7. RESULTS OF REPORTABLE OPERATING SEGMENTS

The following discussion provides details of the 2008 results of operations of each of the Company's reportable operating segments.

7.1 WESTON FOODS OPERATING RESULTS FROM CONTINUING OPERATIONS[1]

($ millions except where otherwise indicated)	**2008**	2007	Change
Sales	**$ 2,197**	$ 2,088	5.2%
Operating income	**$ 154**	$ 147	4.8%
Operating margin	**7.0%**	7.0%	
EBITDA[2]	**$ 214**	$ 209	2.4%
EBITDA margin[2]	**9.7%**	10.0%	
Return on average total assets[2]	**11.0%**	10.5%	

(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.

Weston Foods 2008 sales include $543 million (2007 – $580 million) of sales from the Canadian dairy and bottling operations, which were sold on December 1, 2008. The remaining sales were generated by the continuing baking divisions: the Canadian fresh and frozen bakeries and the frozen baking and biscuit manufacturing operations in the United States.

Sales and operating income in 2008 were impacted by the following trends:

- The shift in consumer eating preferences toward healthier and more nutritious offerings continued in 2008. Weston Foods 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 2009 and Weston Foods is well positioned to participate in this growth with its strong portfolio of on-trend offerings under its *Wonder*, *D'Italiano*, *Country Harvest* and *Gadoua* 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 these alternate format retailers. 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.
- Inflationary cost pressures related to certain ingredients and higher fuel costs continued in 2008.
- The continued focus on productivity and cost reduction contributed to the growth in operating income.

A detailed discussion on how these trends and other factors impacted sales and operating income in 2008 is set out below.

Sales

Weston Foods sales for 2008 of $2.2 billion increased 5.2% compared to 2007. 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%.

The following sales analysis inclusive of the 53rd week excludes the impact of foreign currency translation and the results of the dairy and bottling operations.

Fresh bakery sales, principally bread, rolls, bagels, tortillas and fresh-baked sweet goods, increased by approximately 11.9% in 2008 compared to 2007 and represented approximately 40% of total Weston Foods sales, up from approximately 39% in 2007. Sales growth was driven by price increases in key product categories combined with changes in sales mix. Overall volumes decreased in 2008, with declines in certain categories partially offset by branded volume growth, led by the *D'Italiano* brand. Sales growth in whole grain and whole wheat products exceeded the sales growth of white flour based products. The introduction of new products, such as *D'Italiano Thintini*, *Gadoua Vitalité*, *Wonder+ Headstart*, *Country Harvest Plus* and products under the *Weight Watchers®* licensed brand contributed positively to branded sales growth in 2008.

Frozen bakery sales, principally bread, rolls and sweet goods, increased by approximately 10.0% in 2008 compared to 2007 and represented approximately 40% of total Weston Foods sales in both 2008 and 2007. Sales growth was driven mainly by price increases combined with changes in sales mix. Volumes for the year were flat, with the positive impact of growth in certain higher margin categories being offset by declines in other categories.

Biscuit sales, principally wafers, ice-cream cones, cookies and crackers, increased by approximately 8.7% in 2008 compared to 2007 and represented approximately 20% of total Weston Foods sales, down from approximately 21% in 2007. Sales growth was due to higher sales volumes in Girl Scout cookie sales in 2008 compared to 2007.

Operating Income

Weston Foods operating income for 2008 increased $7 million, or 4.8%, to $154 million from $147 million in 2007. Operating margin was 7.0% in both 2008 and 2007.

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

- a charge of $6 million (2007 – income of $7 million) related to restructuring and other charges;
- income of $9 million (2007 – a charge of $36 million) related to the effect of stock-based compensation net of equity derivatives;
- a charge of $46 million (2007 – income of $9 million) related to the commodity derivatives fair value adjustment;
- income of $47 million (2007 – $48 million) related to the income of the dairy and bottling operations; 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.

