

7. RESULTS OF REPORTABLE OPERATING SEGMENTS

The following discussion provides details of the 2007 results of operations of each of the Company's reportable operating segments.

7.1 WESTON FOODS OPERATING RESULTS

(\$ millions except where otherwise indicated)	2007	2006	Change
Sales	\$ 4,296	\$ 4,350	(1.2)%
Operating income	\$ 366	\$ 256	43.0%
Operating margin	8.5%	5.9%	
Adjusted operating income ⁽¹⁾	\$ 382	\$ 325	17.5%
Adjusted operating margin ⁽¹⁾	8.9%	7.5%	
Adjusted EBITDA ⁽¹⁾	\$ 498	\$ 440	13.2%
Adjusted EBITDA margin ⁽¹⁾	11.6%	10.1%	
Return on average total assets ⁽¹⁾	9.9%	6.6%	

(1) See Non-GAAP Financial Measures beginning on page 55.

Adjusted Operating Income and EBITDA⁽¹⁾

(\$ millions)	2007	2006
Operating income	\$ 366	\$ 256
Add impact of the following:		
Restructuring and other charges	5	46
Net effect of stock-based compensation and the associated equity derivatives	37	23
Commodity futures fair value adjustment	(19)	
Curtailement of post-retirement plan	(7)	
Adjusted operating income ⁽¹⁾	382	325
Add impact of the following:		
Depreciation and amortization	116	115
Adjusted EBITDA ⁽¹⁾	\$ 498	\$ 440

(1) See Non-GAAP Financial Measures beginning on page 55.

Approximately 86% of Weston Foods 2007 sales were generated by the North American baking divisions, with the remaining sales in the Canadian dairy division.

Sales and operating income in 2007 were impacted by the following trends:

- 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 in 2007. Weston Foods has responded to these trends with innovative and expanded products across its product portfolio resulting in new sales growth as well as improved operating margins. These trends are expected to continue into 2008 and Weston Foods is well positioned to participate in this growth with its strong portfolio of on-trend offerings under its *Thomas'*, *Arnold*, *Wonder*, *Country Harvest* and *Neilson* brands, as well as continued support of the licensed brand, *Weight Watchers*®.
- The continuing shift in consumer food shopping patterns toward alternate format retail channels rather than traditional, conventional supermarket formats resulted in sales growth with alternate format retailers, specifically mass merchandisers. Weston Foods continues to focus on ensuring its products are well aligned to serve all its customers' needs.
- Price increases in key product categories combined with a shift in sales mix to higher margin products had a positive impact on both sales and operating income. Continued efforts to focus on identifying and supporting key core brands and higher margin offerings contributed to the positive change in mix.

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- Inflationary cost pressures related to certain ingredients continued and accelerated in 2007.
- The continued focus on productivity and cost reduction contributed to the growth in operating income.
- The negative impact of translating United States dollar denominated sales and operating income resulted in negative sales growth and constrained operating income growth.

A detailed discussion on how these trends and other factors impacted sales and operating income in 2007 is set out below.

Sales

Weston Foods sales for 2007 of \$4.3 billion decreased 1.2% compared to 2006. Foreign currency translation negatively impacted reported sales growth by approximately 3.4%. Price increases across key product categories combined with changes in sales mix increased sales by 3.5% for 2007. Overall volume decreased 1.3% for 2007 and was negatively impacted by approximately 0.7% due to the combined effect of 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. The remaining volume decline of 0.6% for the year was due to growth in certain higher margin categories being more than offset by declines in other categories.

The following sales analysis excludes the impact of foreign currency translation.

Fresh bakery sales, principally bread, rolls, English muffins and bagels, increased approximately 4.5% in 2007 compared to 2006 and represented approximately 51% of total Weston Foods sales in both 2007 and 2006. Sales growth was driven by price increases in key product categories combined with changes in sales mix. Branded volume increases in the *Arnold* and *Thomas'* brands in the United States and the *D'Italiano* brand in Canada were more than offset by volume declines in other categories particularly in food service and private label products. Sales growth in whole grain and whole wheat products exceeded the sales growth of white flour based products. The introduction of new and expanded product offerings contributed positively to branded sales growth in 2007, including:

- *Thomas'* Mini Squares Bagelbread, which combines traditional bagel flavour with the softness of bread in a portion-controlled serving size;
- *Thomas'* 100 Calorie English Muffin; and
- the *Wonder+* line expansion into new categories, all of which offer the same *Wonder* taste with the goodness of whole wheat.

