchangeable debentures)[1] to equity ratio was 0.96:1 compared to the 2005 ratio of 1.02:1. The change in this ratio from 2005 was the result of the following factors:

- the issuance of preferred shares by Weston; and
- an increase in United States dollar denominated cash, cash equivalents and short term investments;

partially offset by:

- lower net earnings primarily due to:
  - lower Loblaw earnings due to the non-cash Loblaw goodwill impairment charge and incremental costs and charges recorded in operating income as outlined previously; and
  - higher interest expense and other financing charges due to the decline in non-cash income to $73 million in 2006 (2005 – $150 million) related to the fair value adjustment of Weston's forward sale agreement for 9.6 million Loblaw common shares.

The Company's 2005 net debt (excluding exchangeable debentures)[1] to equity ratio was 1.02:1 compared to the 2004 ratio of 1.26:1. The change in this ratio from 2004 was the result of the following factors:

- lower debt levels;
- the issuance of preferred shares by Weston;
- an increase in United States dollar denominated cash, cash equivalents and short term investments net of the impact of foreign currency translation as a result of the appreciation of the Canadian dollar relative to the United States dollar in 2005;
- higher net earnings primarily due to:
  - the $150 million non-cash income related to the fair value adjustment of Weston's forward sale agreement for 9.6 million Loblaw common shares; and
  - a lower loss from discontinued operations; partially offset by
  - lower Loblaw earnings due to the short term costs associated with the significant transformational initiatives at Loblaw;

partially offset by:

- the decrease in shareholders' equity resulting from the translation of the Company's U.S. net investment due to the appreciation of the Canadian dollar relative to the United States dollar in 2005.

The 2006 interest coverage ratio declined to 2.0 times compared to 7.9 times in 2005 due to the non-cash Loblaw goodwill impairment charge, incremental costs and charges as outlined above and higher interest expense and other financing charges, including the non-cash income of $73 million (2005 – $150 million) recorded in 2006 related to the fair value adjustment of Weston's 2001 forward

(1) See Non-GAAP Financial Measures beginning on page 51.

sale agreement for 9.6 million Loblaw common shares. The Loblaw goodwill impairment charge, which is a significant non-cash item in operating income, combined with the non-cash income of $73 million related to the fair value adjustment of Weston's 2001 forward sale agreement for 9.6 million Loblaw common shares, adversely impacted the interest coverage ratio by approximately 1.9 times. The 2005 interest coverage ratio improved to 7.9 times compared to 3.9 times in 2004 due to lower interest expense and other financing charges, including the $150 million non-cash income (2004 – non-cash charge of $101 million) recorded in 2005 related to the fair value adjustment of Weston's 2001 forward sale agreement for 9.6 million Loblaw common shares. The non-cash income related to the fair value adjustment of Weston's 2001 forward sale agreement positively impacted the 2005 interest coverage ratio by 3.3 times (2004 – negatively by 1.1 times).

Dividends

The declaration and payment of dividends are at the discretion of the Board. The Company's common share dividend policy is to maintain a common dividend payment equal to approximately 20% to 25% of the prior year's adjusted basic net earnings per common share from continuing operations[1], giving consideration to the year end cash position, future cash flow requirements and investment opportunities. Currently, there is no restriction that would prevent the Company from paying dividends at historical levels. The Company intends to maintain the current dividend level in 2007 putting annualized dividends above the historical range. During 2006, Weston's Board declared quarterly dividends as follows:

($)	2006 Quarterly Dividends Declared per Share
Common shares	$ 0.36
Preferred shares – Series I	$ 0.36
– Series II	$ 0.32
– Series III	$ 0.32
– Series IV	$ 0.32
– Series V	$ 0.30

The 2006 annualized dividend per common share of $1.44 was equal to 25.5% of the 2005 adjusted basic net earnings per common share from continuing operations[1] and was slightly above Weston's common dividend policy range. Subsequent to year end, the Board declared a quarterly dividend per common share of $0.36, payable April 1, 2007 which, on an annualized basis, maintains the 2006 dividend rate per common share.

Outstanding Share Capital

The Company's outstanding share capital is comprised of common shares and preferred shares. The following table details the authorized and outstanding common shares and preferred shares.

Share Capital	Authorized	Outstanding
Common shares	Unlimited	129,074,526
Preferred shares – Series I	Unlimited	9,400,000
– Series II	Unlimited	10,600,000
– Series III	Unlimited	8,000,000
– Series IV	Unlimited	8,000,000
– Series V	Unlimited	8,000,000

For preferred shares Series I, Series II, Series III, Series IV and Series V holders, Weston may at any time after issuance, at its option, give the holders of these preferred shares the right, at the option of the holder, to convert their preferred shares into preferred shares of a further series designated by Weston on a share-for-share basis on a date specified by Weston. In addition, for preferred shares, Series II holders, on or after July 1, 2009, these outstanding preferred shares are convertible, at the option of the holder, into a number of Weston common shares determined by dividing $25.00 by the greater of $2.00 and 95% of the then current market price of Weston common shares. Further information on the Company's outstanding share capital is provided in note 20 to the consolidated financial statements.

At year end, a total of 1,934,258 stock options and share appreciation rights were outstanding and represented 1.5% of Weston's issued and outstanding common shares, which was within Weston's guideline of 5%. Further information on Weston's stock-based compensation is provided in note 21 to the consolidated financial statements.

(1) See Non-GAAP Financial Measures beginning on page 51.

RESULTS OF REPORTABLE OPERATING SEGMENTS

The following discussion provides details of the 2006 results of operations of each of the Company's reportable operating segments.

WESTON FOODS OPERATING RESULTS

($ millions except where otherwise indicated)	2006	2005	Change
Sales	$ 4,350	$ 4,376	(0.6%)
Operating income	$ 256	$ 241	6.2%
Operating margin	5.9%	5.5%	
Adjusted operating income(1)	$ 325	$ 302	7.6%
Adjusted operating margin(1)	7.5%	6.9%	
Adjusted EBITDA(1)	$ 440	$ 428	2.8%
Adjusted EBITDA margin(1)	10.1%	9.8%	
Return on average total assets(1)	6.6%	6.5%	

(1) See Non-GAAP Financial Measures beginning on page 51.

Adjusted Operating Income(1)

($ millions)	2006	2005
Operating income	$ 256	$ 241
Add impact of the following:		
Restructuring and other charges	46	32
Net effect of stock-based compensation and the associated equity derivatives	23	29
Adjusted operating income(1)	$ 325	$ 302

(1) See Non-GAAP Financial Measures beginning on page 51.

Adjusted EBITDA(1)

($ millions)	2006	2005
Adjusted operating income(1)	$ 325	$ 302
Add impact of the following:		
Depreciation and amortization	115	126
Adjusted EBITDA(1)	$ 440	$ 428

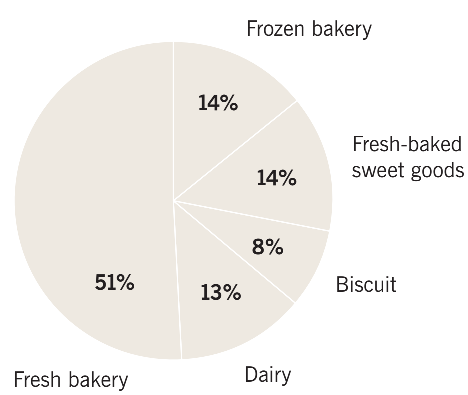
(1) See Non-GAAP Financial Measures beginning on page 51.

Approximately 87% of Weston Foods 2006 sales were generated by the North American baking divisions, with the remaining sales in the Canadian dairy division.

Sales and operating income in 2006 were impacted by the following trends:

- Price increases in key product categories combined with changes in sales mix had a positive impact on both sales and operating income.
- Inflationary cost pressures related to certain ingredients and higher energy costs continued.
- Management's focus on cost reduction and growth initiatives resulted in certain restructuring charges in operating income.
- The continuing shift in consumer food shopping patterns toward alternate format retail channels rather than traditional, conventional supermarket formats resulted in strong sales growth with alternate format retailers, specifically mass merchandisers. This shift has also resulted in weaker

Weston Foods 2006 Sales



sales for some traditional food retailers as a result of the difficulties they are experiencing with the emergence of alternate channels for food products. Weston Foods continues to focus on ensuring its products are well aligned to serve the alternate format retail channel while maintaining its important positions with traditional food retailers.

- The shift in consumer eating preferences toward healthier and more nutritious offerings, as well as toward products that are more convenient, portion controlled and that can be consumed away from home continued. Weston Foods has responded to these trends with innovative new and expanded products across its product portfolio. A more sustained shift in consumer preference for whole grain products rather than white flour based products continued throughout 2006, and is expected to continue into 2007. Weston Foods is well positioned to participate in this growth with investments being made in capacity and expanded product offerings under its *Thomas'*, *Arnold*, *Wonder* and *Country Harvest* brands. Many Weston Foods brands continue to capitalize on their whole grain heritage.

A detailed discussion on how these trends and other factors impacted sales and operating income in 2006 is set out below.

Sales

Weston Foods sales for 2006 of $4.4 billion decreased 0.6% compared to 2005 as a result of a sales increase of 3.8% offset by the negative impact of foreign currency translation, which impacted Weston Foods reported sales growth by approximately 4.4%. Sales growth in 2006 was also impacted by the following factors:

- Overall volume decreases of 0.4% negatively impacted sales growth. 2006 volume growth was negatively impacted by 0.7% due to the exit from the United States frozen foodservice bagel business early in the third quarter of 2006 and the discontinuance of contract manufacturing of biscuits for certain customers during 2006.
- Price increases across key product categories combined with changes in sales mix contributed positively to sales growth by 4.2%.

Fresh bakery sales, principally bread, rolls, English muffins and bagels, increased approximately 6.9% in 2006 compared to 2005 and represented approximately 51% of total Weston Foods sales, up from approximately 50% in 2005. Sales growth for this category in 2006 included the following:

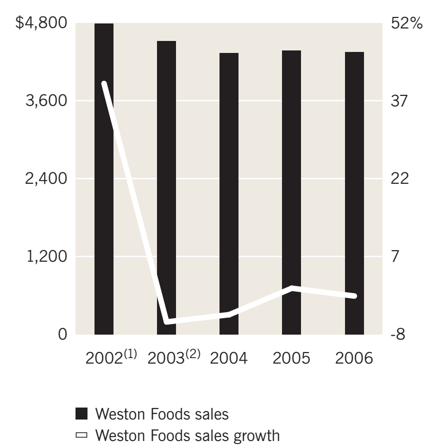
- Branded volume increased including solid growth in *Thomas'* and *Arnold* in the United States and *Wonder*, *D'Italiano* and *Weston* in Canada.
- New and expanded product offerings were introduced, including:
  - *Thomas' Squares* Bagelbread, which combines traditional bagel flavour with the softness of bread; and
  - *Wonder+* bread, which offers the same great *Wonder* taste with the goodness of whole wheat.
- Sales of white flour based products, which remains a significant category for Weston Foods, contributed positively to overall fresh bakery sales growth due to price increases and volume growth in several branded product categories.
- Growth in private label sales supported by price increases were partially offset by lower volumes.

Fresh-baked sweet goods sales, primarily sold under the *Entenmann's* brand, increased approximately 0.9% in 2006 compared to 2005 and represented approximately 14% of total Weston Foods sales, the same as in 2005. Sales growth for this category in 2006 was supported by price increases and reduced promotional activity during the first half of 2006, which was partially offset by volume declines as this category continued to experience a challenging sales environment.

Frozen bakery sales, principally bread, rolls, bagels, English muffins and sweet goods, increased approximately 2.8% in 2006 compared to 2005 and represented approximately 14% of total Weston Foods sales, the same as in 2005. Sales growth for this category in 2006 was due to price increases combined with changes in sales mix, partially offset by lower volumes. Frozen volumes were negatively impacted by the exit from the United States frozen foodservice bagel business early in the third quarter of 2006.

Biscuit sales, principally cookies, crackers, and ice-cream cones and wafers, decreased approximately 5.9% in 2006 compared to 2005 and represented approximately 8% of total Weston Foods sales, down from approximately 10% in 2005. The sales decline in this category in 2006 was due to lower sales volume, partially offset by price increases. Biscuit volumes were negatively impacted by the discontinuance of contract manufacturing of biscuits for certain customers during 2006. This discontinuance was a result of the previously approved plan to restructure the Weston Foods United States biscuit operations.

Weston Foods Sales
and Sales Growth
($ millions)



(1) 2002 sales growth impacted by acquisition of Bestfoods Baking Co., Inc.
(2) 2003 was a 53-week year.

Management's Discussion and Analysis

Dairy sales increased approximately 4.2% in 2006 compared to 2005 and represented approximately 13% of total Weston Foods sales, up from approximately 12% in 2005. Sales growth for this category in 2006 resulted from volume growth, price increases and the improvement in sales mix, as growth continued in value-added products including the continued success of *Neilson® Dairy Oh!* milk enriched with DHA. Strong growth in bottled products was achieved in 2006 with the launch of *Neilson's® The Ultimate Chocolate Milk* in 2006. The Ontario bottling facility with aseptic capabilities provides opportunity for future growth in this category.

Operating Income

Weston Foods operating income increased $15 million, or 6.2%, to $256 million from $241 million in 2005 and was impacted by higher restructuring and other charges and lower net stock-based compensation. Restructuring and other charges in 2006 were $46 million compared to $32 million in 2005 and net stock-based compensation cost was a charge of $23 million in 2006 compared to $29 million in 2005. Adjusting for the net impact of restructuring and other charges and stock-based compensation net of the associated equity derivatives, adjusted operating income(1) for 2006 was $325 million, an increase of 7.6% from $302 million in 2005. Adjusted operating margin(1) and adjusted EBITDA margin(1) for 2006 were 7.5% and 10.1%, respectively (2005 – 6.9% and 9.8%). A detailed discussion on the impact of restructuring and other charges is set forth under the Restructuring and Other Charges section below. In addition, foreign currency translation negatively impacted 2006 adjusted operating income(1) growth by approximately 4.0 percentage points.

Weston Foods 2006 adjusted operating income(1) improved from 2005 and was positively impacted by sales growth, primarily due to price increases in key product categories combined with changes in sales mix, and by the benefits realized from the continued focus on cost reduction initiatives, including restructuring activities.

Sales growth during 2006, including sales price improvements, positively impacted 2006 operating income and margin. This was partially offset by the negative impact of inflationary cost pressures related to certain ingredients, primarily flour and sugar. For the year, higher energy costs were incurred, particularly in the first half of the year, which negatively impacted operating income. In addition to higher energy costs, distribution costs increased compared to 2005, especially in the United States, as Weston Foods continued to focus its manufacturing capacity on more efficient production runs and, where appropriate, on outsourcing shorter-run products to contract manufacturers. The increased use of contract manufacturers and focused manufacturing facilities, however, generally increases distribution complexity and costs. Also during 2006, as part of the restructuring of its United States biscuit operations, Weston Foods incurred approximately $7 million of training and other facility start-up related costs associated with a biscuit facility built in Virginia.

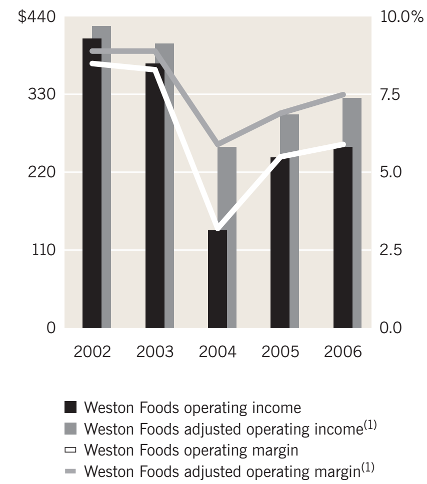
Weston Foods profitability in the United States fresh-baked sweet goods category was comparable to 2005. However, challenges remain as a result of changing consumer eating and shopping preferences and a high fixed cost manufacturing and distribution structure.

Weston Foods has made good progress in improving manufacturing efficiencies and has invested in new flexible bread capacity in order to produce different varieties of bread more efficiently. Examples of new investment include the 2006 completion of a new fresh bakery facility in Orlando and a new fresh bakery facility in Indiana, which recently started production of *Thomas'* English Muffins with fresh bread production expected to begin in 2007. These investments better position supply capacity in Weston Foods highest growth markets.

Weston Foods continues to evaluate strategic and cost reduction initiatives related to its manufacturing assets, distribution networks and administrative infrastructure with the objective of ensuring a low cost operating structure. Certain of these initiatives are in progress or nearing completion while others are still in the planning stages. Individual actions will be initiated and additional charges may be taken as plans are finalized and approved. A further discussion of these activities is included in the Restructuring and Other Charges section below.

Weston Foods Operating Income and Margin, Adjusted Operating Income(1) and Margin(1)

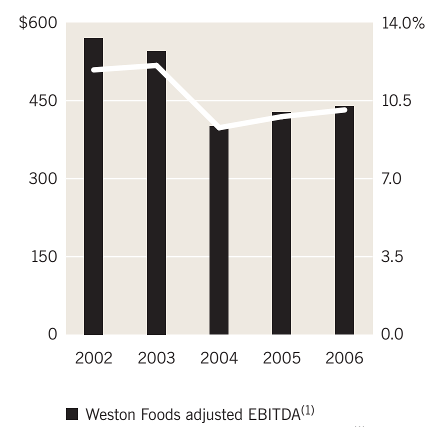
($ millions)



(1) See Non-GAAP Financial Measures beginning on page 51.

