

12. 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 develop a risk-based internal audit plan. The risks identified through its ERA process are presented and discussed with the Audit Committee.

A description of the risks and risk management strategies identified by the ERA is included in the risks discussed below, any of which has the potential to negatively affect financial performance. The Company has operating and risk management strategies including insurance programs, which help to mitigate the potential financial impact of these operating risks. While the Company employs strategies to minimize these risks, these strategies do not guarantee that events or circumstances will not occur which could negatively affect the Company’s financial condition and performance.

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, and are impacted by changing demographic and economic trends such as changes in disposable income, ethnic diversity, health and environmental 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 trends 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’ 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 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 continuing and accelerating cost pressures being experienced by the food processing industry and the difficult sales environment being experienced by many food retailers, Weston Foods anticipates that industry restructurings are likely. Although the outcome and the impact, if any, on the Company’s consolidated financial results from this anticipated restructuring are uncertain, Weston Foods will closely monitor developments in the food processing industry and food retail market and, if required, adjust its strategies and programs as necessary.

Loblaw’s competitors include traditional supermarket operators, as well as mass merchandisers, warehouse clubs, drugstores, limited assortment stores, discount stores, convenience stores and specialty stores. Many of these competitors now offer a selection of food, drugstore and general merchandise. Others remain focused on supermarket-type merchandise. 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 Loblaw’s ability to achieve its objectives. Loblaw’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 its competitors’ pricing activities. Accordingly, Loblaw’s competitive position and financial performance could be negatively impacted.

Loblaw monitors its market share and the markets in which it operates, and will adjust its operating strategies, which include, but are not limited to, closing underperforming stores, relocating stores or reformatting them under a different banner, reviewing pricing and adjusting product offerings and marketing programs.

Management's Discussion and Analysis

Change Management and Execution

2007 was a year of significant change for the Company. Project Simplify resulted in changes to Loblaw's structures and business processes. Other significant initiatives in support of Loblaw's multi-year turnaround plan are underway or planned. 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 realizing the intended benefits.

Ineffective change management may result in disruptions to the operations of the business or affect the ability of the Company to implement and achieve its strategic objectives, due to a lack of clear accountabilities or lack of requisite knowledge which may cause employees to act in a manner which is inconsistent with Company objectives. Any of these events could negatively impact the Company's performance. The Company may not always achieve the expected cost savings and other benefits of its initiatives.

Information Technology

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 ("IT") systems. These have been assessed by management as needing significant upgrading in certain areas in order to act as an enabler for the businesses. These systems may not provide the appropriate degree of efficiency to support the required changes to business processes of the Company. 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 projects which will be undertaken to upgrade existing systems and introduce new systems to enhance effective management of 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. During 2007, Loblaw developed an IT strategic plan to guide the new systems environment it requires. This plan will begin to be implemented in 2008.

Any failures in the Company's information security systems or non-compliance with information security standards, including those in relation to personal information belonging to the Company's customers, could result in harm to the reputation or competitive position of the Company and could negatively affect financial performance.

Supply Chain

The need to invest in and improve the Company's supply chain may adversely affect the Company's capacity to effectively and efficiently access current and potential customers. A significant restructuring of Loblaw's supply chain is planned for the next several years. Although this initiative is expected to result in improved service levels for Loblaw's stores, the scale of the change and the implementation of new processes could cause disruption in the flow of goods to stores, which would negatively affect sales. Loblaw's plans to grow its apparel business depend on improvements to the current supply chain processes related to that merchandise. Before and as these changes are implemented, it is possible that the flow of these goods could also be negatively affected, which could negatively affect sales.

Food Safety and Public Health

The Company is subject to risks 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. Any event related to these matters has the potential to adversely affect the Company's reputation and its financial performance.

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 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 ability of these procedures to address such events is dependent on their successful execution. The existence of these procedures does not mean that the Company will in all circumstances be able to mitigate these risks.

The Company strives to ensure its brands and Loblaw's control label products meet all applicable regulatory requirements including having nutritional labelling so that today's health conscious consumer can make informed choices.

Labour

A significant portion of the Company's workforce is unionized. Renegotiating collective agreements may 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 2007 as 104 collective agreements expired and 101 collective agreements were successfully negotiated which represented a combination of agreements expiring in 2007, those carried over from prior years and those negotiated early. In 2008, 101 collective agreements affecting approximately 17,000 employees will expire, with the single largest agreement covering approximately 3,100 employees. The Company will also continue to negotiate the 75 collective agreements carried over from 2005 to 2007. 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.