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 derivatives to reduce the impact of price fluctuations in a specified percentage of forecasted raw material purchases over a specified period of time. These commodity derivatives are not acquired for trading or speculative purposes. Certain of these derivatives 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 derivatives, which include realized and unrealized gains and losses related to future purchases of raw materials, are recorded in operating income. In 2008, due to significant volatility in the commodity markets, Weston Foods recorded a charge of $46 million (2007 – income of $9 million) related to the fair value adjustment of exchange traded commodity derivatives that were not designated within a hedging relationship. Despite the treatment of these commodity derivatives for accounting purposes, they have the economic impact of largely mitigating the associated risks arising from price fluctuations in the underlying commodities.

Excluding the specific items described above, operating income increased in 2008 compared to 2007. Operating income was positively impacted by sales growth primarily due to price increases combined with changes in sales mix, the additional week of operating results and the benefits realized from the continued focus on cost reduction initiatives and restructuring activities. Pricing and other actions mitigated the impact of higher fuel costs and the inflationary cost pressures related to certain ingredients, primarily flour, oils and sugar. Gross margin decreased in 2008 mainly as a result of the commodity derivatives fair value adjustment.

EBITDA[1] increased $5 million, or 2.4%, to $214 million in 2008 compared to $209 million in 2007. EBITDA margin[1] for 2008 decreased to 9.7% from 10.0% in 2007.

On December 1, 2008, Weston Foods sold the net assets of its dairy and bottling operations for cash proceeds of $467 million, which resulted in a pre-tax gain of $335 million ($281 million, net of tax). The carrying value of the net assets sold consisted of fixed assets of $54 million, goodwill of $11 million and negative working capital of $6 million. Prior to the closing, Weston Foods paid Loblaw $65 million in consideration of Loblaw's agreement to enter into a long term supply agreement with the dairy and bottling operations. This payment will be recognized into operating income by Loblaw over the term of the agreement as goods are purchased. The dairy and bottling operations generated $543 million of sales, operating income of $47 million and earnings before interest, income taxes, depreciation and amortization of $53 million for Weston Foods in 2008.

Restructuring and Other Charges

The following table summarizes the restructuring and other charges by plan for 2008 and 2007:

($ millions)	Employee Termination Costs and Site Closing and Other Exit Costs	Accelerated Depreciation	(Gain) Loss on Sale of Assets	Total
Costs (income) recognized in 2008:				
Manufacturing asset restructuring:				
Fresh bakery operations	**$ 3**	**$ 2**	**$ (1)**	**$ 4**
	3	**2**	**(1)**	**4**
Distribution network restructuring			**(2)**	**(2)**
Operational restructuring	**4**			**4**
Total costs (income) recognized in 2008	**$ 7**	**$ 2**	**$ (3)**	**$ 6**
Costs (income) recognized in 2007:				
Manufacturing asset restructuring:				
Biscuit operations	$ 2		$ (6)	$ (4)
Ice-cream cone operations			(9)	(9)
Frozen bagel operations			1	1
	2		(14)	(12)
Distribution network restructuring	5			5
Total costs (income) recognized in 2007	$ 7		$ (14)	$ (7)

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

Weston Foods continuously evaluates strategic and cost reduction initiatives with the objective of ensuring a low cost operating structure. In 2008 and 2007, Weston Foods recognized expenses related to restructuring activities involving its manufacturing assets, distribution networks and 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.

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

Outlook[1]
As noted above, Weston Foods sold its dairy and bottling operations in 2008, and the sale of its U.S. fresh bakery business was completed in January 2009. The remaining Weston Foods operating businesses are expected to deliver satisfactory operating performance in 2009 despite challenging market conditions. Reported earnings will continue to be impacted by volatility in commodity markets.

