6. OVERALL FINANCIAL PERFORMANCE

6.1 NEW BUSINESS DEVELOPMENTS

Two significant business developments occurred in the Weston Foods operating segment during 2008: the sale of the Canadian dairy and bottling operations and the announcement of an agreement to sell the U.S. fresh bakery business.

Sale of Canadian Dairy and Bottling Operations

On December 1, 2008, Weston Foods closed the previously announced sale of its Canadian dairy and bottling operations to Saputo Inc. resulting in a pre-tax gain of $335 million ($281 million, net of tax). The results of the dairy and bottling operations are not reported as discontinued operations because of Loblaw's continuing purchases of product from the dairy and bottling operations. Therefore, the results of the dairy and bottling operations up to the date of sale, as well as the gain on sale, are included in net earnings from continuing operations.

Sale of U.S. Fresh Bakery Business

Dunedin Holdings S.à r.l., a subsidiary of GWL, announced on December 10, 2008 an agreement to sell its U.S. fresh bakery business to Grupo Bimbo, S.A.B. de C.V. for gross and net proceeds of approximately USD $2.5 billion, including approximately USD $125 million for interest bearing assets. The sale transaction was completed subsequent to the end of 2008. The results of the U.S. fresh bakery business have been reflected separately as discontinued operations in the current and comparative results, and accordingly all comparisons of operating results exclude the results of the U.S. fresh bakery business. The Company expects to recognize a gain on the sale of this business in discontinued operations in the first quarter of 2009 of approximately USD $800 million, which is subject to normal post closing working capital and other adjustments. In addition, the Company expects to recognize a portion of the cumulative foreign currency translation loss currently reflected in shareholders' equity associated with the U.S. net investment in net earnings in the first quarter of 2009.

After the closing of the U.S. fresh bakery transaction in 2009, Dunedin Holdings S.à r.l. converted USD $2.4 billion of its cash and short term investments to approximately $3.0 billion Canadian dollars. The Company will recognize a foreign exchange loss of approximately $50 million associated with this conversion in net earnings in the first quarter of 2009 due to the strengthening of the Canadian dollar relative to the U.S. dollar between the closing date and the dates on which the proceeds were converted to Canadian dollars. In addition, the future net earnings of the Company will reflect translation gains and losses associated with approximately USD $1.1 billion of cash and short term investments.

Weston Foods reorganized its remaining operations subsequent to the disposition of the U.S. fresh bakery business. The reorganization changed the composition of Weston Foods' reporting units for the purpose of goodwill impairment testing. As a result of this change, Weston Foods expects to record a write-down of a portion of the remaining goodwill related to the biscuits, cookies, cones and wafers business in an amount of up to USD $60 million in the first quarter of 2009.

6.2 CONSOLIDATED RESULTS OF OPERATIONS(1)

($ millions except where otherwise indicated)	**2008**	2007	2006
Sales	**$ 32,088**	$ 30,607	$ 29,915
Operating income	**$ 1,192**	$ 875	$ 376
Gain on disposal of business	**$ 335**		
Interest expense and other financing charges	**$ 360**	$ 175	$ 263
Net earnings (loss) from continuing operations	**$ 645**	$ 374	$ (47)
Net earnings	**$ 832**	$ 563	$ 121
Basic net earnings (loss) per common share from continuing operations ($)	**$ 4.63**	$ 2.46	$ (0.78)
Basic net earnings per common share ($)	**$ 6.08**	$ 3.92	$ 0.52
EBITDA(2)	**$ 1,837**	$ 1,525	$ 1,047
EBITDA margin(2)	**5.7%**	5.0%	3.5%

(1) Results of Weston Foods' U.S. fresh bakery business have been reclassified as discontinued operations.

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

Consolidated 2008 results reflect the impact of transformational changes undertaken by both the Weston Foods and Loblaw operating segments in order to position the businesses for strong growth in the future.