Franchisees

A substantial portion of Loblaw's revenues and earnings come from amounts paid by franchisees. Franchisees are independent businesses and, as a result, their operations may be negatively affected by factors beyond the Company's control, which in turn may damage the Company's reputation and potentially affect revenues and earnings. Revenues and earnings would also be negatively affected and the Company's reputation could be harmed if a significant number of franchisees were to: experience operational failures, including health and safety exposures; experience financial difficulty; be unwilling or unable to pay Loblaw for products, rent or other fees; or fail to enter into renewals of franchise agreements. The Company's franchise system is also subject to franchise laws and regulations enacted by a number of provinces. Any new legislation or failure to comply with existing legislation may negatively affect operations, and could add administrative costs and burdens associated with these regulations, all of which could affect the Company's relationship with its franchisees.

Commodity Prices

Weston Foods costs 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 economic effect of these price fluctuations, Weston Foods hedges a portion of its anticipated raw material purchases. As at year end 2007, Weston Foods had entered into commodity future contracts that mitigate the economic impact of price fluctuations on some commodities for approximately 6 months, on average, into 2008.

However, in 2007 and 2006, the prices of many of these commodities increased at unprecedented rates. There can be no assurance that the Company's hedging arrangements will continue to minimize the short term economic impact on the Company's financial results, particularly if commodity prices continue to be volatile.

Employee Future Benefit Contributions

The Company's funded defined benefit pension plans are currently adequately funded and returns on defined benefit pension plan assets are in line with expectations; however, 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 funded defined benefit pension plans in excess of those currently contemplated, which in turn could have a negative effect on the Company's financial performance.

During 2007, the Company contributed \$88 million (2006 – \$125 million) to its funded defined benefit pension plans. During 2008, the Company expects to contribute approximately \$86 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 2008 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% (2006 – 41%) 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; however, poor performance of these plans could have an adverse impact on the Company's employees and former employees who are members of these plans. Pension cost for these plans is recognized as contributions are due.

Management's Discussion and Analysis

During the first quarter of 2007, Weston and Loblaw were two of 17 defendants served with an action brought in the Superior Court of Ontario by certain beneficiaries of a multi-employer pension plan in which employees of Loblaw and those of its independent franchisees participate. 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 and are seeking, among other demands, damages of \$1 billion. The action is framed as a representative action on behalf of all beneficiaries of the multi-employer pension plan. The Company has received notice from counsel for the plaintiffs indicating that he has received instructions from his client to discontinue the action against the employers including the Company. The action against the trustees is ongoing and one of the trustees, an officer of Loblaw, may be entitled to indemnification from Loblaw.

Third-Party Providers

Certain aspects of the Company's business are significantly affected by third-party providers. 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 are manufactured under contract by third-party vendors. To preserve the brands' equity, these vendors are held to high standards of quality but there is no assurance that these standards will be achieved. The Company also uses third-party logistic services including those in connection with a dedicated warehouse and distribution centre in Pickering, Ontario, a planned warehouse and distribution centre in Ajax, Ontario, and third-party common carriers. Any disruption in these services could interrupt the flow of goods 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 a portion of credit and fraud for the *President's Choice Financial MasterCard*®. To minimize operating risk, *PC Bank* and Loblaw actively manage and monitor their relationship with all third-party 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.

Excess Inventory

It is possible that certain of Loblaw's general 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.

Real Estate

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 enabling it to introduce new departments and services that could be precluded under third-party operating leases. At year end 2007, Loblaw owned 73% (2006 – 72%) of its corporate store square footage and owned 46% (2006 – 45%) of its franchise 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.

Employee Development and Retention

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

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 programs to attract the appropriate calibre of employees in a very competitive environment, but there is no certainty that these programs will continue to be effective.

Utility and Fuel Prices

The Company is a significant consumer of electricity, other utilities and fuel. The Company has entered into contracts to fix the price of a portion of its future variable costs associated with electricity and natural gas, and financial contracts to fix a portion of variable costs associated with heating oil requirements for 2008. Despite these arrangements, unanticipated cost increases in these items could negatively affect the Company's financial performance.

Environmental, Health and Safety

Adverse environmental and health and safety events could negatively affect the Company's reputation and financial performance. 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

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, comprised of senior management, which monitors compliance with the Code of Business Conduct and determines how the Company can best ensure it is conducting its business in an ethical manner. The Company encourages reporting of unethical conduct and has established a toll-free anonymous response line, which can be used by employees to report suspected accounting, internal control or auditing irregularities and unethical behaviour impacting the Company. 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. Any failure of the Company or its vendors to adhere to these policies, the law or ethical business practices could significantly affect the Company's reputation and brands and could, therefore, negatively impact the Company's financial performance.

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.

The Company is subject to various laws regarding the protection of personal information and has adopted a Privacy Code setting out guidelines for the handling of personal information. Any failure of the Company to comply with these laws may result in damage to its reputation and negatively affect financial performance.

Management's Discussion and Analysis

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.

Insurance

The Company attempts to limit its exposure to certain risks 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. 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. These programs do not guarantee that any given risk will be mitigated in all circumstances.

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.