Fresh-baked sweet goods sales, primarily sold under the *Entenmann's* brand, decreased approximately 0.8% in 2007 compared to 2006 and represented approximately 13% of total Weston Foods sales, down from approximately 14% in 2006. The sales decline for this category in 2007 was due to lower volumes driven by softness in full size categories that was partially offset by growth in the hand-held category and the introduction of new and expanded products, such as the *Entenmann's* 100 Calorie *Little Bites*.

Frozen bakery sales, principally bread, rolls, bagels, English muffins and sweet goods, increased approximately 3.8% in 2007 compared to 2006 and represented approximately 15% of total Weston Foods sales, up from approximately 14% in 2006. Sales growth for this category in 2007 was due to price increases combined with changes in sales mix. Volumes for the year were flat, as volume gains were offset by the decline in volumes caused by the exit from the United States frozen foodservice bagel business early in the third quarter of 2006.

Dairy and bottled beverage sales increased approximately 3.6% in 2007 compared to 2006 and represented approximately 14% of total Weston Foods sales, up from approximately 13% in 2006. Sales growth for this category in 2007 was driven mainly by pricing, volume gains and the improvement in sales mix as growth continued to be experienced in a number of key categories, particularly value-added and flavoured milk products. Strong growth in aseptically bottled products was achieved in 2007 with the expansion of products offered under *The Ultimate* line by *Neilson*.

Biscuit sales, principally wafers, ice-cream cones, cookies and crackers, decreased approximately 11.0% in 2007 compared to 2006 and represented approximately 7% of total Weston Foods sales, down from approximately 8% in 2006. The sales decline for this category in 2007 was due to lower sales volume in certain categories and 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

Weston Foods operating income increased \$110 million, or 43.0%, to \$366 million from \$256 million in 2006 and was impacted by lower restructuring and other charges, higher net stock-based compensation and non-cash income items.

In 2007, Weston Foods recognized the following in operating income:

- a charge of \$37 million (2006 – \$23 million) for the net effect of stock-based compensation and the associated equity derivatives;
- income of \$19 million (2006 – nil) related to the commodity futures fair value adjustment;
- a charge of \$5 million (2006 – \$46 million) related to restructuring and other charges; and
- income of \$7 million (2006 – nil) related to the curtailment of a post-retirement plan.

Weston Foods is exposed to price fluctuations primarily as a result of anticipated purchases of certain raw materials, fuels and utilities. In accordance with the Company's risk management strategy, Weston Foods enters into commodity futures to reduce the impact of price fluctuations in a specified percentage of forecasted raw material purchases over a specified period of time. These commodity futures are not acquired for trading or speculative purposes. These futures are not designated as cash flow hedges of anticipated future raw material purchases, therefore hedge accounting does not apply. Accordingly, the changes in fair value of these futures are recorded in operating income. During 2007, Weston Foods recorded in operating income a non-cash gain of \$19 million (2006 – nil) related to the fair value adjustment of exchange traded futures that were not designated within a hedging relationship. Regardless of designation for accounting, these futures had the economic impact of largely mitigating the associated risks arising from price fluctuations in the underlying commodities.

During 2007, the amendment of a post-retirement benefit plan resulted in a significant reduction in the number of future years of service, thereby triggering a curtailment. Accordingly, a \$7 million pro rata portion of the unamortized past service gain from a previous plan amendment was recognized as a curtailment gain in 2007. A detailed discussion of the impact of restructuring and other charges is set forth in the Restructuring and Other Charges section below.

After adjusting for the above-noted items, adjusted operating income⁽¹⁾ for 2007 was \$382 million, an increase of 17.5% from \$325 million in 2006. Adjusted operating margin⁽¹⁾ and adjusted EBITDA margin⁽¹⁾ for 2007 were 8.9% and 11.6%, respectively (2006 – 7.5% and 10.1%). In addition, foreign currency translation negatively impacted 2007 adjusted operating income⁽¹⁾ growth by approximately 4.3 percentage points.