Weston Foods Adjusted EBITDA(1) and Margin(1)

($ millions)



(1) See Non-GAAP Financial Measures beginning on page 51.

(1) See Non-GAAP Financial Measures beginning on page 51.

Restructuring and Other Charges

The following table summarizes the restructuring and other charges by plan for 2006 and 2005:

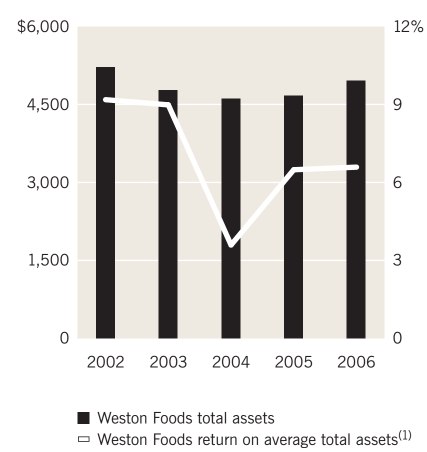
	Employee Termination Benefits and Site Closing and Other Exit Costs	Fixed Asset Impairment and Accelerated Depreciation	Loss (Gain) on Sale of Fixed Assets	Total
Costs recognized in 2006:				
Manufacturing asset restructuring:				
Biscuit operations	**$ 10**	**$ 6**		**$ 16**
Sweet goods operations	**5**	**4**		**9**
Frozen bagel operations	**2**	**5**		**7**
Ice-cream cone operations	**2**	**3**		**5**
Fresh bakery operations	**1**	**1**		**2**
	20	**19**		**39**
Distribution network restructuring	**6**			**6**
Completion of other prior year plans			**$ 1**	**1**
Total costs recognized in 2006	**$ 26**	**$ 19**	**$ 1**	**$ 46**
Costs recognized in 2005:				
Manufacturing asset restructuring:				
Biscuit operations	$ 28	$ 15	$ (18)	$ 25
Fresh bakery operations	1	4		5
	29	19	(18)	30
Administrative restructuring and consolidation of offices	8			8
Completion of other prior year plans	(8)	2		(6)
Total costs recognized in 2005	$ 29	$ 21	$ (18)	$ 32

Manufacturing Asset Restructuring

During 2006, Weston Foods approved the following manufacturing asset restructuring activities:

- Downsizing of its fresh-baked sweet goods facility in Bay Shore, New York. The plan involves the transfer of full-size dessert cake and cookie production to other existing Weston Foods facilities. Once the downsizing is complete, the Bay Shore location will be a more focused facility producing primarily danish and pie products. This restructuring is expected to be completed by the third quarter of 2008. As a result of this restructuring, Weston Foods expects to recognize a total fixed asset impairment charge of $4 million and a total charge of $6 million for employee termination benefits and other exit related costs over the next 18 months. During 2006, Weston Foods recognized $4 million of fixed asset impairment and $5 million of employee termination benefits and other exit related costs associated with the Bay Shore downsizing.
- Closure of a frozen bagel plant in Nebraska, which was completed in 2006. As a result of this restructuring, Weston Foods recognized total accelerated depreciation of $5 million and a charge of $2 million for employee termination benefits and other exit related costs during 2006.
- Closure of an ice-cream cone baking facility in Los Angeles, California and transfer of the production to other existing Weston Foods facilities. This restructuring is expected to be completed in the first quarter of 2007. As a result of this restructuring, Weston Foods recognized total accelerated depreciation of $3 million and a total charge of $2 million for employee termination benefits and other exit related costs during 2006.

Weston Foods Total Assets and Return on Average Total Assets[1]
($ millions)



(1) See Non-GAAP Financial Measures beginning on page 51.

- Closure of a fresh bakery manufacturing facility in Quebec. This manufacturing facility closure is expected to be completed by the end of 2007. During 2006, Weston Foods recognized $1 million of accelerated depreciation and $1 million of employee termination benefits and other exit related costs. In addition, Weston Foods expects to recognize an additional $1 million of other exit related costs in 2007.

During 2005, Weston Foods approved a plan to restructure its United States biscuit operations. This plan included the closure of two biscuit facilities located in Elizabeth, New Jersey and Richmond, Virginia by the end of 2006 with the majority of the production relocated to a new facility in Virginia and an existing Weston Foods facility already operating in South Dakota. The sale and lease-back of these two facilities was completed in 2005. All manufacturing activities ceased in the Elizabeth, New Jersey and Richmond, Virginia facilities by the end of 2006. During 2006, Weston Foods recognized $6 million (2005 – $15 million) of accelerated depreciation, $10 million (2005 – $28 million) of employee termination benefits and other exit related costs and in 2005 a gain of $18 million related to the sale and lease-back of the two facilities. At the end of 2006, total charges of $21 million of accelerated depreciation and $38 million of employee termination benefits and other exit related costs have been recognized on a cumulative basis over 2005 and 2006 related to this restructuring plan.

Also in 2005, Weston Foods made further progress on its objective of simplifying and removing costs from its existing fresh bakery manufacturing processes and approved plans to exit certain bread and roll manufacturing lines in the United States. All production associated with these lines was transferred to other Weston Foods manufacturing facilities or third-party producers by the end of 2005. As a result of this decision, Weston Foods recognized in 2005, $4 million of accelerated depreciation and $1 million of employee termination benefits and other exit related costs related to this restructuring plan.

Subsequent to year end 2006, Weston Foods approved a plan to exit certain bread and roll manufacturing lines in the Southeast United States. All production associated with these lines will be transferred to third-party producers or other Weston Foods manufacturing facilities. As a result of this decision, Weston Foods expects to recognize approximately $5 million of accelerated depreciation and $1 million of employee termination benefits and other exit related costs in the first quarter of 2007.

Distribution Network Restructuring

During 2006, Weston Foods approved a plan to restructure a portion of its distribution network in Quebec. As a result of this restructuring, Weston Foods expects to recognize a total charge of $7 million for employee termination benefits and other exit related costs and is expected to be completed by the end of 2007. During 2006, Weston Foods recognized a charge of $6 million for employee termination benefits and other exit related costs pursuant to this plan.

Administrative Restructuring and Consolidation of Offices

During 2005, Weston Foods approved plans to consolidate, relocate and restructure certain of its administrative offices within North America, which resulted in an $8 million restructuring charge in that year.

Completion of Other Prior Year Plans

During 2006, Weston Foods recognized a loss on the sale of fixed assets of $1 million related to a restructuring plan approved prior to 2006.

During 2005, Weston Foods recognized restructuring income of $8 million, primarily related to the reversal of accruals no longer required and a charge for accelerated depreciation of $2 million related to restructuring plans approved prior to 2005.

Further information on Weston Foods restructuring and other charges is provided in note 4 to the consolidated financial statements.

In 2007, Weston Foods expects to experience improvements in sales and adjusted operating income[1], on a year-over-year basis, as a result of improvements in volume and pricing and as the benefits of restructuring and cost reduction activities continue to be realized. Operating margins are expected to continue to be pressured by underlying cost inflation.

(1) See Non-GAAP Financial Measures beginning on page 51.

LOBLAW OPERATING RESULTS

($ millions except where otherwise indicated)	2006	2005[2]	Change
Sales	**$ 28,640**	$ 27,627	3.7%
Sales excluding the impact of VIEs[1]	**$ 28,257**	$ 27,212	3.8%
Operating income	**$ 281**	$ 1,393	(79.8%)
Operating margin	**1.0%**	5.0%	
Adjusted operating income[1]	**$ 1,318**	$ 1,592	(17.2%)
Adjusted operating margin[1]	**4.7%**	5.9%	
Adjusted EBITDA[1]	**$ 1,884**	$ 2,124	(11.3%)
Adjusted EBITDA margin[1]	**6.7%**	7.8%	
Return on average total assets[1]	**2.2%**	11.0%	

(1) See Non-GAAP Financial Measures beginning on page 51.
(2) During 2006, the Company implemented EIC 156 on a retroactive basis. Accordingly certain sales incentives paid by Loblaw to independent franchisees, associates and independent accounts for prior years have been reclassified between sales and cost of sales, selling and administrative expenses. For a further discussion, see the Accounting Standards Implemented in 2006 section included in this MD&A.

Sales and Sales Growth Excluding the Impact of VIEs[1]

($ millions except where otherwise indicated)	2006	2005[2]
Total sales	**$ 28,640**	$ 27,627
Less: Sales attributable to the consolidation of VIEs	**383**	415
Sales excluding the impact of VIEs[1]	**$ 28,257**	$ 27,212
Total sales growth	**3.7%**	
Less: Impact on sales growth attributable to the consolidation of VIEs	**(0.1%)**	
Sales growth excluding the impact of VIEs[1]	**3.8%**	

(1) See Non-GAAP Financial Measures beginning on page 51.
(2) During 2006, the Company implemented EIC 156 on a retroactive basis. Accordingly certain sales incentives paid by Loblaw to independent franchisees, associates and independent accounts for prior years have been reclassified between sales and cost of sales, selling and administrative expenses. For a further discussion, see the Accounting Standards Implemented in 2006 section included in this MD&A.

Adjusted Operating Income[1]

($ millions)	2006	2005
Operating income	**$ 281**	$ 1,393
Add (deduct) impact of the following:		
Goodwill impairment charge	**800**	
Restructuring and other charges	**44**	86
Ontario collective labour agreement	**84**	
Inventory liquidation	**68**	
Departure entitlement charge	**12**	
Direct costs associated with supply chain disruptions		30
Goods and Services Tax and provincial sales taxes		40
Net effect of stock-based compensation and the associated equity derivatives	**37**	43
VIEs	**(8)**	
Adjusted operating income[1]	**$ 1,318**	$ 1,592

(1) See Non-GAAP Financial Measures beginning on page 51.

Adjusted EBITDA[1]

($ millions)	2006	2005
Adjusted operating income[1]	**$ 1,318**	$ 1,592
Add (deduct) impact of the following:		
Depreciation and amortization	**590**	558
VIE depreciation and amortization	**(24)**	(26)
Adjusted EBITDA[1]	**$ 1,884**	$ 2,124

(1) See Non-GAAP Financial Measures beginning on page 51.

Loblaw results for 2006 were affected by the short term costs associated with one of the largest transformations in Loblaw's history. The need for this transformative process was driven by Loblaw's recent uncharacteristically poor financial performance, its assessment of a fast-changing retail environment and a strategic review of processes, structure and key drivers of its operations.

This strategic review highlighted both core strengths and issues to be addressed. The core strengths include a strong market share, control label products and a strong store network. A number of issues facing Loblaw included unacceptable levels of on-shelf availability, the need to strengthen price positioning, insufficiently distinctive formats, a complex organizational structure with inconsistent procedures and standards which lacked clear accountabilities and insufficient focus on the customer. In response to these findings, Loblaw embarked on planning and developing an organizational transition which focuses on redesigning processes, a leaner administrative structure and a comprehensive strategy designed to fortify its competitive position and maintain its leadership role in meeting the food and everyday household needs of Canadian consumers. In pursuit of this strategy, Loblaw is refocusing the business around the three principles of Simplify, Innovate, Grow and took decisive action in 2006 to initiate tangible change. Additional steps taken in 2006 include the negotiation of a new four-year collective agreement with members of certain Ontario locals of the UFCW, the liquidation of certain general merchandise inventory and the closure of certain underperforming stores.

Changes in 2005 included the restructuring of its supply chain network, the reorganizations involving its merchandising, procurement and operations groups, the establishment of a new National Head Office and Store Support Centre in Brampton, Ontario, which opened in 2005, and the relocation of general merchandise operations from Calgary, Alberta to the new National Head Office.

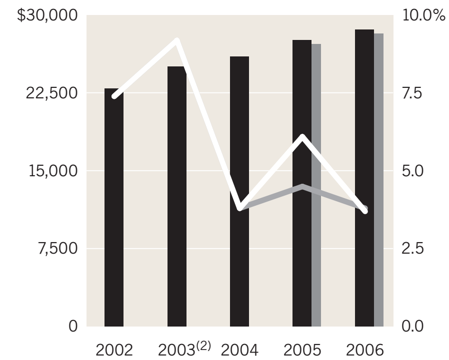
During 2005, Loblaw encountered challenges during the execution of planned changes to its systems, supply chain and general merchandise areas including certain supply chain systems conversions which were initiated as part of the creation of a national information technology platform and the start-up of a new third-party owned and operated general merchandise warehouse and distribution centre for eastern Canada which handles general merchandise and certain drugstore products, primarily health and beauty care products. These challenges disrupted the flow of inventory to Loblaw's stores and caused Loblaw to incur additional operating costs and reduced overall sales as product availability impacted consumers at the store level.

During 2006, Loblaw continued to feel the effects from these changes. However, progress continued to be made in reducing the impact of the supply chain disruptions as follows:

- the third-party owned and operated general merchandise warehouse and distribution centre for eastern Canada posted slight productivity improvements and achieved improved service levels;
- six additional systems conversions were completed during the year with minimal disruption to continuing operations as part of the move to a national systems platform;
- food service levels continued at expected levels during 2006 and service levels for drugstore improved; and
- service levels for general merchandise showed signs of stability and improvement, and while slower than anticipated, progress has been made.

Sales

Full year sales in 2006 increased 3.7% to $28.6 billion from $27.6 billion last year, including a decrease of 0.1% or $32 million in sales relating to the consolidation of certain independent franchisees as required by AcG 15. In 2006, sales excluding the impact of VIEs[1] increased by $1 billion or 3.8% over last year.



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

- food, general merchandise and drugstore sales posted gains over the prior year across all regions of the country;
- significant sales growth from the *Real Canadian Superstore* program in Ontario;
- same-store sales growth of approximately 0.8% compared to 0.2% in 2005;
- a decline in tobacco sales negatively impacted sales and same-store sales by approximately 1.2%;
- national food price inflation as measured by CPI was approximately 2.3% for the year, compared to approximately 2.0% for 2005 with variances by region; Loblaw's calculation of food price inflation, which considers Loblaw-specific product mix and pricing strategy, was reasonably consistent with that of CPI;
- an increase in net retail square footage of 1.2 million square feet or 2.5% due to the net effect of the opening of 37 new corporate and franchised stores and the closure of 33 stores inclusive of stores which underwent conversions and major expansions;
- sales per corporate store increased to $33 million in 2006 from $32 million in 2005 reflecting the introduction of larger stores which are expected to become ultimately more productive; and
- sales per average square foot of corporate stores of $585 in 2006 increased from $579 in 2005 as a result of an increase in sales which outpaced the increase in net retail square footage.

Sales of control label products for 2006 amounted to $6.2 billion compared to $5.9 billion in 2005. Control label penetration, which is measured as control label retail sales as a percentage of total retail sales, was 22.9% for 2006, compared to 22.4% for 2005. Loblaw introduced over 2,000 new control label products in 2006, including 1,400 new general merchandise products. Loblaw's control label program, which includes *President's Choice*, *PC*, *President's Choice* Organics, *President's Choice Blue Menu*, *President's Choice Mini Chefs*, *no name*, *Joe Fresh Style*, *Club Pack*, *President's Choice GREEN*, *EXACT*, *Teddy's Choice* and *Life@Home*, provides additional sales growth potential.

Loblaw expects that the following initiatives, coupled with continued focus on value-for-money, promotions and advertising where appropriate, will generate continued sales growth over the next few years:

- focus on on-shelf availability of product through an enhancement of customer focus and supply chain, and stronger store processes;
- restoring innovation as a competitive advantage both for control label products as well as unique environments in each retail format;
- refining three distinctive retail formats: Superstore, Great Food and Hard Discount, and making the *Real Canadian Superstore* the key platform for growth;
- increasing the number of stores carrying the *Joe Fresh Style* apparel offering;
- emphasizing a fresh first focus by raising presentation and quality standards; and
- training of employees to ensure they are focused on meeting customer needs.

(1) See Non-GAAP Financial Measures beginning on page 51.

Operating Income

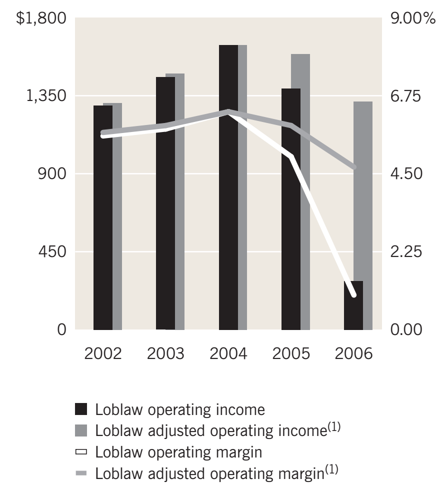
Loblaw operating income for 2006 decreased $1,112 million, or 79.8%, to $281 million resulting in a decline in operating margin to 1.0% in 2006 from 5.0% in 2005. Operating income in both 2006 and 2005 was adversely affected by a number of specific items as outlined below:

- A non-cash goodwill impairment charge of $800 million related to the goodwill established on the acquisition of Provigo Inc. in 1998 was recorded in 2006. The determination that the fair value of goodwill was less than its carrying value resulted from a decline in market multiples, both from an industry and Loblaw perspective, and a reduction of fair value as determined using the discounted cash flow methodology, incorporating both current Loblaw and market assumptions, which in combination resulted in the goodwill impairment. This non-cash goodwill impairment charge recorded in 2006 is expected to be adjusted if necessary in the first half of 2007. Loblaw expects no income tax deduction from this charge. A further discussion regarding the non-cash goodwill impairment charge can be found in the Critical Accounting Estimates section of this MD&A.
- During 2006, members of certain Ontario locals of the UFCW ratified a new four-year collective agreement which enables Loblaw to convert 44 stores in Ontario to the *Real Canadian Superstore* banner or food stores with equivalent labour economics, and the flexibility to invest in additional store labour where appropriate. As a result of securing this agreement, Loblaw recognized a one-time charge of $84 million in 2006, including a $36 million amount due to a multi-employer pension plan and a payment of $38 million which was due upon ratification. Loblaw expects this agreement to generate future economic benefits and to provide increased operating efficiencies, on a store by store basis, in a critical era of intensifying competition.
- As part of management's review of inventory levels, certain excess inventory, primarily general merchandise was identified. Management's decision to proceed with the liquidation of this inventory resulted in a $68 million charge in 2006 reflecting the write-down of inventory to expected net recoverable values net of the associated costs of facilitating the disposition incurred to date. In addition, higher than normal mark downs in the range of $15 million to $20 million were taken in order to clear some of this excess inventory through stores particularly in the last quarter of the year.
- A $12 million charge relating to the departure of John A. Lederer from the position of President and Director of Loblaw was recorded in 2006. An additional $10 million was paid pursuant to various incentive plans, the majority of which was previously accrued.
- A charge of $37 million (2005 – $43 million) was recorded in 2006 for the net effect of stock-based compensation and the associated equity forwards.
- Income of $8 million (2005 – nil) from the consolidation of VIEs was recognized in 2006.