In 2008, the Weston Foods operating segment achieved improved financial results from its continuing operations despite challenging market conditions. Inflationary commodity cost pressures continued in 2008 and consumer eating preferences and food shopping patterns continued to evolve. Industry price increases mitigated higher commodity costs, and cost and productivity improvements and growth in higher margin products resulted in positive earnings growth for the Weston Foods operating segment.

Loblaw's financial results for 2008 continued to edge forward, reflecting the benefits of its turnaround efforts. In 2007, the restructuring initiatives were completed, which has permitted Loblaw to make good progress in 2008 towards achieving its goal of conducting business as a centralized, national organization.

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

In 2008, which was a 53-week fiscal year, consolidated sales increased 4.8% to $32.1 billion from $30.6 billion in 2007, which was a 52-week fiscal year. In 2007, consolidated sales increased 2.3% from $29.9 billion in 2006. In 2008, consolidated net earnings from continuing operations increased $271 million to $645 million from $374 million in 2007 mainly due to the pre-tax gain of $335 million ($281 million, net of tax) on the disposal of Weston Foods' dairy and bottling operations. Consolidated net earnings increased $269 million to $832 million in 2008 from $563 million in 2007. In 2007, consolidated net earnings from continuing operations increased $421 million to $374 million from a net loss of $47 million in 2006. Consolidated net earnings increased $442 million to $563 million in 2007 from $121 million in 2006 primarily due to the inclusion in 2006 of a non-cash Loblaw goodwill impairment charge related to the goodwill established on the Loblaw acquisition of Provigo Inc. in 1998.

The 2008 basic net earnings per common share from continuing operations of $4.63 increased 88.2%, in line with the increase in consolidated net earnings from continuing operations, when compared to $2.46 in 2007. The 2008 basic net earnings per common share of $6.08 increased 55.1% when compared to $3.92 in 2007.

The Company's consolidated financial statements are expressed in Canadian dollars, however a portion of its Weston Foods business is 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 reported 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 United States dollar denominated transactions and the U.S. net investment into Canadian dollars. In 2008 and 2007, the impact of changes in the Canadian dollar relative to the United States dollar on sales and net earnings from continuing operations growth was minimal. Due to the weakening of the Canadian dollar relative to the United States dollar from year end 2007, the value of the Company's net assets at year end 2008 was positively impacted as a result of foreign currency translation. At year end 2007, due to the strengthening of the Canadian dollar relative to the United States dollar from year end 2006, the value of the Company's net assets was negatively impacted as a result of foreign currency translation.

Over the past two years, Weston Foods operated in a challenging marketplace, impacted by changing consumer eating preferences and food shopping patterns as well as inflationary cost pressures. Product rationalization and the planned exit of certain products have negatively impacted volume and sales. Additional factors affecting results over this two-year period include:

- changing consumer eating preferences, including a focus on health and diet, challenged Weston Foods sales growth of certain traditional products, primarily white bread. These challenges were largely offset by growth in the whole grain, whole wheat and higher-priced premium product categories, as well as the development and introduction of new and expanded health related product offerings, enhanced whole grain and whole wheat offerings, and Omega-3, no cholesterol, reduced fat and no trans fat products;
- consumer shopping patterns continue to shift toward alternate format retail channels over traditional, conventional supermarket formats. Weston Foods has penetrated these alternate channels while retaining its strong position in conventional supermarket formats; and
- inflationary cost pressures particularly for wheat, oils and fuel continued and have been volatile over the period. Weston Foods achieved sales price increases across many of its product categories, which helped to offset the impact of this cost inflation.

Management's Discussion and Analysis

Over the past two years, Weston Foods increased investment behind its brands, continued to introduce new products geared towards changing consumer eating preferences, and invested capital to support growth and enhance quality and productivity. These investments, coupled with a continued focus on cost improvements, customer service and growth in higher margin product offerings, resulted in strong financial performance.