Weston Foods 2007 adjusted operating income⁽¹⁾ was positively impacted by sales growth, primarily due to price increases combined with changes in sales mix, and the benefits realized from the continued focus on cost reduction initiatives, including restructuring activities and reduced product returns. Pricing and other actions mitigated the impact of inflationary cost pressures related to certain ingredients, primarily flour, oils and sugar. For the year, lower plant and distribution costs were partially offset by an increased investment in marketing initiatives. Gross margin and adjusted operating margin⁽¹⁾ both improved as a result of the factors described above.

During 2007, a reduction in insurance reserves, relating primarily to workers' compensation benefits in the United States, resulted in a benefit of \$8 million and was recorded in operating income. This benefit was largely a result of favourable experience in workers' compensation claims and an increased focus on workplace safety programs.

Profitability in the United States fresh-baked sweet goods category declined in 2007 and remained a challenge as a result of changing consumer eating and shopping preferences and a high fixed cost manufacturing and distribution structure. Weston Foods is addressing these challenges with the previously announced downsizing of its fresh-baked goods facility in Bay Shore, New York, which is expected to be complete by the third quarter of 2008.

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, are nearing completion or have been completed. Individual actions will be initiated as plans are finalized and approved. A further discussion of these activities is included in the Restructuring and Other Charges section below.

(1) See Non-GAAP Financial Measures beginning on page 55.

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Restructuring and Other Charges

The following table summarizes the restructuring and other charges by plan for 2007 and 2006:

(\$ millions)	Employee Termination Benefits and Site Closing and Other Exit Costs	Fixed Asset Impairment and Accelerated Depreciation	(Gain) Loss on Sale of Fixed Assets	Total
Costs recognized in 2007:				
Manufacturing asset restructuring:				
Biscuit operations	\$ 2		\$ (6)	\$ (4)
Ice-cream cone operations			(9)	(9)
Fresh bakery operations	1	\$ 6		7
Frozen bagel operations			1	1
	3	6	(14)	(5)
Distribution network restructuring	7			7
Administrative restructuring and consolidation of offices	3			3
Total costs recognized in 2007	\$ 13	\$ 6	\$ (14)	\$ 5
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

Manufacturing Asset Restructuring

During 2007, Weston Foods approved the following manufacturing asset restructuring activities:

- Weston Foods approved and completed a plan to transfer two manufacturing lines for certain private label English muffins in the United States to third-party producers or other Weston Foods manufacturing lines already in place. As a result of this decision, Weston Foods recognized \$2 million of accelerated depreciation during 2007.
- Weston Foods approved and completed a plan to exit certain bread and roll manufacturing lines in the Southeastern 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 recognized \$4 million of accelerated depreciation and \$1 million of employee termination benefits and other exit related costs during 2007.

During 2006, Weston Foods approved a plan to close a frozen bagel plant in Nebraska, which was completed in that year. As a result of this restructuring, Weston Foods recognized total accelerated depreciation of \$5 million and \$2 million of employee termination benefits and other exit related costs during 2006. During 2007, Weston Foods completed the sale of this facility for proceeds of \$1 million and recognized a loss on sale of fixed assets of \$1 million.

During 2006, Weston Foods approved a plan to close an ice-cream cone baking facility in Los Angeles, California and transfer the production to other existing Weston Foods facilities. This restructuring was completed in the first quarter of 2007. As a result of this restructuring, Weston Foods recognized total accelerated depreciation of \$3 million and \$2 million of employee termination benefits and other exit related costs during 2006. During 2007, Weston Foods completed the sale of this facility for proceeds of \$11 million and recognized a gain on sale of fixed assets of \$9 million.