Included in restructuring and other charges of $44 million (2005 – $86 million) within operating income were the following:

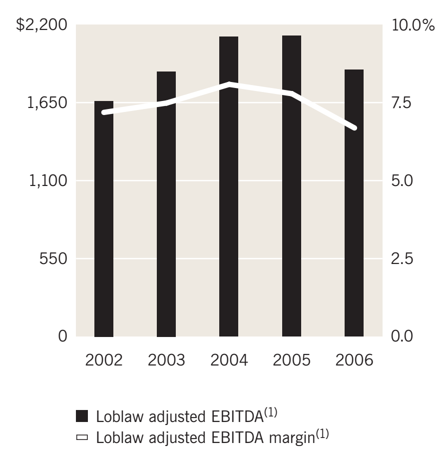
- As part of its assessment of store operations, management of Loblaw approved and communicated a plan in 2006 to close 19 underperforming Quebec stores, mainly within the *Provigo* banner, and 8 stores in the Atlantic region. This resulted in a charge in 2006 of $29 million for fixed asset impairment and other costs arising from these store closures and employee termination costs. In addition, as a result of the loss of tobacco sales following the decision by a major tobacco supplier to sell directly to certain customers of Loblaw, a review of the impact on the Cash & Carry and wholesale club network was undertaken. In 2006, management approved and communicated a formal plan to close 24 wholesale outlets which were impacted most significantly by this change. This initiative resulted in a charge of $6 million in 2006 for fixed asset impairment and other costs arising from these closures and employee termination costs. These closures are expected to be completed during 2007.

Loblaw Operating Income and Margin, Adjusted Operating Income(1) and Margin(1)
($ millions)



(1) See Non-GAAP Financial Measures beginning on page 51.

Loblaw Adjusted EBITDA(1) and Margin(1)
($ millions)



(1) See Non-GAAP Financial Measures beginning on page 51.

- A charge of $8 million (2005 – $62 million) was recorded in 2006 relating to the plan approved in 2005 concerning the restructuring of the supply chain operations, including the closure of six distribution centres and the relocation of certain activities to new distribution centres.
- A charge of $1 million (2005 – $24 million) related to the reorganization of the merchandising, procurement and operations groups, the establishment of a National Head Office and Store Support Centre and the relocation of the general merchandise operations from Calgary, Alberta to Brampton, Ontario, was recorded in 2006, all of which were approved in 2005.

A summary of restructuring and other charges is included in the table below:

($ millions)	**Costs Recognized 2006**	Costs Recognized 2005	Total Expected Costs	Total Expected Costs Remaining
Store operations	**$ 35**		$ 54	$ 19
Supply chain network	**8**	$ 62	90	20
Office move and reorganization of the operation support functions	**1**	24	25	–
Total restructuring and other charges	**$ 44**	$ 86	$ 169	$ 39

Details regarding the nature of the above charges are described in note 4 to the consolidated financial statements.

Additional items specific to 2005 included in operating income in that year are:

- A charge of $40 million related to potential liabilities for GST and PST which was not appropriately charged and remitted; and
- Approximately $30 million of direct costs associated with the supply chain disruptions experienced during the last two quarters of 2005.

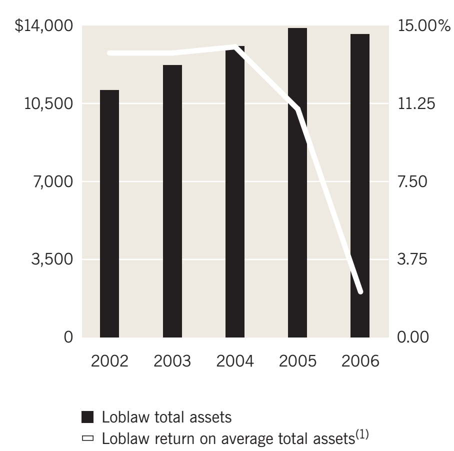
After adjusting for the above noted items, adjusted operating income(1) was $1.3 billion in 2006 compared to $1.6 billion in 2005. Adjusted operating margin(1) was 4.7% in 2006 compared to 5.9% in 2005. Adjusted EBITDA margin(1) decreased to 6.7% from 7.8% in 2005. The $274 million decline in adjusted operating income(1) and the significant decline in adjusted operating margin(1) for 2006 over 2005 was due to a variety of factors as discussed below.

Early in 2006, operating income was adversely impacted by the effects of product supply issues, resulting from the implementation challenges arising from the 2005 conversions, and delays in program activities resulted in foregone sales and lost cost leverage on fixed components of operating and administrative expenses. Loblaw's supply chain performance in the areas of general merchandise and drugstore was not at acceptable levels. Therefore, management early in the year was focused on improving service levels and ensuring product availability at the store level to support merchandising programs. By the end of 2006, the supply chain had stabilized and delivered improved service levels.

Throughout 2006, the continued investments in lower food prices to drive sales growth had a negative impact on operating income. Aggregate gross margin percentage softened as a result of this pricing investment, higher general merchandise mark downs, primarily in the fourth quarter, and higher inventory shrink, partially offset by improvements in buying synergies and improved mix of food, general merchandise and drugstore. Higher information technology investments in addition to store and distribution centre operational costs, principally labour, were incurred in order to stabilize the flow of product to the stores. Short term costs of additional third-party locations for storage of inventory were also absorbed.

A fixed asset impairment charge of $27 million was recorded in 2006 due in part to a decision to suspend plans for a number of sites scheduled for future development.

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



(1) See Non-GAAP Financial Measures beginning on page 51.

(1) See Non-GAAP Financial Measures beginning on page 51.

As mentioned previously, the new management team is refocusing Loblaw through three principles, Simplify, Innovate, Grow, and has developed a Formula for Growth as a framework for a three year renewal plan. Business priorities for 2007 to return Loblaw to higher profitability include the following:

- simplifying the organization by more clearly defining accountabilities, eliminating duplication and establishing consistent, simple and efficient processes;
- restoring innovation as a competitive advantage; and
- focusing on retailing basics in the areas of store operations, supply chain and information technology including on-shelf availability and major investments in price to obtain maximum Credit For Value.

Early in 2007, Loblaw approved and announced the restructuring of its merchandising and store operations into more streamlined functions. Costs of this restructuring including severance, retention and other costs are expected to be in the range of $150 million to $200 million, the substantial portion to be recorded in the first half of 2007. Loblaw is also assessing the loss of drugstore-related operating income in 2007 arising from recently enacted legislative changes late in 2006 by the Ontario government, as more fully explained in the Operating Risks and Risk Management section of this MD&A.

Loblaw has a number of strengths at its core – strong market share and control label products and a strong store network under various store formats with the potential to meet the needs of all Canadians. But as Loblaw looks forward, it must transition into a lean company that is ready and able to compete on all fronts. 2006 marked the beginning of this transition. Loblaw's main focus going forward is on simplifying its organizational structure, on retailing basics such as on-shelf availability and customer focus, on innovation as a competitive advantage and on executing Loblaw's growth strategy. By effectively implementing the Formula for Growth, Loblaw aspires to achieve on average 5% sales growth, 10% adjusted net earnings growth and $250 million of free cash flow.

LIQUIDITY AND CAPITAL RESOURCES

MAJOR CASH FLOW COMPONENTS

($ millions)	2006	2005	Change
Cash flows from operating activities of continuing operations	**$ 1,452**	$ 1,812	$ (360)
Cash flows used in investing activities of continuing operations	**$ (1,715)**	$ (1,092)	$ (623)
Cash flows used in financing activities of continuing operations	**$ (70)**	$ (176)	$ 106

Cash Flows from Operating Activities of Continuing Operations

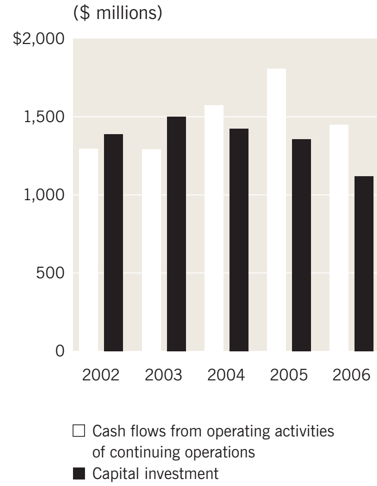
Cash flows from operating activities of continuing operations decreased in 2006 to $1.5 billion from $1.8 billion in 2005. The change in cash flows from operating activities of continuing operations for the year is mainly due to the decrease in operating income and the timing of income tax refunds relating to prior years.

Cash Flows used in Investing Activities of Continuing Operations

Cash flows used in investing activities of continuing operations in 2006 were $1.7 billion compared to $1.1 billion in 2005. The change is primarily due to the longer term to maturity profile of the Company's short term investments portfolio, which resulted in a shift to short term investments from cash and cash equivalents.

Cash Flows from Operating Activities of Continuing Operations and Capital Investment

($ millions)



Capital investment amounted to $1.1 billion (2005 – $1.4 billion), as the Company continued to maintain and renew its asset base and invest for growth across North America. Weston Foods capital investment was $184 million (2005 – $202 million). The capital was directed toward the completion of two new plants in the United States, facility improvements and the upgrade 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 $0.9 billion (2005 – $1.2 billion) for the year. Approximately 79% (2005 – 82%) of Loblaw's capital investment was for new stores, renovations or expansions. The continued capital investment activity benefited all regions in varying degrees and strengthened the existing store base. Some of the new, larger stores replaced older, smaller, less efficient stores that did not offer the broad range of products and services demanded by today's consumer. The remaining 21% (2005 – 18%) of the capital investment was for the warehouse and distribution network, information systems and other infrastructure required to support store growth. Loblaw's levels of capital investment in 2007 are expected to be lower than in previous years as a result of Loblaw's desire to fully prove store format economics before building new stores. Loblaw's 2006 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 2.5% over 2005. During 2006, 37 (2005 – 69) new corporate and franchised stores were opened and 147 (2005 – 77) underwent renovation or minor expansion. The 37 new stores, net of 33 (2005 – 57) store closures, added 1.2 million square feet of retail space (2005 – 2.8 million). The 2006 average corporate store size increased 2.3% to 57,400 square feet (2005 – 56,100) and the average franchised store size increased 1.1% to 27,400 square feet (2005 – 27,100).

During 2006, the Company also generated $116 million (2005 – $170 million) from fixed asset sales. 2005 included proceeds of $47 million from the sale of two Weston Foods biscuit facilities.

Cash Flows used in Financing Activities of Continuing Operations

Cash flows used in financing activities of continuing operations were $70 million in 2006 compared to $176 million in 2005.

During 2006, Weston and Loblaw completed the following financing activities:

- Weston issued $40 million of Series B Debentures;
- Loblaw repaid $125 million of Series 1996 Provigo Inc. Debenture;
- Weston repaid $200 million of Medium Term Notes ("MTN");
- commercial paper increased $340 million; and
- Weston issued 8.0 million preferred shares, Series V for total proceeds of $194 million.

During 2005, Weston and Loblaw completed the following financing activities:

- Loblaw issued $300 million of MTN;
- Weston issued $36 million of Series B Debentures;
- Loblaw repaid $200 million of MTN;
- commercial paper decreased $342 million;
- Weston issued 8.0 million preferred shares, Series III for total proceeds of $194 million;
- Weston issued 8.0 million preferred shares, Series IV for total proceeds of $195 million; and
- Loblaw purchased for cancellation 226,100 of its common shares for $16 million, pursuant to its its Normal Course Issuer Bid ("NCIB").

See notes 8, 18 and 20 to the consolidated financial statements for the terms and details of the debt and share capital transactions.

Weston intends to renew its NCIB to purchase on the Toronto Stock Exchange or enter into equity derivatives to purchase up to 5% of its common shares outstanding.

During 2005, Weston's 2003 Base Shelf Prospectus expired and a new base shelf prospectus under which it may issue preferred shares and MTN in an aggregate amount not to exceed $1 billion was filed. During 2005, Loblaw's 2003 Base Shelf Prospectus expired and a new base shelf prospectus allowing the issue of up to $1 billion of aggregate MTN was filed.

The following tables present the amounts of preferred shares and MTN available to issue under the Weston and Loblaw programs:

Weston Preferred Shares and Medium Term Notes Program

($ millions)	**Base Shelf Prospectus dated April 11, 2005**
Preferred shares and MTN issue limit	**$ 1,000**
Preferred shares, Series III issued in 2005	**200**
Preferred shares, Series IV issued in 2005	**200**
Preferred shares, Series V issued in 2006	**200**
MTN capacity available, year end 2006	**$ 400**

Loblaw Medium Term Notes Program

($ millions)	**Base Shelf Prospectus dated June 20, 2005**	Base Shelf Prospectus dated May 12, 2003
MTN issue limit	**$ 1,000**	$ 1,000
MTN issued in 2003		455
MTN issued in 2004		200
MTN issued in 2005		300
MTN issue expired		$ 45
MTN capacity available, year end 2006	**$ 1,000**	

SOURCES OF LIQUIDITY

The Company can obtain short term financing through a combination of cash generated from operating activities, cash, cash equivalents, short term investments, bank indebtedness and commercial paper programs. Weston's cash, cash equivalents and short term investments, as well as $268 million in uncommitted credit facilities and $300 million in committed credit facilities extended by several banks, support Weston's $500 million commercial paper program. Loblaw's cash, cash equivalents and short term investments, as well as $845 million in uncommitted operating lines of credit extended by several banks, support its $1.2 billion commercial paper program. Weston's and Loblaw's commercial paper borrowings generally mature less than 90 days from the date of issuance, although the term can be up to 364 days.

Securitization of credit card receivables provides *PC* Bank with an additional source of funds for the operation of its business. Under *PC* Bank's securitization program, a portion of the total interest in the credit card receivables is sold to independent trusts. In 2006, *PC* Bank restructured its credit card securitization program and Eagle Credit Card Trust ("Eagle"), a previously established independent trust, issued $500 million of five year senior notes and subordinated notes due 2011 at a weighted average rate of 4.5%. The restructuring of the portfolio yielded a nominal net loss. *PC* Bank securitized an aggregate $240 million of credit card receivables during 2006 (2005 – $225 million). Information on *PC* Bank's credit card receivables and securitization is provided in notes 1 and 13 to the consolidated financial statements and in the Off-Balance Sheet Arrangements section of this MD&A.

The Company obtains its long term financing primarily through MTN and preferred share programs. The Company intends to refinance existing long term debt as it matures.

In the normal course of business, the Company enters into certain arrangements, such as providing comfort letters to third-party lenders in connection with financing activities of certain franchisees, with no recourse liability to the Company. In addition, the Company establishes standby letters of credit used in connection with certain obligations related to the financing program for 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 $552 million (2005 – $547 million), against which the Company had $615 million (2005 – $632 million) in credit facilities available to draw on.

It is the intention of Loblaw to enter into a committed credit facility expected to be extended by several banks in the amount of $500 million for general corporate purposes and to support Loblaw's commercial paper program.

The Company has the following sources from which it can fund its 2007 cash requirements: cash flows generated from operating activities, cash, cash equivalents, short term investments, bank indebtedness, commercial paper programs, preferred shares and MTN programs, and additional credit card receivable securitizations from future growth in the *PC* Bank credit card operations.

During the fourth quarter of 2006, the Company's long term corporate credit and preferred share ratings were downgraded by Standard & Poor's ("S&P") to "BBB+" from "A-", and to "P-2 (low)" from "P-2", respectively and the commercial paper rating was confirmed at "A-1 (low)". The Company was removed from CreditWatch with negative implications and the outlook was changed to "stable".

During the third quarter of 2006, Loblaw's MTN and debentures were downgraded by Dominion Bond Rating Service ("DBRS") to "A" from "A (high)" and the commercial paper rating was confirmed at "R-1 (low)". In both cases the trend was changed to "stable" from "negative". During the fourth quarter of 2006, Loblaw's long term credit and commercial paper ratings were downgraded by S&P to "A-" from "A" and to "A-1 (low)" from "A-1 (mid)", respectively. Loblaw was removed from CreditWatch with negative implications and the outlook was changed to "stable".