In 2008, Loblaw continued to refine and simplify its processes and systems, initiated several innovation efforts and made measured progress on key growth opportunities. Some of Loblaw's key accomplishments in 2008 include:

- continued to improve price position by format and effectively embed pricing index management in the organization;
- leveraged national scale to negotiate cost of goods sold and goods not for resale reductions to offset planned margin investment;
- successfully piloted a food renewal and enhanced customer service program in 18 "Back to Best" Ontario great food stores;
- enhanced local merchandising focus by appointing a small number of local market merchants;
- initiated the revitalization and redesign of *President's Choice* and *no name* control label brands;
- commenced the western Canada store refurbishment program;
- continued to embed the new store operations model across the country to improve shrink, labour, store expenses and availability;
- progressed in efforts to rebuild supply chain and information technology infrastructure; and
- completed three key management changes, appointing a new President, Chief Merchandising Officer and a new Chief Financial Officer.

2007 marked the introduction of Loblaw's three to five year turnaround plan based on Simplify, Innovate and Grow. There were challenges, as would be expected, with an organizational change of such magnitude, but Loblaw made good progress in 2007. Net earnings in 2007 were pressured by Loblaw's investment in lower retail prices and increased costs including significant expenses in restructuring and consulting.

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 2008 consolidated sales (53 weeks) increased 4.8% to $32.1 billion from $30.6 billion in 2007 (52 weeks).

Consolidated sales growth for 2008 was impacted by each reportable operating segment as follows:

- Positively by 0.4% due to the sales increase of 5.2% at Weston Foods. The results of the dairy and bottling operations and foreign currency translation negatively impacted reported sales growth by approximately 4.8% and 0.3%, respectively, while the additional week of operating results in 2008 positively impacted sales by approximately 1.6%. Price increases across key product categories combined with changes in sales mix contributed positively to sales growth by 9.9% for 2008. Volume declined 3.8% for the year and was negatively impacted by 4.0% due to the results of the dairy and bottling operations, while the additional week of operating results in 2008 positively impacted volume growth by approximately 1.4%.
- Positively by 4.6% due to the sales increase of 4.8% at Loblaw. Same-store sales increased 4.2%, including an increase in sales and same-store sales growth of 1.9% due to the extra selling week in 2008. Net retail square footage increased 0.2 million square feet or 0.5% in 2008 from year end 2007. Corporate store sales per average square foot increased to $624 in 2008 from $591 in 2007.

The Company's 2007 consolidated sales increased 2.3% to $30.6 billion from $29.9 billion in 2006. The translation of United States dollar denominated sales in the Weston Foods operating segment reduced consolidated sales growth by approximately 0.1%.

Consolidated sales growth for 2007 was impacted by each reportable operating segment as follows:

- Negatively due to the sales decrease of 0.5% at Weston Foods, which included the negative impact of foreign currency translation of approximately 1.5%. Price increases across key product categories combined with changes in sales mix increased sales by 2.8% for 2007. Overall volume decreased 1.8% for 2007 and was negatively impacted by approximately 1.1% due to the combined effect of the exit from the United States frozen food service 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 0.7% for the year was due to growth in certain higher margin categories being more than offset by declines in other categories.
- Positively by 2.5% due to the sales increase of 2.6% at Loblaw. Same-store sales increased 2.4%. Loblaw experienced sales growth in all of its regions and concentrated on driving comparable sales growth in its existing asset base. Net retail square footage decreased 0.1 million square feet or 0.2% in 2007 from year end 2006. Corporate store sales per average square foot increased to $591 in 2007 from $585 in 2006.

Operating Income

The Company's 2008 consolidated operating income increased $317 million, or 36.2%, to $1,192 million. The consolidated operating margin in 2008 was 3.7% compared to 2.9% in 2007. The Company's 2008 consolidated operating income was impacted positively by 0.8% due to an increase of 4.8% in operating income at Weston Foods, and positively by 35.4% due to an increase of 42.6% in operating income at Loblaw.