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 sales of these two facilities were completed in 2005. All manufacturing activities ceased in the Elizabeth, New Jersey and Richmond, Virginia facilities by the end of 2006. During 2007, Weston Foods vacated the Elizabeth, New Jersey facility in accordance with the terms and conditions of the sale lease-back arrangement and accordingly, recognized the previously deferred gain on the sale of fixed assets of \$6 million. In addition, during 2007, Weston Foods recognized nil (2006 – \$6 million) of accelerated depreciation and \$2 million (2006 – \$10 million) of employee termination benefits and other exit related costs. By the end of 2007, total charges of \$21 million of accelerated depreciation and \$40 million of employee termination benefits and other exit related costs had been recognized on a cumulative basis related to this restructuring plan, which is now complete.

Additional activities during 2006 included:

- During 2006, Weston Foods approved a restructuring plan to downsize 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 recognized a total fixed asset impairment charge of \$4 million and a total charge of \$5 million for employee termination benefits and other exit related costs during 2006.
- During 2006, Weston Foods approved and completed a plan to close a fresh bakery manufacturing facility in Quebec. During 2006, Weston Foods recognized \$1 million of accelerated depreciation and \$1 million of employee termination benefits and other exit related costs.

Distribution Network Restructuring

During 2007, Weston Foods approved the following distribution network restructuring activities:

- Weston Foods approved plans to restructure its Ontario frozen bakery distribution operations, to further restructure its Quebec fresh bakery distribution operations and to restructure the dairy distribution network. These plans involve the closure and/or consolidation of certain warehouses, outsourcing certain warehousing and distribution functions to third-party warehousing service providers and certain route restructurings. As a result of these restructuring plans, Weston Foods recognized \$3 million of employee termination benefits and other exit related costs during 2007 and expects to record an additional \$1 million related to other exit costs in 2008 when these plans are expected to be substantially completed.
- Weston Foods also approved a restructuring plan to exit and transfer certain distribution and transportation activities in the mid-Western United States to third-party logistic providers which is expected to be completed by the end of the second quarter of 2008. As a result of this plan, Weston Foods recognized \$2 million of employee termination benefits during 2007.

During 2006, Weston Foods approved a plan to restructure a portion of its distribution network in Quebec. During 2007, Weston Foods recognized \$2 million (2006 – \$6 million) of employee termination benefits and other exit related costs pursuant to this plan which is expected to be substantially completed in 2008.

Administrative Restructuring and Consolidation of Offices

During 2007, Weston Foods approved plans to consolidate, relocate and restructure certain sales and administrative functions in the United States. These plans will be completed by the second quarter of 2008. As a result of this decision, Weston Foods recognized \$3 million of employee termination benefits and other exit related costs during 2007 and no additional restructuring and other charges are anticipated.

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.

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

In 2008, Weston Foods anticipates challenging market conditions as unprecedented increases for ingredient and other input costs are expected. Weston Foods plans to offset these higher input costs by ongoing cost reduction initiatives and pricing as necessary.

This outlook should be read in conjunction with the Forward-Looking Statements section of the MD&A on page 5.

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7.2 LOBLAW OPERATING RESULTS

(\$ millions except where otherwise indicated)	2007	2006	Change
Sales	\$ 29,384	\$ 28,640	2.6%
Sales excluding the impact of tobacco sales and VIEs ⁽¹⁾	\$ 27,915	\$ 26,834	4.0%
Operating income	\$ 728	\$ 281	159.1%
Operating margin	2.5%	1.0%	
Adjusted operating income ⁽¹⁾	\$ 1,026	\$ 1,318	(22.2)%
Adjusted operating margin ⁽¹⁾	3.7%	4.9%	
Adjusted EBITDA ⁽¹⁾	\$ 1,581	\$ 1,884	(16.1)%
Adjusted EBITDA margin ⁽¹⁾	5.7%	7.0%	
Return on average total assets ⁽¹⁾	5.7%	2.2%	

(1) See Non-GAAP Financial Measures beginning on page 55.