Subsequent to year end, DBRS placed the Company's MTN, debentures, commercial paper and preferred share ratings Under Review with negative implications; and S&P placed the Company's long term corporate credit, commercial paper and preferred share ratings on CreditWatch with negative implications.

Also subsequent to year end, DBRS placed Loblaw's MTN and debentures Under Review with negative implications and at the same time, confirmed Loblaw's commercial paper rating at its current level with a "stable" trend; and S&P placed Loblaw's long term corporate credit and commercial paper ratings on CreditWatch with negative implications.

Although a further rating decline will increase borrowing costs, the Company and Loblaw anticipate no difficulty in obtaining external financing based on past experience and the expectation of stable market conditions.

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

Credit Ratings (Canadian Standards)	Dominion Bond Rating Service	Standard & Poor's
Commercial paper	R-1 (low)	A-1 (low)
Medium term notes	A (low)	BBB+
Exchangeable debentures	BBB (high)	
Preferred shares	Pfd-2 (low)	P-2 (low)
Other notes and debentures	A (low)	BBB+

The rating organizations listed above base their credit ratings on quantitative and qualitative considerations. These credit ratings are intended to give an indication of the risk that Weston will not fulfill its obligations in a timely manner.

CONTRACTUAL OBLIGATIONS

The following illustrates certain of the Company's significant contractual obligations and discusses other obligations as at December 31, 2006:

Summary of Contractual Obligations

	Payments due by year						
($ millions)	2007	2008	2009	2010	2011	Thereafter	Total
Long term debt (including capital lease obligations)	$ 27	$ 420	$ 398	$ 319	$ 669	$ 4,290	$ 6,123
Operating leases[(1)]	225	205	176	151	128	758	1,643
Contracts for purchase of real property and capital investment projects[(2)]	153	4	4				161
Purchase obligations[(3)]	921	671	568	568	565	365	3,658
Total contractual obligations	$ 1,326	$ 1,300	$ 1,146	$ 1,038	$ 1,362	$ 5,413	$ 11,585

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

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

(3) These include material contractual obligations to purchase goods or services where the contract prescribes fixed or minimum volumes to be purchased or payments to be made within a fixed period of time for a set or variable price. While estimates of anticipated financial commitments were made for the purpose of this disclosure, the amount of actual payments may vary. The purchase obligations do not include purchase orders issued in the ordinary course of business for goods which are meant for resale, nor do they include any contracts which may be terminated on relatively short notice 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. The Company believes such excluded contracts do not have a material impact on its liquidity.

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

- future payments of accrued benefit plan liability, principally post-retirement benefits, depend on when and if retirees submit claims;
- future payments of income taxes depend on the levels of taxable earnings 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 prices of Weston and Loblaw common shares on the exercise date and the manner in which they exercise those stock options;
- future payments of restricted share units depend on the market prices of Weston's and Loblaw's common shares;
- future payments of insurance claims can extend over several years and depend on the timing of anticipated settlements and results of litigation; and
- future payments relating to the settlement of the equity forward obligation based on 9.6 million Loblaw common shares which matures in 2031 (see note 22 to the consolidated financial statements) will depend on the market price of Loblaw common shares at the time of maturity; further, the market value of the 9.6 million Loblaw common shares that Weston has used to secure this obligation exceeds the amount owing under the forward contract, and a portion of the proceeds from a future sale of these shares may be used to satisfy the obligation under this forward contract upon termination or maturity.

OFF-BALANCE SHEET ARRANGEMENTS

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

- standby letters of credit used in connection with certain obligations mainly related to real estate transactions and benefit programs, the aggregate gross potential liability of which is approximately $221 million (2005 – $143 million);
- the securitization of a portion of *PC* Bank's credit card receivables through independent trusts;
- a standby letter of credit to an independent funding trust which provides loans to Loblaw's independent franchisees for their purchase of inventory and fixed assets;
- guarantees; and
- financial derivative instruments in the form of interest rate swaps.

Guarantees

The Company has entered into various guarantee agreements, including standby letters of credit in relation to the securitization of *PC* Bank's credit card receivables and in relation to third-party financing made available to the Company's 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 24 to the consolidated financial statements.

Securitization of Credit Card Receivables

Loblaw, through *PC* Bank, securitizes credit card receivables through an independent trust administered by a major Canadian chartered bank 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 ("ABCP") and asset-backed term notes respectively, 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 Accounting Guideline ("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 servicing obligations. *PC* Bank does not receive a servicing fee from the trusts for its servicing obligations 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 ABCP issuing trust's recourse to *PC* Bank's assets is limited to *PC* Bank's retained interests and is further supported through a standby letter of credit provided by a major Canadian chartered bank for 9% (2005 – 9%) of the securitized amount. This standby letter of credit could be drawn upon in the event of a major decline in the income flow from or in the value of the securitized credit card receivables. Loblaw has agreed to reimburse the issuing bank for any amount drawn on the standby letter of credit. Loblaw believes that the likelihood of this occurrence is remote. The subordinated notes issued by Eagle provide credit support to those notes which are more senior. The carrying value of the retained interests is periodically reviewed and when a decline in value is identified that is other than temporary, the carrying value is written down to fair value.

As at year end 2006, the total amount of securitized credit card receivables outstanding which *PC* Bank continues to service was $1.25 billion (2005 – $1.01 billion) and the associated retained interests amounted to $5 million (2005 – $5 million). The standby letter of credit supporting a portion of these securitized receivables amounted to approximately $68 million (2005 – $91 million). During 2006, *PC* Bank received income of $116 million (2005 – $106 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 13 and 24 to the consolidated financial statements.

Independent Funding Trust

Independent franchisees of Loblaw may 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 fixturing and equipment. These trusts are administered by a major Canadian chartered bank. The independent funding trust within the structure finances its activities through the issuance of short term ABCP to third-party investors. The total amount of loans issued to Loblaw's independent franchisees outstanding as of year end 2006 was $419 million (2005 – $420 million) including $124 million (2005 – $126 million) of loans payable of VIEs consolidated by the Company in 2006. 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 10% of the principal amount of the loans outstanding at any point in time, $44 million (2005 – $42 million) as of year end 2006. This credit enhancement allows the independent funding trust to provide favourable financing terms to Loblaw's independent franchisees. 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 may 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. No amount has ever been drawn on the standby letter of credit. Loblaw believes it would be able to fully recover from the independent franchisee any amounts it had reimbursed to the issuing bank. Neither the independent funding trust nor Loblaw can voluntarily terminate the agreement prior to December 2009, and following that date only upon six months' prior notice. Automatic termination of the agreement can only occur if specific, predetermined events occur and are not remedied within the time periods required including a credit rating downgrade of Loblaw below a long term credit rating of A(low) issued by DBRS. If the arrangement is terminated, the independent franchisees would be required to replace the loans provided by the independent funding trust with alternative financing. Loblaw is under no contractual obligation to provide funding to independent franchisees under such circumstances. In accordance with Canadian GAAP, the financial statements of the independent funding trust are not consolidated with those of the Company.

Derivative Instruments

The Company uses off-balance sheet financial derivative instruments to manage its exposure to changes in interest rates. For a detailed description of the Company's off-balance sheet derivative instruments and the related accounting policies, see notes 1 and 22 to the consolidated financial statements.

During 2005, Weston terminated its interest rate swaps with a notional value of $200 million which were designated as a fair value hedge of the $200 million of 5.05% MTN due 2014. The gain realized on the termination of these swaps of $5 million, was deferred and is being recognized over the remaining term of the initial hedge and recognized in interest expense and other financing charges.

QUARTERLY RESULTS OF OPERATIONS

The 52-week reporting cycle followed by the Company is divided into four quarters of 12 weeks each except for the third quarter, which is 16 weeks in duration. The following is a summary of selected consolidated financial information derived from the Company's unaudited interim consolidated financial statements for each of the eight most recently completed quarters. This information was prepared in accordance with Canadian GAAP and is reported in Canadian dollars.

QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

($ millions except where otherwise indicated)		First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total (audited)
Sales[1]	**2006**	**$ 6,997**	**$ 7,507**	**$ 10,085**	**$ 7,578**	**$ 32,167**
	2005	$ 6,908	$ 7,242	$ 9,694	$ 7,345	$ 31,189
Net earnings (loss) from continuing operations	**2006**	**$ 128**	**$ 184**	**$ 226**	**$ (428)**	**$ 110**
	2005	$ 101	$ 179	$ 196	$ 240	$ 716
Net earnings (loss)	**2006**	**$ 128**	**$ 184**	**$ 226**	**$ (417)**	**$ 121**
	2005	$ 100	$ 153	$ 196	$ 249	$ 698
Net earnings (loss) per common share from continuing operations ($)						
Basic	**2006**	**$ 0.91**	**$ 1.32**	**$ 1.62**	**$ (3.42)**	**$ 0.43**
	2005	$ 0.73	$ 1.33	$ 1.41	$ 1.78	$ 5.25
Diluted	**2006**	**$ 0.91**	**$ 1.32**	**$ 1.62**	**$ (3.42)**	**$ 0.43**
	2005	$ 0.73	$ 1.33	$ 1.41	$ 1.78	$ 5.25
Net earnings (loss) per common share ($)						
Basic	**2006**	**$ 0.91**	**$ 1.32**	**$ 1.62**	**$ (3.33)**	**$ 0.52**
	2005	$ 0.72	$ 1.13	$ 1.41	$ 1.85	$ 5.11
Diluted	**2006**	**$ 0.91**	**$ 1.32**	**$ 1.62**	**$ (3.33)**	**$ 0.52**
	2005	$ 0.72	$ 1.13	$ 1.41	$ 1.85	$ 5.11

(1) During 2006, the Company implemented EIC 156 on a retroactive basis. Accordingly certain sales incentives paid by Loblaw to independent franchisees, associates and independent accounts for prior years have been reclassified between sales and cost of sales, selling and administrative expenses. For a further discussion, see the Accounting Standards Implemented in 2006 section included in this MD&A.

Results by Quarter

2006 quarterly sales growth was impacted by various factors including Loblaw and Weston Foods sales growth and the impact of Weston Foods foreign currency translation. Adjusting for the quarterly impacts of foreign currency translation, Weston Foods 2006 quarterly sales were positively impacted by price increases across key product categories combined with changes in sales mix. Weston Foods quarterly sales growth was negatively impacted by the discontinuance of contract manufacturing of biscuits for certain customers during 2006 and by the exit from the United States frozen foodservice bagel business early in the third quarter of 2006. Sales growth in the first quarter of 2006 was negatively impacted by approximately 1% due to the shift in Easter from the first quarter to the second quarter of 2006, the impact of holiday timing during the first quarter of 2006 and the impact of one less selling day in the quarter. Loblaw sales growth during the last two quarters of 2006 continued to be negatively impacted by the loss in tobacco sales as discussed previously. Loblaw sales and same-store sales in the fourth quarter were higher by approximately 2.0% excluding the loss in tobacco sales. Tobacco sales are not a large operating income contributor for Loblaw. Loblaw quarterly same-store sales growth for 2006 improved during the year from a decline of 2.5% in the first quarter to an increase of approximately 1.3% in the fourth quarter. Overall national food price inflation, as measured by CPI, during 2006 was approximately 2.3%. The adverse effects of the 2005 systems conversions and the start-up of the third-party warehouse continued into 2006. Early in 2006, service levels for general merchandise were below expected running rates but improved throughout 2006 with increasing stability. Net retail square footage increased by 1.2 million square feet in 2006 and was more heavily weighted over the last two quarters. Holidays such as Easter, Thanksgiving and Christmas impact the Company's sales volumes and have fallen within the same quarters year over year except for Easter. In addition, Weston Foods is impacted by the timing of seasonal sales items such as pies, rolls, Girl Scout cookies and ice cream cones and wafers. The sales timing of these seasonal items generally occurs in the same quarters year over year.

Quarter-to-quarter variability in consolidated operating income was also caused by the following, all of which have been discussed previously:

- restructuring and other charges incurred by Weston Foods and Loblaw;
- fluctuations in stock-based compensation net of the impact of the associated equity derivatives as a result of changes in the market price of Weston's and Loblaw's common shares;
- non-cash Loblaw goodwill impairment charge;
- Loblaw's charge related to the Ontario collective labour agreement;
- Loblaw's charge related to inventory liquidation;
- a departure entitlement payment at Loblaw;
- costs associated with Loblaw's supply chain disruptions; and
- Loblaw charges related to Goods and Services Tax and provincial sales taxes in 2005.

2006 quarterly adjusted operating income(1) was negatively impacted by lower adjusted operating margins(1) at Loblaw partially offset by higher adjusted operating margins(1) at Weston Foods. The improvement in Weston Foods adjusted operating margin(1) was primarily due to sales growth, including price increases combined with changes in sales mix, and by the benefits realized from the restructuring and other cost reduction activities initiated over the last few years. Loblaw's quarterly adjusted operating income(1) was impacted by various factors. Softening sales in the first quarter of 2006 from continued product supply issues and deliberate delays in program activities resulted in lost leverage on the fixed components in administrative and operating expenses. In the second, third and fourth quarters, higher store and distribution centre operational costs were incurred to stabilize the flow of product to the stores and additional storage costs were absorbed to quicken the supply chain stabilization process. Loblaw's fourth quarter performance reflects the adverse impact on operating income of the following:

- higher inventory shrink of approximately $35 million and higher store labour costs of approximately $20 million;
- an investment of approximately 0.5% in food pricing, resulting in an impact of approximately $30 million;
- higher general merchandise mark downs in the range of $15 million to $20 million to clear inventory through retail stores;
- a fixed asset impairment charge of $24 million due in part to a decision to suspend plans for a number of sites scheduled for future development; and
- incremental supply chain costs and information technology investments of approximately $15 million.

Investments in the form of lower food prices continue to be made in specific markets in support of Loblaw's business strategy to grow sales levels.

Interest expense and other financing charges incurred on a quarterly basis in 2006 as compared to the prior year were generally impacted by decreases in average borrowing levels outstanding and higher short term interest income, offset by the negative impact of interest on financial derivative instruments as a result of an increase in Canadian short term interest rates. In addition, interest expense and other financing charges included non-cash income or a non-cash charge relating to the accounting for Weston's 2001 forward sale agreement for 9.6 million Loblaw common shares which fluctuates as the market price of Loblaw common shares changes.

The change in the quarterly effective income tax rate for 2006 over 2005 was primarily due to changes in the Canadian federal and certain provincial statutory income tax rates and a change in the proportion of taxable income earned in each tax jurisdiction in which the Company operated, including the jurisdiction in which the income tax impact of restructuring and other charges and stock-based compensation and the associated equity derivatives occurred. During the fourth quarter, the effective income tax rate was impacted by the non-deductible Loblaw goodwill impairment charge. In addition, during the second quarter of 2006, the Company recognized a $24 million reduction to future income tax expense due to the cumulative effects of changes in Canadian federal and certain provincial statutory income tax rates on future income tax assets and liabilities, which were included in the consolidated financial statements at the time of substantive enactment.

The results of discontinued operations reflect the benefit of final adjustments to the proceeds associated with the prior year's completed sale of the Fisheries operations in 2006, an income tax recovery in the fourth quarter of 2005 and the loss from the sales of the remaining Fisheries operations in the second quarter of 2005.

Net earnings were impacted by all the items described above.

(1) See Non-GAAP Financial Measures beginning on page 51.

FOURTH QUARTER RESULTS

The following is a summary of selected information for the fourth quarter of 2006. This information was prepared in accordance with Canadian GAAP and is reported in Canadian dollars. The analysis of the data contained in the table focuses on the results of operations and changes in the financial condition and cash flows in the fourth quarter.

Selected Consolidated Information for the Fourth Quarter

($ millions except where otherwise indicated)	2006	2005[2]
Sales	$ 7,578	$ 7,345
Sales excluding the impact of VIEs[1]	$ 7,486	$ 7,247
Adjusted EBITDA[1]	$ 516	$ 669
Operating (loss) income	$ (630)	$ 440
Adjusted operating income[1]	$ 362	$ 509
Interest expense and other financing charges	$ 90	$ (47)
Income taxes	$ (3)	$ 170
Net (loss) earnings from continuing operations	$ (428)	$ 240
Net (loss) earnings	$ (417)	$ 249
Net (loss) earnings per common share from continuing operations ($)		
Basic and diluted	$ (3.42)	$ 1.78
Adjusted basic[1]	$ 1.15	$ 1.55
Cash flows from (used in) continuing operations:		
Operating activities	$ 889	$ 902
Investing activities	$ (383)	$ (494)
Financing activities	$ (391)	$ (395)

(1) See Non-GAAP Financial Measures beginning on page 51.
(2) During 2006, the Company implemented EIC 156 on a retroactive basis. Accordingly certain sales incentives paid by Loblaw to independent franchisees, associates and independent accounts for prior years have been reclassified between sales and cost of sales, selling and administrative expenses. For a further discussion, see the Accounting Standards Implemented in 2006 section included in this MD&A.