The year-over-year change in the following items influenced operating income and operating margin for 2008 compared to 2007:

- a charge of $5 million (2007 – $215 million) related to restructuring and other charges for restructuring plans undertaken by both Weston Foods and Loblaw;
- income of $2 million (2007 – a charge of $108 million) related to the effect of stock-based compensation net of equity derivatives of both GWL and Loblaw. The amount of net stock-based compensation cost recorded in operating income is mainly dependent upon the number of unexercised, vested stock options and restricted share units net of the number of common shares associated with the equity derivatives and the change in the market prices of the underlying common shares;
- a charge of $46 million (2007 – income of $9 million) related to the commodity derivatives fair value adjustment at Weston Foods. This commodity derivatives fair value adjustment includes realized and unrealized gains and losses related to future purchases of raw materials;
- income of $47 million (2007 – $48 million) related to the income of Weston Foods' dairy and bottling operations;
- income of $22 million (2007 – nil) related to the gain on the sale of Loblaw's food service business; and
- income of $7 million (2007 – nil) related to the redemption of the remaining outstanding GWL 3% Exchangeable Debentures and the sale of the Domtar (Canada) Paper Inc. shares.

Excluding the impact of these specific items, operating income for 2008 improved compared to 2007.

The Company's 2008 consolidated EBITDA margin[1] increased to 5.7% from 5.0% in 2007.

The Company's 2007 consolidated operating income increased $499 million, or 132.7%, to $875 million. The consolidated operating margin in 2007 was 2.9% compared to 1.3% in 2006. The Company's 2007 consolidated operating income was impacted positively by 13.8% due to an increase of 54.7% in operating income at Weston Foods, and positively by 118.9% due to an increase of 159.1% in operating income at Loblaw.

The year-over-year change in the following items influenced operating income and operating margin for 2007 compared to 2006:

- a charge of $215 million (2006 – $79 million) related to restructuring and other charges for restructuring plans undertaken by both Weston Foods and Loblaw;
- a charge of $108 million (2006 – $54 million) related to the effect of stock-based compensation net of equity derivatives of both GWL and Loblaw;
- income of $9 million (2006 – nil) related to the commodity derivatives fair value adjustment at Weston Foods;
- income of $48 million (2006 – $44 million) related to the income of Weston Foods' dairy and bottling operations;
- nil (2006 – a charge of $800 million) related to the non-cash Loblaw goodwill impairment charge;
- nil (2006 – a charge of $84 million) related to the Ontario collective labour agreement at Loblaw; and
- nil (2006 – a charge of $12 million) related to a departure entitlement charge at Loblaw.

Excluding the impact of these specific items, operating income for 2007 declined compared to 2006.

The Company's 2007 consolidated EBITDA margin[1] increased to 5.0% from 3.5% in 2006.

Gain on Disposal of Business

The Company recorded a pre-tax gain of $335 million ($281 million, net of tax) on the disposal of Weston Foods' dairy and bottling operations in 2008. The effect on basic net earnings per common share for the year was income of $2.18.

Interest Expense and Other Financing Charges

Interest expense and other financing charges consist primarily of interest on short and long term debt, interest and other financing charges on financial derivative instruments and dividends on capital securities, net of interest earned on short term investments and security deposits, and interest capitalized to fixed assets.

In 2008, interest expense and other financing charges increased $185 million to $360 million from $175 million in 2007.