Sales and Sales Growth Excluding the Impact of Tobacco Sales and VIEs⁽¹⁾

(\$ millions except where otherwise indicated)	2007	2006
Total sales	\$ 29,384	\$ 28,640
Less: Sales attributable to tobacco sales	1,013	1,423
Sales attributable to the consolidation of VIEs ⁽¹⁾	456	383
Sales excluding the impact of tobacco sales and VIEs ⁽¹⁾	\$ 27,915	\$ 26,834
Total sales growth	2.6%	3.7%
Less: Impact on sales growth attributable to tobacco sales	(1.7)%	(1.2)%
Impact on sales growth attributable to the consolidation of VIEs	0.3%	(0.1)%
Sales growth excluding the impact of tobacco sales and VIEs ⁽¹⁾	4.0%	5.0%
Same-store sales growth	2.4%	0.8%
Same-store sales growth excluding the impact of decreased tobacco sales ⁽¹⁾	3.4%	2.0%

(1) See Non-GAAP Financial Measures beginning on page 55.

Adjusted Operating Income and EBITDA⁽¹⁾

(\$ millions)	2007	2006
Operating income	\$ 728	\$ 281
Add (deduct) impact of the following:		
Restructuring and other charges	222	44
Net effect of stock-based compensation and the associated equity forwards	72	37
Inventory liquidation	15	68
VIEs	(11)	(8)
Goodwill impairment charge		800
Ontario collective labour agreement		84
Departure entitlement charge		12
Adjusted operating income ⁽¹⁾	1,026	1,318
Add (deduct) impact of the following:		
Depreciation and amortization	588	590
VIE depreciation and amortization	(33)	(24)
Adjusted EBITDA ⁽¹⁾	\$ 1,581	\$ 1,884

(1) See Non-GAAP Financial Measures beginning on page 55.

Sales

Full year sales for 2007 increased \$744 million, or 2.6%, to \$29.4 billion compared to \$28.6 billion in 2006. Total sales excluding the impact of tobacco sales and VIEs⁽¹⁾ increased by \$1.1 billion or 4.0% over 2006. The following factors further explain the major components in the change in sales over the prior year:

- same-store sales growth excluding the impact of decreased tobacco sales⁽¹⁾ increased 3.4% (2006 – 2.0%). In the third quarter of 2006, a major tobacco supplier commenced shipping directly to certain customers of Loblaw's Cash & Carry and wholesale club network, adversely impacting sales. This loss of sales affects comparisons to 2006 for the first three quarters of 2007;
- same-store sales growth by format in 2007 for Superstore, Hard Discount and Great Food were 3.8%, 4.6% and 0.4%, respectively, compared to 2006. The pricing investments in 2007 were targeted primarily within the Superstore and Hard Discount formats;
- national food price inflation as measured by "The Consumer Price Index for Food Purchased from Stores" ("CPI") in 2007 was 2.7% (2006 – 2.3%). Loblaw's analysis indicates that its internal retail food price inflation for 2007 was approximately 1.3% compared to 2006;
- positive volume growth based on retail units sold in 2007 of 1.9% (2006 – 1.6%); and
- 34 (2006 – 37) new corporate and franchised stores were opened and 79 (2006 – 33) stores were closed, including 46 stores that were closed as part of a previously announced store operations restructuring plan, and stores which underwent conversions and major expansions. Net retail square footage decreased 0.1 million square feet (2006 – increased 1.2 million square feet), or (0.2)%, in 2007 from year end 2006.

Sales of control label products for 2007 amounted to \$6.6 billion compared to \$6.2 billion in 2006. Control label penetration, which is measured as control label retail sales as a percentage of total retail sales, was 24.0% for 2007, compared to 22.9% for 2006. Loblaw introduced over 600 new control label products in 2007, plus 800 new home products. Loblaw's control label program, which includes *President's Choice*, *PC*, *President's Choice Organics*, *Blue Menu*, *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 will be focusing on the following initiatives, coupled with continued focus on value-for-money, promotions and advertising where appropriate:

- 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 distinctive environments in each retail format;
- refining three distinctive retail formats: Superstore, Great Food and Hard Discount;
- increasing the number of stores carrying the *Joe Fresh Style* brand apparel offering;
- emphasizing a fresh first focus by raising presentation and quality standards; and
- investing in employees and providing training to encourage meeting customer needs.

Operating Income

Operating income of \$728 million for 2007 increased by \$447 million or 159.1% compared to \$281 million in 2006 resulting in an increase in operating margin to 2.5% in 2007 from 1.0% in 2006.