Sales and Sales Growth Excluding the Impact of VIEs[1]

($ millions except where otherwise indicated)	2006	2005[2]
Total sales	$ 7,578	$ 7,345
Less: Sales attributable to the consolidation of VIEs	92	98
Sales excluding the impact of VIEs[1]	$ 7,486	$ 7,247
Total sales growth	3.2%	
Less: Impact on sales growth attributable to the consolidation of VIEs	(0.1%)	
Sales growth excluding the impact of VIEs[1]	3.3%	

(1) See Non-GAAP Financial Measures beginning on page 51.
(2) During 2006, the Company implemented EIC 156 on a retroactive basis. Accordingly certain sales incentives paid by Loblaw to independent franchisees, associates and independent accounts for prior years have been reclassified between sales and cost of sales, selling and administrative expenses. For a further discussion, see the Accounting Standards Implemented in 2006 section included in this MD&A.

Sales

Sales for the fourth quarter of 2006 of $7.6 billion increased 3.2% compared to 2005, including a decrease of 0.1% related to the consolidation of certain Loblaw independent franchisees and a 0.2% decrease due to foreign currency translation.

Operating (Loss) Income

Operating loss of $630 million for the fourth quarter of 2006 declined compared to income of $440 million in 2005. Fourth quarter operating income included a $800 million charge for the non-cash Loblaw goodwill impairment charge, a $51 million (2005 – $7 million) charge for restructuring and other charges, an $84 million charge related to Loblaw's Ontario collective labour agreement, a $68 million charge related to Loblaw's inventory liquidation and income of $11 million (2005 – charge of $48 million) related to net stock-based compensation net of the impact of the associated equity derivatives. In addition, operating income for the fourth quarter of 2005 included a $10 million charge related to Loblaw's estimated impact of direct costs associated with supply chain disruptions and a negative $4 million VIE impact. Adjusting for the net negative impact of these items, consolidated adjusted operating income[1] for the fourth quarter of 2006 was $362 million compared to $509 million in 2005, a decline of 28.9%. Consolidated adjusted operating margin[1] for the fourth quarter of 2006 was 4.8% compared to 7.0% in 2005.

Interest Expense and Other Financing Charges

Interest expense and other financing charges for the fourth quarter of 2006 increased to $90 million from interest income of $47 million in 2005. The increase of $137 million in interest expense and other financing charges was primarily as a result of the non-cash charge of $17 million (2005 – non-cash income of $122 million), reflecting the accounting for Weston's 2001 forward sale agreement for 9.6 million Loblaw common shares.

Income Taxes

The effective income tax rate for the fourth quarter of 2006 was 0.4% compared to 34.9% in 2005. This significant change in the effective income tax rate was due to the non-cash Loblaw goodwill impairment charge recorded in the quarter which is non-deductible for income tax purposes. In addition, the effective income tax rate was impacted due to the change in the proportion of taxable income earned across the different tax jurisdictions in which the Company operated, including the jurisdictions in which the income tax impact of restructuring and other charges and stock-based compensation and the associated equity derivatives occurred.

Net (Loss) Earnings from Continuing Operations

Net loss from continuing operations for the fourth quarter of 2006 was $428 million compared to net earnings from continuing operations of $240 million in 2005. Basic net loss per common share from continuing operations for the fourth quarter of 2006 was $3.42 compared to basic net earnings per common share from continuing operations of $1.78 in 2005. Basic net loss per common share from continuing operations included the net negative impact of $4.57 per common share for the fourth quarter as a result of the following factors:

- a $3.84 per common share charge related to the non-cash Loblaw goodwill impairment;
- a $0.20 per common share charge related to restructuring and other charges for restructuring plans undertaken by both Weston Foods and Loblaw;
- a $0.26 per common share charge related to the Ontario collective labour agreement at Loblaw;
- a $0.21 per common share charge related to the inventory liquidation at Loblaw;
- a $0.09 per common share non-cash charge related to the accounting for Weston's 2001 forward sale agreement for 9.6 million Loblaw common shares which is offset on an economic basis; and
- $0.03 per common share income for the net effect of stock-based compensation and the associated equity derivatives.

After adjusting for the above noted items, Weston's 2006 adjusted basic net earnings per common share from continuing operations[1] was $1.15 for the fourth quarter. These results compare to 2005 adjusted basic net earnings per common share from continuing operations[1] of $1.55, which were adjusted for the net negative impact of restructuring and other charges, Loblaw's direct costs associated with supply chain disruptions, stock-based compensation and the associated equity derivatives, the accounting for Weston's 2001 forward sale agreement for 9.6 million Loblaw common shares, changes in statutory income tax rates in certain Canadian provinces and the consolidation of VIEs by Loblaw. Adjusted basic net earnings per common share from continuing operations[1] for the fourth quarter of 2006 decreased 25.8% compared to 2005.

Discontinued Operations

The gain from discontinued operations for the fourth quarter of 2006 was $11 million compared to $9 million in 2005. The 2006 gain from discontinued operations is primarily related to final adjustments to the proceeds associated with the previously completed sale of the remaining Fisheries operations in 2005.

(1) See Non-GAAP Financial Measures beginning on page 51.

During 2006, the Company reached an agreement to settle claims against it relating to certain alleged misrepresentations and warranties arising from the sale of the Company's forest products business in 1998. The Company did not admit any wrongdoing or liability in connection with the settlement. The net impact of this settlement agreement was reflected in the 2005 fourth quarter gain from discontinued operations.

Net (Loss) Earnings

Net loss for the fourth quarter of 2006 was $417 million compared to net earnings of $249 million in 2005. Basic net loss per common share for the fourth quarter of 2006 was $3.33 compared to basic net earnings per common share of $1.85 in 2005 as a result of the factors discussed above.

Reportable Operating Segments

The Company's consolidated sales and operating income were impacted by each of its reportable operating segments as follows:

WESTON FOODS

($ millions except where otherwise indicated)	**2006**	2005
Sales	**$ 986**	$ 980
Adjusted EBITDA[1]	**$ 104**	$ 98
Operating income	**$ 67**	$ 48
Adjusted operating income[1]	**$ 78**	$ 70

(1) See Non-GAAP Financial Measures beginning on page 51.

Sales for the fourth quarter of 2006 of $1.0 billion increased 0.6% compared to 2005, as a result of a sales increase of 2.3% offset in part by the negative impact of foreign currency translation, which impacted Weston Foods reported sales growth by approximately 1.7%. Sales growth for the fourth quarter of 2006 was also impacted by the following:

- overall volume decreased 1.4%, which was negatively impacted by 1.0% due to the exit from the United States frozen foodservice bagel business early in the third quarter of 2006 and the discontinuance of contract manufacturing of biscuits for certain customers during 2006;
- price increases in key product categories combined with changes in sales mix contributed positively to sales growth by approximately 3.7%;
- fresh bakery sales increased 6.6%, driven by price increases partially offset by slightly lower volumes. Branded volume increases included growth in the *Thomas'* and *Arnold* brands in the United States and the *Wonder*, *D'Italiano* and *Weston* brands in Canada. Continued growth in products made with whole grains and the introduction of new and expanded product offerings, such as *Thomas' Squares* Bagelbread and *Wonder+* bread contributed positively to branded sales, partially offset by the impact of product rationalizations. Sales of white flour based products contributed positively to sales growth during the quarter due to price increases and volume growth in several branded product categories;
- sales in the fresh-baked sweet goods category declined 2.2% due to lower volumes, partially offset by price increases combined with changes in sales mix;
- frozen bakery sales increased 1.9% due to price increases combined with changes in sales mix, partially offset by lower volumes. Frozen bakery sales were negatively impacted during the fourth quarter due to the exit from the United States frozen foodservice bagel business early in the third quarter of 2006;
- dairy sales increased 3.7% as a result of volume growth, price increases and improvements in sales mix, as growth continued to be experienced in value-added products; and
- biscuit category sales declined 16.7% primarily due to lower volume, which was negatively impacted by the discontinuance of contract manufacturing of biscuits for certain customers during 2006. This discontinuance was a result of the previously approved plan to restructure the Weston Foods United States biscuit operations.

Operating income for the fourth quarter of 2006 was $67 million compared to $48 million in 2005. Fourth quarter operating income included a $16 million (2005 – $1 million) charge for restructuring and other charges and income of $5 million (2005 – charge of $21 million) related to net stock-based compensation net of the impact of the associated equity derivatives. Adjusting for the net negative impact of restructuring and other charges and stock-based compensation net of the associated equity derivatives, adjusted operating

(1) See Non-GAAP Financial Measures beginning on page 51.

income[1] for the fourth quarter of 2006 was $78 million, an increase of 11.4% compared to $70 million in 2005. Adjusted operating margin[1] and adjusted EBITDA margin[1] for the fourth quarter of 2006 were 7.9% and 10.5%, respectively (2005 – 7.1% and 10.0%). Adjusted operating income[1] for the fourth quarter of 2006 was impacted by the following:

- foreign currency translation negatively impacted adjusted operating income[1] growth by approximately 2.7 percentage points;
- operating income and margin were positively impacted by sales growth, primarily due to price increases in key product categories combined with changes in sales mix; and
- inflationary cost pressures related to certain ingredient costs continued to adversely affect Weston Foods operating income and margin growth.

As previously discussed, Weston Foods approved several restructuring plans in 2006. During the fourth quarter of 2006, Weston Foods recognized $16 million (2005 – $1 million) of restructuring and other charges in connection with these restructuring plans.

LOBLAW

($ millions except where otherwise indicated)	**2006**	2005[2]
Sales	**$ 6,784**	$ 6,552
Sales excluding the impact of VIEs[1]	**$ 6,692**	$ 6,454
Adjusted EBITDA[1]	**$ 412**	$ 571
Operating (loss) income	**$ (697)**	$ 392
Adjusted operating income[1]	**$ 284**	$ 439

(1) See Non-GAAP Financial Measures beginning on page 51.
(2) During 2006, the Company implemented EIC 156 on a retroactive basis. Accordingly certain sales incentives paid by Loblaw to independent franchisees, associates and independent accounts for prior years have been reclassified between sales and cost of sales, selling and administrative expenses. For a further discussion, see the Accounting Standards Implemented in 2006 section included in this MD&A.

Sales and Sales Growth Excluding the Impact of VIEs[1]

($ millions except where otherwise indicated)	**2006**	2005[2]
Total sales	**$ 6,784**	$ 6,552
Less: Sales attributable to the consolidation of VIEs	**92**	98
Sales excluding the impact of VIEs[1]	**$ 6,692**	$ 6,454
Total sales growth	**3.5%**	
Less: Impact on sales growth attributable to the consolidation of VIEs	**(0.2%)**	
Sales growth excluding the impact of VIEs[1]	**3.7%**	

(1) See Non-GAAP Financial Measures beginning on page 51.
(2) During 2006, the Company implemented EIC 156 on a retroactive basis. Accordingly certain sales incentives paid by Loblaw to independent franchisees, associates and independent accounts for prior years have been reclassified between sales and cost of sales, selling and administrative expenses. For a further discussion, see the Accounting Standards Implemented in 2006 section included in this MD&A.

Sales for the fourth quarter of 2006 increased 3.5% or $232 million to $6.8 billion from $6.6 billion reported in the fourth quarter of 2005, including a decrease of 0.2% related to the consolidation of certain independent franchisees. Sales increases were realized across all regions of the country and in all areas of food, general merchandise and drugstore. Fourth quarter same-store sales increased approximately 1.3% when compared to the same period last year. The growth in sales and same-store sales in the quarter is higher by approximately 2.0% excluding the loss of tobacco sales. During the fourth quarter of 2006, 8 new corporate and franchised stores were opened and 4 stores were closed, resulting in a net increase of 0.3 million square feet or 0.6%. Loblaw's calculation of food price inflation was consistent with the national food price inflation as measured by CPI of approximately 1.5% for the quarter.

During the fourth quarter of 2006, Loblaw focused on on-shelf availability, targeted pricing investments and incremental marketing. Loblaw experienced some positive sales momentum particularly when the decrease in tobacco sales is excluded. A successful holiday *Insider's Report* contributed to this improved sales performance.

(1) See Non-GAAP Financial Measures beginning on page 51.

Operating income for the fourth quarter of 2006 decreased $1,089 million from the fourth quarter of 2005 to an operating loss of $697 million and operating margin declined to (10.3)% from 6.0% in the comparable period of 2005 due to the effects of the charges described below, all of which have been previously detailed in the Loblaw Operating Results section of this MD&A:

- A non-cash goodwill impairment charge of $800 million related to the goodwill established on the acquisition of Provigo Inc. in 1998;
- A one-time charge of $84 million in the fourth quarter related to the ratification of a new four-year collective agreement with members of certain Ontario locals of the UFCW;
- A charge of $68 million in connection with the liquidation process for selected general merchandise inventory reflecting the expected inventory value through liquidation as well as the associated costs of facilitating the disposition incurred to date; and
- A charge of $35 million recorded upon management's approval and announcement of its plans to close 19 underperforming stores in Quebec, mainly within the *Provigo* banner, 8 stores in the Atlantic region, and 24 wholesale outlets. These closures are expected to result in total costs of $54 million.

Adjusted operating income[(1)] in the fourth quarter of 2006 was $284 million compared to $439 million in 2005, resulting in adjusted operating margins[(1)] of 4.2% and 6.8% respectively. During the fourth quarter of 2006, Loblaw continued to incur higher than anticipated store and distribution centre operational costs, particularly in higher inventory shrinkage and labour of approximately $35 million and approximately $20 million, respectively. Investments in lower food prices continued into the fourth quarter with an approximate 0.5% investment in food pricing, which resulted in an adverse impact to operating income of approximately $30 million when compared to the same period last year. As Loblaw continued to manage its inventory levels down to more desirable levels in store backrooms, outside storage and distribution centres, some success was realized in the fourth quarter from the focused clearance pricing of certain categories resulting in higher general merchandise mark downs in the range of $15 million to $20 million from the clearance of inventory through retail stores. Incremental supply chain costs and information technology investments of approximately $15 million were also absorbed in the fourth quarter.

Adjusted EBITDA[(1)] and EBITDA margin[(1)] for the fourth quarter were $412 million and 6.2%, respectively. For the comparable period of 2005, adjusted EBITDA[(1)] and EBITDA margin[(1)] were $571 million and 8.8%, respectively.

Liquidity and Capital Resources

Cash flows from operating activities of continuing operations

Fourth quarter cash flows from operating activities of continuing operations were $889 million in 2006 compared to $902 million in the comparable period of 2005.

Cash flows used in investing activities of continuing operations

Fourth quarter 2006 cash flows used in investing activities of continuing operations were $383 million in 2006 compared to $494 million in 2005. Capital investment for the fourth quarter amounted to $307 million (2005 – $390 million).

Cash flows used in financing activities of continuing operations

Fourth quarter 2006 cash flows used in financing activities of continuing operations were $391 million in 2006 compared to $395 million in 2005.

MANAGEMENT'S CERTIFICATION OF DISCLOSURE CONTROLS AND PROCEDURES

Management is responsible for designing disclosure controls and procedures to provide reasonable assurance that all material information relating to the Company and its subsidiaries is gathered and reported to senior management on a timely basis so that appropriate decisions can be made regarding public disclosure. As required by Multilateral Instrument 52-109 (Certification of Disclosure in Issuers' Annual and Interim Filings) of the Canadian Securities Administrators, the Chairman & President and the Chief Financial Officer ("CFO") have evaluated the effectiveness of such disclosure controls and procedures and have concluded that the Company's disclosure controls and procedures are effective as at December 31, 2006.

(1) See Non-GAAP Financial Measures beginning on page 51.

OPERATING RISKS AND RISK MANAGEMENT

Each year, the Company performs an Enterprise Risk Assessment ("ERA"), which identifies the key risks facing the Company and evaluates the risk management effectiveness for each of these risks. The assessment is primarily carried out through interviews with senior management, who assess the potential impact of risks and the likelihood that a negative impact will occur. The results of the ERA are used to prioritize risk management activities, allocate resources effectively and inform overall business direction. The Audit Committee receives a report on the ERA.

A description of the risks and risk management strategies identified by the ERA is included in the operational risks discussed below, any of which has the potential to negatively affect financial performance. The Company has operating and risk management strategies and insurance programs, which help to mitigate the potential financial impact of these operating risks.

Industry and Competitive Environment

The North American food processing and retail industries are evolving and operate in increasingly competitive markets. Consumers' needs drive changes in the industries, which are impacted by changing demographic and economic trends such as changes in disposable income, ethnic diversity, nutritional awareness and time availability. Customer satisfaction is central to the Company's business. Over the past several years, consumers have demanded more choice, value and convenience. If the Company is ineffective in responding to these demands or ineffective in executing its strategies, its financial performance could be negatively impacted.

The Company reviews and monitors operating plans and results, including market share in its reportable operating segments. When necessary, the segments will modify their operating strategies, including relocating production facilities or stores, closing underperforming stores, reviewing pricing and adjusting product offerings, brand positioning and/or marketing programs to take into account competitive activity. A significant competitive advantage the Company has developed is its brands. Both segments focus on brand development and building upon their core brand equity. Weston Foods' brands provide it with a strategic advantage over its competitors. Its premium and mainstream brands provide Weston Foods with strong core brands and product lines that enhance consumer loyalty, trusted as they are for quality, great taste and freshness. Loblaw's control label program represents a significant competitive advantage because it enhances customer loyalty by offering superior value and provides some protection against national brand pricing strategies.

As a result of the difficult sales environment being experienced by United States traditional food retailers, coupled with the continuing cost pressures being experienced by the industry, Weston Foods anticipates that competitive business restructuring will continue in 2007. Although the outcome and the impact, if any, on the Company's consolidated financial results from this anticipated restructuring is uncertain, Weston Foods will closely monitor the United States food retail market and, if required, adjust its strategies and programs as necessary.