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

The increase was mainly due to:

- a non-cash charge of $11 million (2007 – non-cash income of $141 million) recorded in other financing charges representing the fair value adjustment of GWL's forward sale agreement for 9.6 million Loblaw common shares. See notes 5 and 27 to the consolidated financial statements for additional information;
- a decrease in net short term interest income to $13 million (2007 – $31 million), primarily due to lower interest income on United States dollar denominated cash, cash equivalents and short term investments due to lower interest rates, partially offset by lower average short term debt levels;
- dividends on capital securities of $22 million compared to nil in 2007; and
- interest on financial derivative instruments, which includes the net effect of the Company's interest rate swaps, cross currency swaps and equity derivatives, resulting in a charge of $2 million (2007 – $21 million). The change was due mainly to a decrease in United States short term interest rates.

The 2008 weighted average fixed interest rate on long term debt (excluding capital lease obligations and the Exchangeable Debentures) was 6.6% (2007 – 6.6%) and the weighted average term to maturity was 15 years (2007 – 16 years).

In 2007, interest expense and other financing charges decreased $88 million, or 33.5%, to $175 million from $263 million in 2006.

The decrease was mainly due to:

- a decrease in interest expense on long term debt of $7 million, or 1.7%, to $396 million from $403 million in 2006 primarily as a result of lower average long term debt levels;
- interest on financial derivative instruments, which includes the net effect of the Company's interest rate swaps, cross currency swaps and equity derivatives, resulting in a charge of $21 million (2006 – $15 million). The change was due mainly to an increase in United States short term interest rates and the cumulative loss transferred from other comprehensive loss and subsequent change in fair market value of the interest rate swaps previously designated as a cash flow hedge of the variable interest rate exposure on commercial paper;
- non-cash income of $141 million (2006 – $73 million) recorded in other financing charges representing the fair value adjustment of GWL's forward sale agreement for 9.6 million Loblaw common shares. See notes 5 and 27 to the consolidated financial statements for additional information; and
- an increase in net short term interest income to $31 million (2006 – $18 million) primarily due to higher interest income on United States dollar denominated cash, cash equivalents and short term investments and lower average short term debt levels partially offset by an increase in Canadian short term interest rates.

The 2007 weighted average fixed interest rate on long term debt (excluding capital lease obligations and the Exchangeable Debentures) was 6.6% (2006 – 6.6%) and the weighted average term to maturity was 16 years (2006 – 16 years).

Income Taxes

The Company's effective income tax rate decreased in 2008 to 26.0% from 28.0% in 2007. The decrease was primarily due to non-taxable amounts including capital gains, lower Canadian federal and certain provincial statutory income tax rates relative to 2007 and a change in the proportion of taxable income earned across different tax jurisdictions, which were partially offset by a charge of $11 million related to tax on unrealized foreign exchange gains on short term investments, a 2007 cumulative adjustment of future taxes pursuant to a reduction in Canadian federal and certain provincial statutory income tax rates and an increase in income tax accruals relating to certain income tax matters.

The Company's effective income tax rate decreased in 2007 to 28.0% from 214.2% in 2006. In 2006, a non-deductible Loblaw goodwill impairment charge was recorded. The effective income tax rate in 2006 before the impact of the non-deductible goodwill impairment charge was 26.5%. The 2007 effective income tax rate was impacted by the change in the proportion of taxable income earned across different tax jurisdictions and the income tax impact of the non-taxable amounts, and a $24 million net reduction to the future income tax expense 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.

Net Earnings from Continuing Operations

Net earnings from continuing operations for 2008 increased $271 million, or 72.5%, to $645 million from $374 million in 2007. Basic net earnings per common share from continuing operations for 2008 increased $2.17, or 88.2%, to $4.63 from $2.46 in 2007.