Operating income in both 2007 and 2006 was affected by a number of specific items as outlined below:

- a charge of \$197 million (2006 – nil) related to Project Simplify involving restructuring and streamlining of merchandising and store operations. Costs were comprised of \$139 million for employee termination benefits including severance, additional pension costs resulting from the termination of employees and retention costs; and \$58 million of other costs, primarily consulting. Total restructuring costs under this plan, comprised primarily of severance costs, are now anticipated to be approximately \$200 million with the remaining costs to be expensed in 2008;
- a charge of \$9 million (2006 – \$8 million) in connection with the previously announced plan to restructure Loblaw's supply chain network;
- a charge of \$16 million (2006 – \$35 million) in connection with the previously announced closure of certain stores in the Quebec and Atlantic markets and in the wholesale network that were part of store operations restructuring activities;

(1) See Non-GAAP Financial Measures beginning on page 55.

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- a charge of \$72 million (2006 – \$37 million) for the net effect of stock-based compensation and the associated equity forwards. The majority of the expense in 2007 included a non-cash loss on equity forwards of \$67 million (2006 – \$32 million) resulting from a decline in Loblaw's share price during the year;
- a charge of \$15 million (2006 – \$68 million) for the liquidation of general merchandise inventory;
- income of \$11 million (2006 – \$8 million) resulting from the consolidation of VIEs;
- nil (2006 – charge of \$1 million) related to the head office move and reorganization of the operation support functions;
- nil (2006 – charge of \$800 million) for a non-cash goodwill impairment charge related to the goodwill established on the acquisition of Provigo Inc. in 1998;
- nil (2006 – charge of \$84 million) related to the ratification of a new four-year collective agreement with members of certain Ontario locals of the UFCW; and
- nil (2006 – charge of \$12 million) related to a departure entitlement charge.

In 2007, restructuring and other charges of \$222 million (2006 – \$44 million) were recorded within operating income. A summary of restructuring and other charges is included in the table for the years indicated below:

(\$ millions)	Costs Recognized 2007	Costs Recognized 2006	Costs Recognized 2005	Total Expected Costs	Total Expected Costs Remaining
Project Simplify	\$ 197			\$ 200	\$ 3
Store operations	16	\$ 35		51	
Supply chain network	9	8	\$ 62	90	11
Office move and reorganization of the operation support functions		1	24	25	
Total restructuring and other charges	\$ 222	\$ 44	\$ 86	\$ 366	\$ 14

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

After adjusting for the above-noted items, adjusted operating income⁽¹⁾ for 2007 decreased by \$292 million, or 22.2%, to \$1,026 million compared to \$1,318 million in 2006. Adjusted operating margin⁽¹⁾ decreased to 3.7% in 2007 compared to 4.9% in 2006 as growth in operating expenses exceeded growth in sales. Adjusted EBITDA margin⁽¹⁾ decreased to 5.7% from 7.0% in 2006.

In addition, the 2007 adjusted operating income⁽¹⁾ was influenced by the following items:

- incremental consulting costs compared to the prior year, other than those in connection with Project Simplify, amounted to \$75 million including expenses related to new supply chain and information technology improvement initiatives of \$16 million;
- pharmacy-related operating income was reduced by \$25 million due to legislative changes introduced in 2006 by the Ontario government;
- adjustments in estimates related to post-employment and long term disability benefits and deferred product development and information technology costs reduced operating income by \$24 million;
- costs associated with the change in Loblaw's executive bonus plan were \$11 million;
- a gain of \$11 million from the sale of an office building in Calgary, Alberta;
- an incremental non-cash fixed asset impairment charge of \$6 million related to asset carrying values in excess of fair values at specific store locations. The 2007 charge was \$33 million compared to \$27 million in 2006; and
- a decline in the gross margin, primarily due to targeted price reductions to provide value to customers and changes in sales mix partially offset by improvements in shrink.

Loblaw's sales volumes have been positively responding to its investments in lower prices to give value to its customers. Loblaw expects this to continue in 2008. Investments in price will also continue. However, Loblaw expects that cost reductions in 2008 will help to support its profitability. Sales, margins and profitability in the first half of 2008 in relation to 2007 may be affected by more difficult comparables.

(1) See Non-GAAP Financial Measures beginning on page 55.