Loblaw faces increasing competition from many types of non-traditional competitors, such as mass merchandisers, warehouse clubs, drugstores, limited assortment stores, discount stores, convenience stores and specialty stores, all of which continue to increase their offerings of products typically associated with traditional supermarkets. Loblaw is also subject to competitive pressures from new entrants into the marketplace and from the expansion of existing competitors, particularly those expanding into the grocery market. These competitors may have extensive resources, which will allow them to compete effectively with Loblaw in the long term.

Increased competition could adversely affect the Company's ability to achieve its objectives. The Company's inability to compete effectively with its current or any future competitors could result in, among other things, lessening of market share and lower pricing in response to competitors' pricing activities. Accordingly, the Company's competitive position and financial performance could be negatively impacted. The Company may not always achieve the expected cost savings and other benefits of these initiatives, which could negatively impact the Company's financial performance.

Change Management

2006 was a year of significant change for Loblaw. The change in Loblaw senior management will be followed by changes to its structures and business processes. While these changes are expected to bring benefits to Loblaw in the form of a more agile and consumer-focused business, success is dependent on management effectively implementing these changes. Ineffective change management may result in disruptions to the operations of the business or affect its ability to implement and achieve its strategic objectives, due to a lack of clear accountabilities, or cause employees to act in a manner which is inconsistent with its objectives. Any of these events could negatively impact the Company's performance.

Food Safety and Public Health

The Company is subject to potential liabilities connected with its business operations, including potential exposures associated with product defects, food safety and product handling. Such liabilities may arise in relation to the manufacturing, preparation, storage, distribution and display of products and, with respect to the Company's control label and contract manufactured products, in relation to the production, packaging and design of products.

A majority of the Company's sales are generated from food products and the Company could be vulnerable in the event of a significant outbreak of food-borne illness or increased public health concerns in connection with certain food products. Such an event could negatively affect the Company's financial performance. Procedures are in place to manage such events, should they occur. These procedures identify risks, provide clear communication to employees and consumers and are aimed at ensuring that potentially harmful products are expeditiously removed from inventory. The ability of these procedures to address such events is dependent on their successful execution. Food safety related liability exposures are insured by the Company's insurance program. In addition, the Company has food safety procedures and programs, which address safe food handling and preparation standards. The Company endeavours to employ best practices for the storage and distribution of food products and also actively supports consumer awareness of safe food handling and consumption.

The Company strives to ensure its brands and Loblaw's control label products have informative nutritional labelling so that today's health conscious consumer can make informed choices.

Information Technology

In order to support the current and future requirements of the business in an efficient, cost effective and well-controlled manner, the Company is reliant on information technology systems. These have been assessed by management to need significant upgrading in order to act as an enabler for the business to achieve its operating objectives. These systems are essential in providing management with the appropriate information for decision making, including its key performance indicators. Change management risk and other associated risks will arise from the various information technology projects which will be undertaken to upgrade existing systems and introduce new systems to effectively manage the business going forward. Failure by the Company to appropriately invest in information technology or failure to implement information technology infrastructure in a timely or effective manner may negatively impact the Company's financial performance.

Labour

A significant portion of the Company's workforce is unionized. Renegotiating collective agreements might result in work stoppages or slowdowns, which could negatively affect the Company's financial performance, depending on their nature and duration. The Company is willing to accept the short term costs of labour disruption in order to negotiate competitive labour costs and operating conditions for the longer term. Significant labour negotiations took place across the Company in 2006 as 108 collective agreements expired and 78 collective agreements were successfully negotiated which represented a combination of agreements expiring in 2006, those carried over from prior years and those negotiated early. In 2007, 105 collective agreements affecting approximately 22,500 employees will expire, with the single largest agreement covering approximately 8,600 employees. The Company will also continue to negotiate the 67 collective agreements carried over from 2004 to 2006. The Company has good relations with its employees and unions and, although it is possible, does not anticipate any unusual difficulties in renegotiating these agreements.

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

Commodity Prices

Weston Foods operating results are directly impacted by fluctuations in the price of commodities such as wheat, flour, sugar, vegetable oil, cocoa, natural gas and fuel. Increases in the price of these commodities could adversely affect the Company's financial performance. In order to minimize the effect of these fluctuations on current operating results and to lessen the resulting uncertainty of future financial results, the Company hedges a portion of its anticipated commodity purchases. As at year end 2006, Weston Foods had entered into commodity future contracts that mitigate price fluctuations on some commodities for approximately 6 months, on average, into 2007.

Employee Future Benefit Contributions

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

During 2006, the Company contributed $125 million (2005 – $103 million) to its registered funded defined benefit pension plans. During 2007, the Company expects to contribute approximately $93 million to these plans. This estimate may vary subject to the completion of actuarial valuations, market performance and regulatory requirements. The Company also expects to make contributions in 2007 to defined contribution pension plans and multi-employer pension plans, as well as benefit payments to the beneficiaries of the unfunded defined benefit pension and other benefit plans.

Multi-Employer Pension Plans

In addition to the Company-sponsored pension plans, the Company participates in various multi-employer pension plans, providing pension benefits in which approximately 41% (2005 – 40%) of employees of the Company and of its independent franchisees participate. The administration of these plans and the investment of their assets are legally controlled by boards of independent trustees generally consisting of an equal number of union and employer representatives. In some circumstances, the Company may have a representative on the board of trustees of these multi-employer pension plans. The Company's responsibility to make contributions to these plans is limited by the amounts established pursuant to its collective agreements. Pension cost for these plans is recognized as contributions are due.

Subsequent to year end 2006, the Company was served with an action brought by certain beneficiaries of a multi-employer pension plan in the Superior Court of Ontario. In their claim against the employers and the trustees of the multi-employer pension plan, the plaintiffs claim that assets of the multi-employer pension plan have been mismanaged. Loblaw is one of the employers affected by the action. One billion dollars of damages are claimed in the action against a total of 17 defendants. In addition, the plaintiffs are seeking to have a representative defendant appointed for the employers of all the members of the multi-employer pension plan. The action is framed as a representative action on behalf of all of the beneficiaries of the multi-employer pension plan. The action is at a very early stage and the Company intends to vigorously defend it. Statements of Defence have not yet been filed.

During 2006, the trustees of a multi-employer pension plan (including an employee who was appointed by the Company) were charged under the Pension Benefits Act (Ontario) by the Superintendent of Financial Services with failure to administer various investments made by the trustees in a manner consistent with the legislation. It is not anticipated that the trial relating to these charges will be scheduled before February 2008.

Third-Party Service Providers

Certain aspects of the Company's business are significantly affected by third parties. Although appropriate contractual arrangements are put in place with these third parties, the Company has no direct influence over how such third parties are managed. It is possible that negative events affecting these third parties could in turn negatively impact the Company's operations and its financial performance.

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

In addition, certain of Weston Foods products and Loblaw's control label products, which are among the most recognized brands in Canada, are manufactured under contract by third-party vendors, and in order to preserve the brands' equity, these vendors are held to high standards of quality. Loblaw also uses third-party logistic services including those in connection with a dedicated warehouse and distribution centre in Pickering, Ontario and third-party common carriers. Any disruption in these services could interrupt the delivery of merchandise to the stores and therefore could negatively impact sales.

President's Choice Financial banking services are provided by a major Canadian chartered bank. *PC* Bank uses third-party service providers to process credit card transactions, operate call centres and monitor credit and fraud for the *President's Choice Financial* MasterCard®. In order to minimize operating risk, *PC* Bank and Loblaw actively manage and monitor their relationship with all third-party service providers. *PC* Bank has developed a vendor management policy, approved by its Board of Directors, and has established a vendor management team that provides its Board with regular reports on vendor management and risk assessment. *PC Financial* home and auto insurance products are provided by companies within the Aviva Canada group, the Canadian subsidiary of a major international property and casualty insurance provider.

Real Estate

The availability and conditions affecting the acquisition and development of real estate properties may impact Loblaw's ability to execute its planned real estate program on schedule and therefore, its ability to achieve its sales targets. Real estate development plans may be contingent on successful negotiation of labour agreements with respect to same-site expansion or redevelopment. As Loblaw continues to offer general merchandise, on-time execution of the real estate program becomes increasingly important due to significantly longer lead times required for ordering this merchandise. Delays in execution could lead to inventory management issues. Loblaw maintains a significant portfolio of owned retail real estate and, whenever practical, pursues a strategy of purchasing sites for future store locations. This enhances Loblaw's operating flexibility by allowing it to introduce new departments and services that could be precluded under operating leases. At year end 2006, Loblaw owned 72% (2005 – 72%) of its corporate store square footage.

Seasonality

The Company's operations as they relate to food, specifically inventory levels, sales volumes and sales mix, are impacted to some degree by certain holiday periods throughout the year. Both of the Company's reportable operating segments continuously monitor the impact holidays may have on their operations and adjust inventory levels and production and delivery schedules as required. As Loblaw expands the breadth of its general merchandise offering, it may increase the number of seasonal products offered and its operations may therefore be subject to more seasonal fluctuations.

Excess Inventory

As Loblaw continues to offer general merchandise, it is possible that certain merchandising programs will result in excess inventory that cannot be sold profitably through Loblaw's stores. Excess inventory may result in mark downs, shrink or the need to liquidate the inventory, all of which may negatively impact the Company's financial performance. In addition, Loblaw's current inventory management infrastructure, including its information technology systems, is not efficient in its tracking of inventory through all stages of the supply chain. Loblaw has implemented procedures and information technology workarounds which provide management with the ability to adequately detect and quantify excess and obsolete inventory. Loblaw expects to implement new systems in this area to address this risk.

Employee Development and Retention

Effective employee development and succession planning are essential to sustaining the growth and success of the Company. The Company continues to focus on the development of employees at all levels and across all regions. The degree to which the Company is not effective in developing its employees and establishing appropriate succession planning processes could lead to a lack of requisite knowledge, skills and experience which could, in turn, affect its ability to execute its strategies, efficiently run its operations and meet its goals for financial performance.

The tight labour market in Western Canada has created unique challenges to effectively operate manufacturing facilities, stores and distribution centres thereby affecting the Company's ability to meet its business objectives. The Company has implemented targeted programs to attract the appropriate calibre of employees in a very competitive environment.

Subsequent to year end 2006, Loblaw has announced a reorganization of some of its functions and an associated reduction of between 800 and 1,000 store support and regional office employees. These actions, if not properly executed, will impact Loblaw's ability to execute its strategies going forward. These actions will require Loblaw to address employee engagement in the process and ensure that key employees remain empowered to effectively execute Loblaw's strategies.

Utility and Fuel Prices

The Company is a significant consumer of electricity, other utilities and fuel. Unanticipated cost increases in these items could negatively affect the Company's financial performance. The Company has entered into contracts with suppliers to fix the price of a portion of its future variable costs associated with electricity and natural gas, and financial contracts to fix a portion of variable costs associated with heating oil requirements for 2007.

Insurance

The Company limits its exposure to risk through a combination of appropriate levels of self-insurance and the purchase of various insurance coverages, including an integrated insurance program. The Company's insurance program is based on various lines and limits of coverage, which provide the appropriate level of retained and insured risks. Insurance is arranged on a multi-year basis with reliable, financially stable insurance companies as rated by A.M. Best Company, Inc. The Company combines comprehensive risk management programs and the active management of claims handling and litigation processes by using internal professionals and external technical expertise to reduce and manage the risk it retains.

Environmental, Health and Safety

The Company has environmental, health and workplace safety programs in place and has established policies and procedures aimed at ensuring compliance with applicable legislative requirements. To this end, the Company employs environmental risk assessments and audits using internal and external resources together with employee awareness programs throughout its operating locations.

The Company endeavours to be socially and environmentally responsible, and recognizes that the competitive pressures for economic growth and cost efficiency must be integrated with sound environmental stewardship and ecological considerations. Environmental protection requirements do not and are not expected to have a material effect on the Company's financial performance.

The Environmental, Health and Safety Committee of the Board receives regular reporting from management, addressing current and potential future issues, identifying new regulatory concerns and related communication efforts. The Company's dedicated Environmental Affairs staff work closely with the operations to help ensure that corporate requirements are met.

Ethical Business Conduct

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

Legal, Taxation and Accounting

Changes to any of the laws, rules, regulations or policies related to the Company's business, including the production, processing, preparation, distribution, packaging and labelling of its products could have an adverse impact on its financial and operational performance. In the course of complying with such changes, the Company may incur significant costs. Failure by the Company to fully comply with applicable laws, rules, regulations and policies may subject it to civil or regulatory actions or proceedings, including fines, assessments, injunctions, recalls or seizures, which may have an adverse effect on the Company's financial results.

During 2006, the Government of Ontario passed a new law which prohibits the receipt of rebates paid by manufacturers to pharmacies in respect of interchangeable products and products listed in Ontario's Formulary. Pharmacies are permitted to accept only limited defined professional allowances to be used in compliance with a new Code of Conduct. As a result of this recently enacted legislation, drugstore-related operating income could decrease although Loblaw is attempting to mitigate some of the impact of these changes. It is possible that similar legislation could be implemented in other provinces, which could have a further negative impact.

There can be no assurance that the tax laws and regulations in the jurisdictions affecting the Company will not be changed in a manner which could adversely affect the Company. New accounting pronouncements introduced by appropriate authoritative bodies may also impact the Company's financial results.

Holding Company Structure

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

FINANCIAL RISKS AND RISK MANAGEMENT

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

Derivative Instruments

The Company uses over-the-counter financial derivative instruments, specifically cross currency basis swaps, interest rate swaps, equity forwards and swaps, and commodity futures and options, to minimize the risks and costs associated with its financing activities, stock-based compensation plans and future purchases of commodities. The Company maintains treasury centres that operate under policies and guidelines approved by the Board, covering funding, investing, equity, foreign currency exchange and interest rate management. The Company's policies and guidelines prevent it from using any derivative instrument for trading or speculative purposes. See notes 1 and 22 to the consolidated financial statements for additional information on the Company's derivative instruments.

Foreign Currency Exchange Rate

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

Interest Rate

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

Common Share Market Price

The Company enters into equity derivative agreements to manage its exposure to fluctuations in its stock-based compensation cost as a result of changes in the market prices of Weston and Loblaw common shares. These equity derivative agreements change in value as the market prices of the underlying common shares change, which effectively results in a partial offset to fluctuations in the Company's stock-based compensation cost. The partial offset between the Company's stock-based compensation cost and the equity derivatives exists as long as the market prices of Weston and Loblaw common shares exceed the exercise price of employee stock options. The amount of net stock-based compensation cost recorded in operating income is dependent upon the number of unexercised, vested stock options and restricted share units relative to the number of underlying common shares on the equity derivatives and the fluctuations in the market price of the underlying common shares. As at year end 2006, 1,912,293 Weston stock options and share appreciation rights and 4,068,646 Loblaw stock options had exercise prices which were greater than the respective market price of Weston and Loblaw common shares at year end. The fair value of Weston's equity forward sale agreement based on 9.6 million Loblaw common shares is based on fluctuations in the market price of Loblaw common shares, and is a non-cash item that will ultimately be offset by the recognition of any gain on Weston's disposition of the 9.6 million Loblaw common shares.

Counterparty

Over-the-counter financial derivative instruments are subject to counterparty risk. Counterparty risk arises from the possibility that market changes may affect a counterparty's position unfavourably and that the counterparty defaults on its obligations to the Company. The Company has sought to minimize potential counterparty risk and losses by conducting transactions for its derivative agreements with counterparties that have at minimum a long term "A" credit rating from a recognized credit rating agency and by placing risk adjusted limits on its exposure to any single counterparty for its financial derivative agreements. The Company has internal policies, controls and reporting processes, which require ongoing assessment and corrective action, if necessary, with respect to its derivative transactions. In addition, principal amounts on cross currency basis swaps and equity forwards are each netted by agreement and there is no exposure to loss of the original notional principal amounts on the interest rate swaps and equity forwards and swaps.

Credit

The Company's exposure to credit risk relates to the Company's cash equivalents and short term investments, Weston Foods trade accounts receivables and Loblaw's credit card receivables and accounts receivable from independent franchisees, associates and independent accounts. Credit risk associated with the Company's cash equivalents and short term investments results from the possibility that a counterparty may default on the repayment of a security. This risk is mitigated by the established policies and guidelines that require issuers of permissible investments to have at minimum a long term "A" credit rating from a recognized credit rating agency and that specify minimum and maximum exposures to specific issuers.

Weston Foods performs ongoing credit evaluations of new and existing customers' financial condition and reviews the collectibility of its trade accounts receivables in order to mitigate any possible credit losses.

Loblaw's exposure to credit risk relates to *PC* Bank's credit card receivables. *PC* Bank manages the *President's Choice Financial* MasterCard®. *PC* Bank grants credit to its customers on *President's Choice Financial* MasterCard® with the intention of increasing the loyalty of those customers and Loblaw profitability. Credit risk results from the potential for loss due to those customers defaulting on their payment obligations. In order to minimize the associated credit risk, *PC* Bank employs stringent credit scoring techniques, actively monitors the credit card portfolio and reviews techniques and technology that can improve the effectiveness of its collection process. In addition, these receivables are dispersed among a large, diversified group of credit card customers. Loblaw also has accounts receivable from its independent franchisees, associates and independent accounts, mainly as a result of sales to these customers. Loblaw actively monitors the balances on an ongoing basis and collects funds from its independent franchisees on a frequent basis in accordance with terms specified in the applicable agreements.