Basic net earnings per common share from continuing operations for 2008 were affected by the following factors compared to 2007:

- a $0.02 per common share charge (2007 – $0.66) related to restructuring and other charges for restructuring plans undertaken by both Weston Foods and Loblaw;
- a $0.06 per common share charge (2007 – $0.62) related to the effect of stock-based compensation net of equity derivatives of both GWL and Loblaw;
- a $0.24 per common share charge (2007 – $0.05 per common share income) related to the commodity derivatives fair value adjustment at Weston Foods;
- $0.25 per common share income (2007 – $0.25) related to the income of Weston Foods' dairy and bottling operations;
- $0.07 per common share income (2007 – nil) related to the gain on the sale of Loblaw's food service business;
- $2.18 per common share income (2007 – nil) related to the gain on disposal of Weston Foods' dairy and bottling operations;
- a $0.06 per common share non-cash charge (2007 – $0.81 per common share non-cash income) related to the accounting for GWL's forward sale agreement for 9.6 million Loblaw common shares;
- a $0.03 per common share charge (2007 – $0.05) related to the income tax effect of the fair value adjustment of the Domtar (Canada) Paper Inc. shares, net of the re-measurement of the GWL 3% Exchangeable Debentures;
- $0.04 per common share income (2007 – nil) related to the redemption of the remaining outstanding GWL 3% Exchangeable Debentures and the sale of the Domtar (Canada) Paper Inc. shares; and
- nil per common share (2007 – $0.15 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.

Net earnings from continuing operations for 2007 increased $421 million to $374 million from a net loss of $47 million in 2006. Basic net earnings per common share from continuing operations for 2007 increased $3.24 to $2.46 from a loss of $0.78 in 2006.

Basic net earnings per common share from continuing operations for 2007 were affected by the following factors compared to 2006:

- a $0.66 per common share charge (2006 – $0.31) related to restructuring and other charges for restructuring plans undertaken by both Weston Foods and Loblaw;
- a $0.62 per common share charge (2006 – $0.35) related to the effect of stock-based compensation net of equity derivatives of both GWL and Loblaw;
- $0.05 per common share income (2006 – nil) related to the commodity derivatives fair value adjustment at Weston Foods;
- $0.25 per common share income (2006 – $0.22) related to the income of Weston Foods' dairy and bottling operations;
- $0.81 per common share non-cash income (2006 – $0.40) related to the accounting for GWL's forward sale agreement for 9.6 million Loblaw common shares;
- a $0.05 per common share charge (2006 – nil) related to the income tax effect of the fair value adjustment of the Domtar (Canada) Paper Inc. shares, net of the re-measurement of the GWL 3% Exchangeable Debentures;
- $0.15 per common share income (2006 – $0.14) related to the adjustment to future income tax balances resulting from changes in the Canadian federal and certain provincial statutory income tax rates;
- nil per common share (2006 – $3.84 per common share charge) related to the non-cash Loblaw goodwill impairment charge;
- nil per common share (2006 – $0.26 per common share charge) related to the Ontario collective labour agreement at Loblaw; and
- nil per common share (2006 – $0.04 per common share charge) related to a departure entitlement charge at Loblaw.

Discontinued Operations

Net earnings from discontinued operations were $187 million in 2008 compared to $189 million in 2007, and $168 million in 2006.

For additional information, see note 10 to the consolidated financial statements.

Net Earnings

Net earnings for 2008 of $832 million increased $269 million compared to $563 million in 2007. Basic net earnings per common share for 2008 of $6.08 increased $2.16 compared to $3.92 in 2007, including basic net earnings per common share from discontinued operations of $1.45 compared to $1.46 in 2007.

Net earnings for 2007 of $563 million increased $442 million compared to $121 million in 2006. Basic net earnings per common share for 2007 of $3.92 increased $3.40 compared to $0.52 in 2006, including basic net earnings per common share from discontinued operations of $1.46 compared to $1.30 in 2006.

The new accounting standards implemented in 2008 and the resulting impact on the financial position and results of operations are outlined in the Accounting Standards Implemented in 2008 section of this MD&A and note 2 to the consolidated financial statements. Accounting Standards Implemented in 2007 are discussed in note 2 to the consolidated financial statements.