SUBSEQUENT EVENTS

On March 7, 2007, pursuant to a transaction whereby Domtar Inc. ("Domtar") was combined with the fine paper business of Weyerhauser Inc., Domtar common shares were exchanged for an equal number of either non-voting exchangeable shares of Domtar (Canada) Paper Inc. or common shares of Domtar Corporation (the "New Domtar"), a Delaware corporation.

After March 7, 2007, the holders of Weston's 3% Exchangeable Debentures ("Debentures") are entitled to exchange their Debentures for common shares of New Domtar on the basis of 95.2381 common shares of New Domtar for each one thousand dollar principal amount of Debentures. Weston's obligation on the exchange or redemption of these Debentures can be satisfied by delivery of a cash amount equivalent to the current market price of the common shares of New Domtar at such time, the common shares of New Domtar or any combination thereof.

In addition, the Share Purchase Agreement governing the June 1998 sale by Weston of E.B. Eddy Limited and E.B. Eddy Paper, Inc. to Domtar (the "SPA") contains a price adjustment clause. The SPA provides, subject to certain exceptions, that if any person subsequently acquired more than 50% of the outstanding voting shares of Domtar, the price adjustment clause applies. Weston believes that a price adjustment in the amount of $110 million is payable and Weston has demanded payment of such amount from Domtar. Domtar's position is that the purchase price adjustment does not apply because of the application of an exception contained in the SPA. Weston intends to pursue its legal rights pursuant to the SPA.

In addition, as previously discussed in the Loblaw Operating Results section of this MD&A, Loblaw approved and announced, early in 2007, the restructuring of its merchandising and store operations.

RELATED PARTY TRANSACTIONS

Weston's majority shareholder, Wittington Investments, Limited ("Wittington"), and its affiliates are related parties. Weston, in the normal course of business, has routine transactions with these related parties, including the rental of office space at market prices from Wittington. Rental payments amounted to approximately $6 million in 2006 (2005 – $5 million). In addition, Loblaw purchased from Wittington a property designated for future development for consideration of $8 million, which was prepaid in accordance with a former ground lease between the parties. It is Weston's policy to conduct all transactions and settle balances with related parties on normal trade terms and conditions. For a detailed description of the Company's related party transactions, see note 25 to the consolidated financial statements.

From time to time, the Company and Wittington 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.

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts and disclosures made in the consolidated financial statements and accompanying notes. Management continually evaluates the estimates and assumptions it uses. These estimates and assumptions are based on management's historical experience, best knowledge of current events and conditions and activities that the Company may undertake in the future. Actual results could differ from these estimates. The estimates and assumptions described in this section depend upon subjective or complex judgments about matters that may be uncertain and changes in these estimates and assumptions could materially impact the consolidated financial statements.

Inventories

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

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

During 2006, Loblaw decided to proceed with the liquidation of certain inventory, consisting primarily of general merchandise. A charge of $68 million was recorded in 2006 in connection with this liquidation process. Significant estimation or judgment was required in the determination of what is considered excess inventory, estimated recovery values and discounted cost of retail store inventories.

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

Employee Future Benefits
The cost and accrued benefit plan obligations of the Company's defined benefit pension plans and other benefit plans are accrued based on actuarial valuations which are dependent on assumptions determined by management. These assumptions include the discount rate, the expected long term rate of return on plan assets, the expected growth rate of health care costs, the rate of compensation increase, retirement ages and mortality rates. These assumptions are reviewed annually by management and the Company's actuaries.

The discount rate, the expected long term rate of return on plan assets and the expected growth rate in health care costs are the three most significant assumptions.

The discount rates are based on market interest rates, as at the Company's measurement date of September 30 on a portfolio of Corporate AA bonds with terms to maturity that, on average, match the terms of the accrued benefit plan obligations. The discount rates used to determine the 2006 net cost for defined benefit pension and other benefit plans were 5.3% and 5.3% respectively on a weighted average basis, compared to 6.2% and 6.1% respectively in 2005. The discount rates used to determine the net 2007 defined benefit pension and other benefit plans costs decreased to 5.0% and 5.0%, respectively in Canada and increased to 5.75% and 5.75%, respectively in the United States.

The expected long term rate of return on plan assets is based on current market conditions, the asset mix, the active management of defined benefit pension plan assets and on historical returns. The Company's defined benefit pension plan assets had a 10 year annualized return of 8.8% as at the 2006 measurement date. The actual annual returns within this 10 year period varied with market conditions. The Company has assumed a 7.75% expected long term rate of return on plan assets in Canada and 8.0% on plan assets in the United States in calculating its defined benefit pension plans cost for 2007.

The expected growth rate in health care costs for 2006 was based on external data and the Company's historical trends for health care costs, and in 2007 initial growth rates will be relatively consistent with that of 2006.

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

Additional information regarding the Company's pension and other benefit plans, including a sensitivity analysis for changes in key assumptions, is provided in note 17 to the consolidated financial statements and in the Employee Future Benefit Contributions discussion in the Operating Risks and Risk Management section of this MD&A.

Goodwill and Indefinite Life Intangible Assets
Goodwill is not amortized and is assessed for impairment at the reporting unit level at least annually. Any potential goodwill impairment is identified by comparing the fair value of a reporting unit to its carrying value. If the fair value of the reporting unit exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value of the reporting unit exceeds its fair value, a more detailed goodwill impairment assessment must be undertaken. A goodwill impairment charge is recognized to the extent that, at the reporting unit level, the carrying value of goodwill exceeds the implied fair value. Fair value of goodwill is estimated in the same manner as goodwill is determined at the date of acquisition in a business acquisition, that is, the excess of the fair value of the reporting unit

over the fair value of the identifiable net assets of the reporting unit. Any goodwill impairment will result in a reduction in the carrying value of goodwill on the consolidated balance sheet and in the recognition of a non-cash impairment charge in operating income in the consolidated statement of earnings.

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

In 2006, Loblaw performed the annual goodwill impairment test and it was determined that the carrying value of the goodwill established on the acquisition of Provigo Inc. in 1998 exceeded its respective fair value. As a result, Loblaw recorded in operating income a non-cash goodwill impairment charge of $800 million relating to this goodwill, which was within its previously disclosed range of $600 million to $900 million. Loblaw expects no income tax deduction from this non-cash goodwill impairment charge. The determination that the fair value of goodwill was less than its carrying value resulted from a decline in market multiples, both from an industry and Loblaw perspective, and a reduction of fair value as determined using the discounted cash flow methodology, incorporating both current Loblaw and market assumptions, which in combination resulted in the goodwill impairment. This non-cash goodwill impairment charge is expected to be adjusted if necessary in the first half of 2007 and may result in a charge or credit to operating income in the consolidated statement of earnings and in the carrying value of goodwill on the balance sheet.

Intangible assets with indefinite lives, primarily consisting of certain Weston Foods trademarks and brand names, are assessed for impairment at least annually. Any potential intangible asset impairment is identified by comparing the fair value of the indefinite life intangible asset to its carrying value. If the fair value of the intangible asset exceeds its carrying value, the intangible asset is considered not to be impaired. If the carrying value of the intangible asset exceeds its fair value, impairment is identified as the difference between the fair value and the carrying value and will result in a reduction in the carrying value of the intangible assets on the consolidated balance sheet and in the recognition of a non-cash impairment charge in operating income in the consolidated statement of earnings.

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

During the fourth quarter of 2006, Weston Foods performed the annual goodwill and indefinite life intangible assets impairment tests and it was determined that the fair value of each reporting unit and indefinite life intangible asset exceeded its respective carrying value. Therefore, no impairment of goodwill or indefinite life intangible assets was identified.

Income Taxes

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

On an ongoing basis, future income tax assets are reviewed to determine if a valuation allowance is required and if it is deemed more likely than not that the future income tax assets will not be realized based on taxable income projections, a valuation allowance is recorded.

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

Fixed Assets

Fixed assets to be held and used are reviewed for impairment annually and when events or circumstances indicate that their carrying value exceeds the sum of the undiscounted cash flows expected from their use and eventual disposition. An impairment loss is measured as the amount by which the fixed assets carrying value exceeds the fair value. As discussed in notes 4 and 15 to the consolidated financial statements, the Company reviewed certain fixed assets for impairment in the Weston Foods and Loblaw operating segments due to circumstances that indicated that their carrying values may not be recovered. Factors that most significantly influence the impairment assessments and calculations are estimates of future cash flows. The Company uses its internal plans in estimating future cash flows. These plans reflect the Company's current best estimate of future cash flows but may change in the future due to uncertain competitive and economic market conditions or changes in business strategies. Changes or differences in these estimates may result in changes to fixed assets on the consolidated balance sheet and a charge to operating income on the statement of earnings.

Goods and Services Tax and Provincial Sales Taxes

During 2005, Loblaw recorded a charge relating to an audit and proposed assessment by the Canada Revenue Agency relating to GST on certain products sold on which GST was not appropriately charged and remitted. In light of this proposed assessment, the Company assessed and estimated the potential liabilities for GST and PST in other areas of its operations for various periods. Accordingly, a charge of $40 million was recorded in operating income in 2005. Approximately $1 million was paid in 2006 (2005 – $15 million) and approximately $24 million remains accrued as at year end 2006. The ultimate remaining amount paid will depend on the outcome of audits performed by or settlements reached with the various tax authorities, and therefore may differ from this estimate. Management will continue to assess the remaining accrual as progress towards resolution with the various tax authorities is made and will adjust the remaining accrual accordingly. Changes in this accrual may result in a charge or credit to operating income in the consolidated statement of earnings.

ACCOUNTING STANDARDS IMPLEMENTED IN 2006

During the year, the Company implemented the following accounting standards issued by the Canadian Institute of Chartered Accountants:

- Section 3831, "Non-Monetary Transactions", issued in June 2005, replaces Section 3830 of the same name. The revised standard addresses the measurement and disclosure of non-monetary transactions and defines when an exchange of assets is measured at fair value and when it is measured at the carrying amount. The criterion for the measurement of a non-monetary transaction at fair value is based on whether the non-monetary transaction has commercial substance rather than the culmination of the earnings process under Section 3830. The revised standard is applied to non-monetary transactions initiated in periods beginning after January 1, 2006. The adoption of these new recommendations, on a prospective basis, did not have a material impact on the Company's consolidated financial statements.
- EIC Abstract 156, "Accounting by a Vendor for Consideration Given to a Customer (Including a Reseller of the Vendor's Products)", issued in September 2005, addresses cash consideration, including sales incentives, given by a vendor to a customer. This consideration is presumed to be a reduction of the selling price of the vendor's products and should therefore be classified as a reduction of sales in the vendor's statement of earnings.

Prior to the implementation of EIC 156, Loblaw recorded certain sales incentives paid to independent franchisees, associates and independent accounts in costs of sales, selling and administrative expenses on the statement of earnings. Accordingly, the implementation of EIC 156, on a retroactive basis, resulted in a reduction in both sales and cost of sales, selling and administrative expenses as follows:

	First Quarter (12 weeks)		Second Quarter (12 weeks)		Third Quarter (16 weeks)		Fourth Quarter (12 weeks)		Total (52 weeks)	
($ millions)	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004
Sales as previously reported	$ 6,972	$ 6,551	$ 7,273	$ 6,915	$ 9,737	$ 9,260	$ 7,381	$ 7,072	$31,363	$29,798
Sales after reclassification	$ 6,908	$ 6,496	$ 7,242	$ 6,882	$ 9,694	$ 9,215	$ 7,345	$ 7,026	$31,189	$29,619
Reclassification between sales and cost of sales, selling and administrative expenses	$ 64	$ 55	$ 31	$ 33	$ 43	$ 45	$ 36	$ 46	$ 174	$ 179

As reclassifications, these changes did not impact net earnings from continuing operations. Operating margins, adjusted operating margins[(1)] and adjusted EBITDA margins[(1)] for prior years have also been recalculated and updated, if applicable, as a result of the change in sales.

- EIC Abstract 157, "Implicit Variable Interest under AcG 15", issued in October 2005, provides new guidance and clarification to the recommendations in AcG 15 with respect to all implicit variable interests held by an enterprise or its related parties. The guidance addresses how implicit variable interests should be included in the assessment as to whether the entity is the primary beneficiary of the VIE. An implicit variable interest is an interest that indirectly absorbs or receives the variability of the entity. The adoption of these recommendations in the first quarter of 2006 did not have a material impact on the Company's consolidated financial statements.
- EIC Abstract 159, "Conditional Asset Retirement Obligations", issued in December 2005, provides guidance on the recognition and measurement of a conditional asset retirement obligation and further clarifies the requirements under Section 3110, "Asset Requirement Obligations" such that a conditional asset retirement obligation should be recognized at fair value when the obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and/or method of settlement. These recommendations were adopted retroactively for the second quarter of 2006 and did not have a material impact on the Company's consolidated financial statements.
- EIC Abstract 162, "Stock-Based Compensation for Employees Eligible to Retire before the Vesting Date", issued in July 2006, requires that stock-based compensation granted to employees eligible to retire should be expensed at the time of grant. Weston's and Loblaw's stock-based compensation plans do not continue to vest after retirement, and therefore the adoption of this abstract did not have an impact on the Company's consolidated financial statements.

FUTURE ACCOUNTING STANDARDS

The Company closely monitors new accounting standards to assess the impact, if any, on its consolidated financial statements. In 2007, the Company will be reviewing the implications of the following standards and implementing the recommendations as required:

- The Accounting Standards Board continues to work towards the transition from Canadian GAAP to International Financial Reporting Standards over a five-year period. After this transitional period, Canadian GAAP will cease to exist as a separate, distinct basis of financial reporting. The Company continues to closely monitor the changes resulting from this transition in preparation for the convergence.

Section 3855, "Financial Instruments – Recognition and Measurement", Section 3865, "Hedges", Section 1530, "Comprehensive Income", Section 3861, "Financial Instruments – Disclosures and Presentation", and Section 3251, "Equity", issued in April 2005:

- Section 3855, "Financial Instruments – Recognition and Measurement", establishes guidance for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. The standard requires that financial instruments within scope, including derivatives, be included on the Company's balance sheet and measured, either at fair value or, in limited circumstances, at cost or amortized cost. All financial instruments must be classified into a defined category, namely, held-to-maturity investments, held-for-trading financial assets or financial liabilities, loans and receivables, available-for-sale financial assets, and other financial liabilities. This classification will determine how each instrument is measured and how gains and losses are recognized. Held-for-trading financial assets and financial liabilities are measured at fair value with gains and losses recognized in net income. Financial assets held-to-maturity, loans and receivables and financial liabilities, other than those held-for-trading, are measured at amortized cost using the effective interest method of amortization. Available-for-sale financial assets are measured at fair value, with unrealized gains and losses including changes in foreign exchange rates being recognized in other comprehensive income, a new section of shareholders' equity. Investments in equity instruments classified as available-for-sale that do not have a quoted market price in an active market can be measured at cost. The recommendations further define derivatives to include non-financial derivatives and embedded derivatives, which meet certain criteria. All derivatives must be classified as held-for-trading unless they are designated in a hedging relationship.
- Section 3865, "Hedges", replaces AcG 13, "Hedging Relationships" and the guidance formerly in Section 1650, "Foreign Currency Translation" will be replaced by Section 1651 of the same name, such that foreign exchange gains or losses on available-for-sale financial assets be accounted for in other comprehensive income instead of net earnings. The requirements for identification, designation and documentation of hedging relationships remain unchanged. The new guidance addresses the accounting treatment of qualifying hedging relationships and the necessary disclosures. The standard defines three specific hedging relationships, namely, fair value hedges, cash flow hedges, and hedges of a net investment in self-sustaining foreign operations, and defines

(1) See Non-GAAP Financial Measures beginning on page 51.

how the accounting should be performed. Changes in the fair value of hedging derivatives in a fair value hedge are offset in the consolidated statement of earnings against the change in fair value of the asset, liability or cash flow being hedged. In cash flow hedges, the changes in fair value are recorded in other comprehensive income, a new section of shareholders' equity. To the extent the change in fair value of the derivative is not completely offset by the change in fair value of the item it is hedging, the ineffective portion of the hedging relationship is recorded immediately in the consolidated statement of earnings.

- Section 1530, "Comprehensive Income", introduces a statement of comprehensive income, which will be included in the interim and annual financial statements. Comprehensive income is comprised of net income and other comprehensive income, and represents the change in equity during a period from transactions and other events with non-owner sources. Other comprehensive income will include unrealized gains and losses on financial assets that are classified as available-for-sale and changes in fair value of the effective portion of cash flow hedges.
- Section 3861, "Financial Instruments – Disclosure and Presentation", replaces Section 3860 of the same name, and addresses the presentation and disclosure of financial instruments and non-financial derivatives. The main features of these new recommendations revise the requirements to provide accounting policy disclosures and provide new requirements for disclosure on fair value.
- Section 3251, "Equity", replaces Section 3250, "Surplus" and establishes standards for the presentation of equity and changes in equity during the reporting period and requires that an enterprise present separately equity components and changes in equity arising from (i) net income; (ii) other comprehensive income; (iii) other changes in retained earnings; (iv) changes in contributed surplus; (v) changes in share capital; and (vi) changes in reserves.

These standards are effective for interim and annual financial statements for fiscal years beginning on or after October 1, 2006. Consequently, the Company will implement them in the first quarter of 2007. The transitional adjustments resulting from these standards will be recognized in the opening balances of retained earnings and other comprehensive income as appropriate. The Company is determining the impact of these changes based on the transitional guidance within these sections. Prior periods will not be restated.

- Section 1506, "Accounting Changes", issued in July 2006, revises current standards on changes in accounting policy, estimates or errors. An entity is permitted to change an accounting policy only when it results in financial statements that provide reliable and more relevant information or results from a requirement under a primary source of Canadian GAAP. The guidance also addresses how to account for a change in accounting policy, estimate or corrections of errors, and establishes enhanced disclosures about their effects on the financial statements. These recommendations are effective for fiscal years beginning on or after January 1, 2007. The Company will implement these recommendations as required on a prospective basis.
- Section 3862, "Financial Instruments – Disclosure" and Section 3863, "Financial Instruments – Presentation", both issued in December 2006, revise the current standards on financial instrument disclosure and presentation, and place an increased emphasis on disclosures regarding the risks associated with both recognized and unrecognized financial instruments and how these risks are managed. Section 3863 establishes standards for presentation of financial instruments and non-financial derivatives and provides additional guidance with classification of financial instruments, from the perspective of the issuer, between liabilities and equity. These recommendations are effective for fiscal years beginning on or after October 1, 2007 and therefore the Company will implement them in the first quarter of 2008.
- Section 1535, "Capital Disclosures", issued in December 2006, establishes guidelines for the disclosure of information regarding a company's capital and how it is managed. Enhanced disclosure with respect to the objectives, policies and processes for managing capital and quantitative disclosures about what a company regards as capital are required. These recommendations are effective for fiscal years beginning on or after October 1, 2007 and therefore the Company will implement them in the first quarter of 2008.
- EIC Abstract 163, "Determining the variability to be considered in applying AcG 15", issued in September 2006, addresses how to assess whether arrangements should be treated as variable interests or considered as creators of variability by a reporting enterprise in applying AcG 15. This abstract is effective for fiscal years beginning on or after January 1, 2007. The Company will implement these recommendations as required on a prospective basis. The Company does not expect the adoption of this abstract to have a material impact on the consolidated financial statements.

OUTLOOK

The outlook for the consolidated results of George Weston Limited for 2007 reflects the underlying results of its operating segments as discussed below. The consolidated results continue to reflect the changes undertaken by both the Weston Foods and Loblaw operating businesses in order to position them for strong growth in the future.

In 2007, Weston Foods expects to experience improvements in sales and adjusted operating income[1], on a year-over-year basis, as a result of improvements in volume and pricing and as the benefits of restructuring and cost reduction activities continue to be realized. Operating margins are expected to continue to be pressured by underlying cost inflation.

Loblaw has a number of strengths at its core – strong market share and control label products and a strong store network under various store formats with the potential to meet the needs of all Canadians. But as Loblaw looks forward, it must transition into a lean company that is ready and able to compete on all fronts. 2006 marked the beginning of this transition. Loblaw's main focus going forward is on simplifying its organizational structure, on retailing basics such as on-shelf availability and customer focus, on innovation as a competitive advantage and on executing Loblaw's growth strategy.

This outlook should be read in conjunction with the Forward-Looking Statements section of the MD&A on page 1.

NON-GAAP FINANCIAL MEASURES

The Company reports its financial results in accordance with Canadian GAAP. However, the Company has included certain non-GAAP financial measures and ratios, which it believes provide useful information to both management and readers of this Annual Report, including this Financial Report, in measuring the financial performance and financial condition of the Company for the reasons set out below. These measures do not have a standardized meaning prescribed by Canadian GAAP and, therefore, may not be comparable to similarly titled measures presented by other publicly traded companies, nor should they be construed as an alternative to other financial measures determined in accordance with Canadian GAAP.

Sales and Sales Growth Excluding the Impact of VIEs

These financial measures exclude the impact on sales from the consolidation by the Company of certain Loblaw independent franchisees which resulted from the implementation of AcG 15 retroactively without restatement effective January 1, 2005. This impact on sales is excluded because the Company believes this allows for a more effective analysis of the operating performance of the Company. Both the current and comparative measures reflect the retroactive implementation of EIC 156. A reconciliation of the financial measures to the Canadian GAAP financial measures is included in the tables "Sales and Sales Growth Excluding the Impact of VIEs" included on pages 4, 21, 34 and 37 of this MD&A.

(1) See Non-GAAP Financial Measures beginning on page 51.

Adjusted Operating Income and Margin

The following table reconciles adjusted operating income to Canadian GAAP operating income reported in the consolidated statements of earnings for the quarters ended December 31, 2006 and December 31, 2005 and the years ended December 31 as indicated. Items listed in the reconciliation below are excluded because the Company believes this allows for a more effective analysis of the operating performance of the Company. In addition, they affect the comparability of the financial results and could potentially distort the analysis of trends. The exclusion of these items does not imply that they are non-recurring. Adjusted operating income and margin are useful to management in assessing the Company's performance and in making decisions regarding the ongoing operation of its business.

CONSOLIDATED

($ millions)	**Quarter ended Dec. 31, 2006**	Quarter ended Dec. 31, 2005	**Year ended Dec. 31, 2006**	Year ended Dec. 31, 2005	Year ended Dec. 31, 2004	Year ended Dec. 31, 2003	Year ended Dec. 31, 2002
Operating (loss) income	**$ (630)**	$ 440	**$ 537**	$ 1,634	$ 1,782	$ 1,832	$ 1,704
Add (deduct) impact of the following:							
Loblaw goodwill impairment charge	**800**		**800**				
Restructuring and other charges	**51**	7	**90**	118	122	60	
Ontario collective labour agreement	**84**		**84**				
Inventory liquidation	**68**		**68**				
Departure entitlement charge			**12**				
Direct costs associated with supply chain disruptions		10		30			
Goods and Services Tax and provincial sales taxes				40			
Net effect of stock-based compensation and the associated equity derivatives	**(11)**	48	**60**	72	(3)	(11)	32
VIEs		4	**(8)**				
Adjusted operating income	**$ 362**	$ 509	**$ 1,643**	$ 1,894	$ 1,901	$ 1,881	$ 1,736

WESTON FOODS

($ millions)	**Quarter ended Dec. 31, 2006**	Quarter ended Dec. 31, 2005	**Year ended Dec. 31, 2006**	Year ended Dec. 31, 2005	Year ended Dec. 31, 2004	Year ended Dec. 31, 2003	Year ended Dec. 31, 2002
Operating income	**$ 67**	$ 48	**$ 256**	$ 241	$ 138	$ 374	$ 409
Add (deduct) impact of the following:							
Restructuring and other charges	**16**	1	**46**	32	121	35	
Net effect of stock-based compensation and the associated equity derivatives	**(5)**	21	**23**	29	(3)	(7)	18
Adjusted operating income	**$ 78**	$ 70	**$ 325**	$ 302	$ 256	$ 402	$ 427

LOBLAW

($ millions)	Quarter ended Dec. 31, 2006	Quarter ended Dec. 31, 2005	Year ended Dec. 31, 2006	Year ended Dec. 31, 2005	Year ended Dec. 31, 2004	Year ended Dec. 31, 2003	Year ended Dec. 31, 2002
Operating (loss) income	**$ (697)**	$ 392	**$ 281**	$ 1,393	$ 1,644	$ 1,458	$ 1,295
Add (deduct) impact of the following:							
Goodwill impairment charge	**800**		**800**				
Restructuring and other charges	**35**	6	**44**	86	1	25	
Ontario collective labour agreement	**84**		**84**				
Inventory liquidation	**68**		**68**				
Departure entitlement charge			**12**				
Direct costs associated with supply chain disruptions		10		30			
Goods and Services Tax and provincial sales taxes				40			
Net effect of stock-based compensation and the associated equity derivatives	**(6)**	27	**37**	43		(4)	14
VIEs		4	**(8)**				
Adjusted operating income	**$ 284**	$ 439	**$ 1,318**	$ 1,592	$ 1,645	$ 1,479	$ 1,309

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

Adjusted EBITDA and Margin

The following table reconciles adjusted EBITDA to adjusted operating income which is reconciled to Canadian GAAP measures reported in the consolidated statements of earnings for the quarters ended December 31, 2006 and December 31, 2005 and the years ended December 31 as indicated. Adjusted EBITDA is useful to management in assessing the Company's performance of its ongoing operations and its ability to generate cash flows to fund its cash requirements, including the Company's capital investment program.

CONSOLIDATED

($ millions)	Quarter ended Dec. 31, 2006	Quarter ended Dec. 31, 2005	Year ended Dec. 31, 2006	Year ended Dec. 31, 2005	Year ended Dec. 31, 2004	Year ended Dec. 31, 2003	Year ended Dec. 31, 2002
Adjusted operating income	**$ 362**	$ 509	**$ 1,643**	$ 1,894	$ 1,901	$ 1,881	$ 1,736
Add (deduct) impact of the following:							
Depreciation and amortization	**159**	168	**705**	684	618	537	498
VIE depreciation and amortization	**(5)**	(8)	**(24)**	(26)			
Adjusted EBITDA	**$ 516**	$ 669	**$ 2,324**	$ 2,552	$ 2,519	$ 2,418	$ 2,234

WESTON FOODS

($ millions)	Quarter ended Dec. 31, 2006	Quarter ended Dec. 31, 2005	Year ended Dec. 31, 2006	Year ended Dec. 31, 2005	Year ended Dec. 31, 2004	Year ended Dec. 31, 2003	Year ended Dec. 31, 2002
Adjusted operating income	**$ 78**	$ 70	**$ 325**	$ 302	$ 256	$ 402	$ 427
Add impact of the following:							
Depreciation and amortization	**26**	28	**115**	126	145	144	144
Adjusted EBITDA	**$ 104**	$ 98	**$ 440**	$ 428	$ 401	$ 546	$ 571

LOBLAW

($ millions)	**Quarter ended Dec. 31, 2006**	Quarter ended Dec. 31, 2005	**Year ended Dec. 31, 2006**	Year ended Dec. 31, 2005	Year ended Dec. 31, 2004	Year ended Dec. 31, 2003	Year ended Dec. 31, 2002
Adjusted operating income	**$ 284**	$ 439	**$ 1,318**	$ 1,592	$ 1,645	$ 1,479	$ 1,309
Add (deduct) impact of the following:							
Depreciation and amortization	**133**	140	**590**	558	473	393	354
VIE depreciation and amortization	**(5)**	(8)	**(24)**	(26)			
Adjusted EBITDA	**$ 412**	$ 571	**$ 1,884**	$ 2,124	$ 2,118	$ 1,872	$ 1,663

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

Adjusted Basic Net Earnings per Common Share from Continuing Operations
The following table reconciles adjusted basic net earnings per common share from continuing operations to Canadian GAAP basic net earnings per common share from continuing operations reported in the consolidated statements of earnings for the quarters ended December 31, 2006 and December 31, 2005 and the years ended December 31 as indicated. Items listed in the reconciliation below are excluded because the Company believes this allows for a more effective analysis of the operating performance of the Company. In addition, they affect the comparability of the financial results and could potentially distort the analysis of trends. The exclusion of these items does not imply that they are non-recurring. Adjusted basic net earnings per common share from continuing operations is useful to management in assessing the Company's performance and in making decisions regarding the operation of its business.

CONSOLIDATED

	Quarter ended Dec. 31, 2006	Quarter ended Dec. 31, 2005	**Year ended Dec. 31, 2006**	Year ended Dec. 31, 2005	Year ended Dec. 31, 2004	Year ended Dec. 31, 2003	Year ended Dec. 31, 2002
Basic net (loss) earnings per common share from continuing operations	**$ (3.42)**	$ 1.78	**$ 0.43**	$ 5.25	$ 4.49	$ 5.91	$ 5.19
Add (deduct) impact of the following:							
Loblaw goodwill impairment charge	**3.84**		**3.84**				
Restructuring and other charges	**0.20**	0.02	**0.36**	0.42	0.58	0.24	
Ontario collective labour agreement	**0.26**		**0.26**				
Inventory liquidation	**0.21**		**0.21**				
Departure entitlement charge			**0.04**				
Direct costs associated with supply chain disruptions		0.03		0.09			
Goods and Services Tax and provincial sales taxes				0.14			
Net effect of stock-based compensation and the associated equity derivatives	**(0.03)**	0.31	**0.38**	0.46	(0.01)	(0.08)	0.15
Accounting for Loblaw forward sale agreement	**0.09**	(0.63)	**(0.40)**	(0.77)	0.51		
Changes in statutory income tax rates		0.02	**(0.14)**	0.02		0.03	
Resolution of certain income tax matter					(0.07)	(0.26)	
VIEs		0.02		0.03			
Adjusted basic net earnings per common share from continuing operations	**$ 1.15**	$ 1.55	**$ 4.98**	$ 5.64	$ 5.50	$ 5.84	$ 5.34

Net Debt

The following table reconciles net debt excluding exchangeable debentures to Canadian GAAP measures reported in the consolidated balance sheets as at the years ended as indicated. The Company calculates net debt as the sum of long term debt and short term debt less cash, cash equivalents and short term investments and believes this measure is useful in evaluating the amount of leverage employed. The Company calculates net debt excluding exchangeable debentures as net debt (as calculated above) less exchangeable debentures and believes this measure is also useful in evaluating the amount of leverage employed as the exchangeable debentures can be settled with the Company's investment in Domtar common shares included in other assets.

($ millions)	**Dec. 31, 2006**	Dec. 31, 2005	Dec. 31, 2004	Dec. 31, 2003	Dec. 31, 2002
Bank indebtedness	**$ 99**	$ 113	$ 123	$ 108	$ 61
Commercial paper	**838**	498	840	696	715
Short term bank loans	**178**	138	102	67	33
Long term debt due within one year	**27**	361	222	307	110
Long term debt	**5,918**	5,913	6,004	5,829	5,387
Less: Cash and cash equivalents	**1,219**	1,540	1,008	965	1,157
Short term investments	**610**	50	388	545	398
Net debt	**5,231**	5,433	5,895	5,497	4,751
Less: Exchangeable debentures	**220**	225	373	374	374
Net debt excluding exchangeable debentures	**$ 5,011**	$ 5,208	$ 5,522	$ 5,123	$ 4,377

Total Assets

The following table reconciles total assets used in the return on average total assets measure to Canadian GAAP measures reported in the consolidated balance sheets as at the years ended as indicated. The Company believes the return on average total assets ratio is useful in assessing the performance of operating assets and therefore excludes cash, cash equivalents, short term investments, assets of operations held for sale and the Domtar investment from the total assets used in this ratio.

				As at December 31, 2006
($ millions)	**Weston Foods**	**Loblaw**	**Discontinued Operations**	**Consolidated**
Total assets	**$ 4,964**	**$ 13,631**	**$ –**	**$ 18,595**
Less:				
Cash and cash equivalents	**550**	**669**		**1,219**
Short term investments	**283**	**327**		**610**
Domtar investment	**215**			**215**
Total assets	**$ 3,916**	**$ 12,635**	**$ –**	**$ 16,551**

				As at December 31, 2005
($ millions)	Weston Foods	Loblaw	Discontinued Operations	Consolidated
Total assets	$ 4,675	$ 13,906	$ 12	$ 18,593
Less:				
Cash and cash equivalents	624	916		1,540
Short term investments	46	4		50
Long term assets of discontinued operations			12	12
Domtar investment	220			220
Total assets	$ 3,785	$ 12,986	$ –	$ 16,771

As at December 31, 2004

($ millions)	Weston Foods	Loblaw	Discontinued Operations	Consolidated
Total assets	$ 4,614	$ 13,082	$ 73	$ 17,769
Less:				
Cash and cash equivalents	459	549		1,008
Short term investments	113	275		388
Current assets of discontinued operations			62	62
Long term assets of discontinued operations			11	11
Domtar investment	365			365
Total assets	$ 3,677	$ 12,258	$ –	$ 15,935

As at December 31, 2003

($ millions)	Weston Foods	Loblaw	Discontinued Operations	Consolidated
Total assets	$ 4,780	$ 12,230	$ 268	$ 17,278
Less:				
Cash and cash equivalents	347	618		965
Short term investments	167	378		545
Current assets of discontinued operations			179	179
Long term assets of discontinued operations			89	89
Domtar investment	367			367
Total assets	$ 3,899	$ 11,234	$ –	$ 15,133

As at December 31, 2002

($ millions)	Weston Foods	Loblaw	Discontinued Operations	Consolidated
Total assets	$ 5,228	$ 11,104	$ 292	$ 16,624
Less:				
Cash and cash equivalents	334	823		1,157
Short term investments	94	304		398
Current assets of discontinued operations			207	207
Long term assets of discontinued operations			85	85
Domtar investment	367			367
Total assets	$ 4,433	$ 9,977	$ –	$ 14,410

The following table provides additional financial information.

	As at December 31, 2006	As at December 31, 2005	As at December 31, 2004
Market price per common share ($)	**$ 75.60**	$ 86.31	$ 109.71
Actual common shares outstanding (in millions)	**129.1**	129.0	128.9
Weighted average common shares outstanding (in millions)	**129.0**	129.0	128.9

ADDITIONAL INFORMATION

Additional information has been filed electronically with various securities regulators in Canada through the System for Electronic Document Analysis and Retrieval (SEDAR) and is available online at www.sedar.com.

This Annual Report includes selected information on Loblaw Companies Limited, a 62%-owned public reporting company with shares trading on the Toronto Stock Exchange. For information regarding Loblaw, readers should also refer to the materials filed by Loblaw with the Canadian securities regulatory authorities from time to time. These filings are also maintained at Loblaw's corporate website at www.loblaw.ca.

March 15, 2007
Toronto, Canada