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

6.3 CONSOLIDATED FINANCIAL CONDITION

($ millions except where otherwise indicated)	**2008**	2007	2006
Total assets	**$ 19,664**	$ 18,434	$ 18,647
Total long term debt (excluding amount due within one year)	**$ 5,308**	$ 5,494	$ 5,918
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**	$ 1.30	$ 1.30
Series IV	**$ 1.30**	$ 1.30	$ 1.30
Series V	**$ 1.19**	$ 1.19	$ 0.83

The Company's total assets in 2008 were greater than in 2007 and 2006. The increase in 2008 was primarily due to weakening of the Canadian dollar relative to the United States dollar compared to 2007, causing an increase in the translated balances of United States dollar denominated assets. On a foreign currency adjusted basis, the Company's total assets were also higher in 2008 than in 2007, primarily due to increases in cash and cash equivalents and short term investments, as well as inventories. The increase in inventories was driven by Loblaw's on-shelf availability program. The decrease in total assets in 2007 compared to 2006 was primarily due to a significant strengthening of the Canadian dollar relative to the United States dollar, causing a decline in the translated balances of United States dollar denominated assets. On a foreign currency adjusted basis, the Company's total assets were higher in 2007 than in 2006, driven by increases in net credit card receivables and an increase in other assets due to the increase in fair value of GWL's forward sale agreement for 9.6 million Loblaw shares, partially offset by decreases in fixed assets.

Cash flows from operating activities have covered a large portion of the funding requirements for the Company over the past two years.

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

- capital investment programs;
- dividends paid on common and preferred shares; and
- repayment of long term debt.

In 2008, as a result of the depreciation of the Canadian dollar relative to the United States dollar, the change in the cumulative foreign currency translation adjustment positively impacted shareholders' equity by $677 million. In 2007, 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 negatively impacted shareholders' equity by $508 million.

Financial Ratios

The Company's 2008 return on average total assets(1) of 8.3% was higher than the 2007 return of 6.2%, and the Company's 2008 return on average common shareholders' equity of 13.3% was higher than the 2007 return of 7.9%. The increase in both measures in 2008 was largely the result of higher operating income, while the increase in the return on average common shareholders' equity in 2008 was also impacted by the gain on sale of Weston Foods' dairy and bottling operations, partially offset by higher interest expense and other financing charges in 2008, including the $11 million non-cash charge (2007 – $141 million non-cash income) related to the fair value adjustment of GWL's forward sale agreement for 9.6 million Loblaw common shares.

The Company's 2007 return on average total assets(1) of 6.2% was higher than the 2006 return of 2.7%, and the Company's 2007 return on average common shareholders' equity of 7.9% was higher than the 2006 return of negative 2.4%. Both measures were negatively impacted in 2006 by the non-cash Loblaw goodwill impairment charge recorded in operating income, and the 2007 return on average

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

common shareholders' equity was also positively impacted by lower interest expense and other financing charges in 2007, including the $141 million non-cash income (2006 – $73 million) related to the fair value adjustment of GWL's forward sale agreement for 9.6 million Loblaw common shares.

The Company's 2008 net debt (excluding Exchangeable Debentures)[1] to equity ratio was 0.58:1 compared to 0.96:1 in 2007. The change in the ratio was driven by the following:

- a decrease in short term borrowings funded by the proceeds from the sale of Weston Foods' dairy and bottling operations;
- an increase in cash and cash equivalents, short term investments and security deposits included in other assets, partially due to the depreciation of the Canadian dollar relative to the United States dollar; and
- an increase in shareholders' equity resulting from the translation of the Company's U.S. net investment due to the depreciation of the Canadian dollar relative to the United States dollar in 2008 and higher retained earnings.

The Company's 2007 net debt (excluding Exchangeable Debentures)[1] to equity ratio remained unchanged from 2006 at 0.96:1. The decrease in commercial paper and increase in cash and cash equivalents, short term investments and security deposits included in other assets were 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 2007, partially offset by higher retained earnings.

The 2008 interest coverage ratio decreased to 3.1 times compared to 4.4 times in 2007 due to higher interest expense and other financing charges, partially offset by an increase in operating income. Interest expense and other financing charges include the non-cash charge of $11 million (2007 – non-cash income of $141 million) recorded in 2008 related to the fair value adjustment of GWL's forward sale agreement for 9.6 million Loblaw common shares, which negatively impacted the change in the interest coverage ratio by approximately 1.9 times.

The 2007 interest coverage ratio increased to 4.4 times compared to 1.3 times in 2006 due to an increase in operating income and lower interest expense and other financing charges, including the non-cash income of $141 million (2006 – $73 million) recorded in 2007 related to the fair value adjustment of GWL's forward sale agreement for 9.6 million Loblaw common shares which positively impacted the change in the interest coverage ratio by approximately 1.6 times.

Outstanding Share Capital and Capital Securities

GWL'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.

	Authorized	Outstanding
Common shares	Unlimited	129,074,526
Preferred shares – Series I	10,000,000	9,400,000
– Series II[1]	10,600,000	10,600,000
– Series III	10,000,000	8,000,000
– Series IV	8,000,000	8,000,000
– Series V	8,000,000	8,000,000

(1) Preferred Shares, Series II are presented as capital securities and are included in current liabilities.

For preferred shares Series I, Series III, Series IV and Series V holders, GWL may, at its option, redeem for cash, in whole or in part, these outstanding preferred shares on or after the redemption dates specified by the terms of each series of preferred shares. GWL may at any time after issuance 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 GWL on a share-for-share basis on a date specified by GWL. Further information on GWL's outstanding share capital is provided in note 23 to the consolidated financial statements.

Series II preferred shares are redeemable on or after April 1, 2009, at GWL's option, for cash of $25.00 per share, together with all accrued but unpaid dividends to but not including the redemption date, and are convertible on or after July 1, 2009, at the option of the holder, into that number of GWL's common shares determined by dividing $25.00, together with accrued and unpaid dividends to but not including the conversion date, by the greater of $2.00 and 95% of the then current market price of GWL's common shares. Subsequent to year end, GWL provided the holders of the Preferred Shares, Series II with notice that on April 1, 2009 the Company will redeem for cash the 10.6 million outstanding shares for $25.00 per share, or $265 million in aggregate, plus accrued and unpaid dividends to but excluding the date of redemption. These preferred shares are presented as capital securities and are included in current liabilities.

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

During 2008, Loblaw issued 9.0 million non-voting Second Preferred Shares, Series A. Twelve million of these shares are authorized and 9.0 million were outstanding at year end 2008. These preferred shares are presented as capital securities and are included in liabilities.

Further information on the Company's capital securities is provided in note 22 to the consolidated financial statements.

At year end, a total of 1,522,344 stock options were outstanding, representing 1.2% of GWL's issued and outstanding common shares, which was within GWL's guideline of 5%. Further information on GWL's stock-based compensation is provided in note 25 to the consolidated financial statements.

Dividends

The declaration and payment of dividends and the amount thereof are at the discretion of the Board, which takes into account the Company's financial results, capital requirements, available cash flow and other factors the Board considers relevant from time to time. Over the long term, GWL's objective is for its common dividend payment ratio to be in the range of 20% to 25% of the prior year's basic net earnings per common share from continuing operations, adjusted as appropriate for items which are not regarded to be reflective of ongoing operations, giving consideration to the year end cash position, future cash flow requirements and investment opportunities. Currently, there is no restriction that would prevent GWL from paying common dividends at historical levels. Dividends on the preferred shares rank in priority ahead of the common shares. During 2008, the Board declared quarterly dividends as follows:

($)	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

Dividends on the Preferred Shares, Series II are presented in interest expense and other financing charges in the consolidated statement of earnings.

Subsequent to year end, the Board declared a quarterly dividend of $0.36 per common share, payable April 1, 2009.