7.2 LOBLAW OPERATING RESULTS

($ millions except where otherwise indicated)	**2008**	2007	Change
Sales	**$ 30,802**	$ 29,384	4.8%
Operating income	**$ 1,038**	$ 728	42.6%
Operating margin	**3.4%**	2.5%	
EBITDA[1]	**$ 1,623**	$ 1,316	23.3%
EBITDA margin[1]	**5.3%**	4.5%	
Return on average total assets[1]	**8.1%**	5.7%	

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

Sales
Sales for 2008 increased $1.4 billion, or 4.8%, to $30.8 billion compared to $29.4 billion in 2007. The following factors further explain the major components in the change in sales over the prior year:

- same-store sales growth of 4.2% (2007 – 2.4%) including an increase in sales and same-store sales growth of 1.9% due to the extra selling week in 2008;
- on an equivalent 52 week basis:
  - total sales growth in both food and drugstore was moderate, with strong growth in the fourth quarter;
  - general merchandise sales growth was negative. Unseasonable weather, the mark down of merchandise to sell through seasonal inventory, and reductions in assortment and square footage contributed to the decline;
  - apparel sales growth was strong largely due to improvements in availability and product offering;
  - customer count growth increased marginally while item count growth remained flat versus 2007;
  - gas bar sales growth was strong as a result of fuel price inflation and volume growth;
- Loblaw's analysis indicated that internal retail food price inflation was higher than 2007, but lower than the national food price inflation of 4.0% (2007 – 2.7%) as measured by "The Consumer Price Index for Food Purchased from Stores" ("CPI"). This measure of inflation does not necessarily reflect the effect of inflation on the specific mix of goods sold in Loblaw stores; and
- 37 (2007 – 34) new stores, net of 37 (2007 – 79) store closures, each category including stores which underwent conversions and major expansions, increased net retail square footage 0.2 million square feet (2007 – net decrease of 0.1 million square feet) or 0.5%.

Sales of control label products for 2008 amounted to $7.4 billion compared to $6.9 billion in 2007. In 2008, Loblaw introduced over 800 new food and non food control label products and redesigned over 1,000 products. Loblaw's control label program, which includes *President's Choice*, *no name*, *President's Choice Organics*, *President's Choice Blue Menu*, *President's Choice G.R.E.E.N.*, *Joe Fresh Style* and *PC Home,* provides additional sales growth potential.

Operating Income
Operating income of $1,038 million for 2008 increased $310 million, or 42.6%, compared to $728 million in 2007 resulting in an increase in operating margin to 3.4% in 2008 from 2.5% in 2007.

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

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

- income of $1 million (2007 – charge of $222 million) related to lower than anticipated restructuring and other charges;
- a charge of $7 million (2007 – $72 million) related to the effect of stock-based compensation net of equity forwards; and
- income of $22 million (2007 – nil) related to the gain on the sale of Loblaw's food service business in the fourth quarter of 2008.

Included in 2008 operating income was a $14 million gain from the sale of financial investments by *President's Choice* Bank ("*PC* Bank"), a wholly owned subsidiary of Loblaw, and a $29 million fixed asset impairment charge. Included in 2007 operating income is an $11 million gain related to the sale of an office building in Calgary, Alberta, a $33 million fixed asset impairment charge, and a $24 million charge as a result of adjustments in estimates related to post-employment and long term disability benefits, deferred product development and information technology costs.

Excluding the impact of restructuring and other charges, the effect of stock-based compensation net of equity forwards, and the gain on sale of Loblaw's food service business, operating income was flat in 2008 compared to 2007.

In the third and fourth quarters of 2007, Loblaw made an investment in pricing in specific markets. These investments negatively impacted operating income and margins.

Loblaw's focus on cost reduction, including shrink initiatives, has improved margins in 2008 compared to 2007. Buying synergies and more disciplined vendor management are resulting in lower purchase costs for both merchandise and not-for-resale items.

Loblaw experienced higher store labour costs in 2008 as a result of higher sales. Labour productivity improved slightly in 2008 compared to 2007 despite investments in training and Loblaw's commitment to improve customer service.

Restructuring activities were substantially completed in 2007, which positively impacted operating income in 2008. Project Simplify charges in 2008 were $3 million (2007 – $197 million), which related to the restructuring and streamlining of merchandise and store operations. In 2008, as actual costs were less than the amounts estimated, income of $4 million (2007 – charge of $25 million) was included in operating income related to supply chain and store closure restructuring initiatives. Additional information is provided in note 4 to the consolidated financial statements.

2008 EBITDA[1] increased $307 million, or 23.3%, to $1,623 million compared to $1,316 million in 2007. EBITDA margin[1] increased to 5.3% compared to 4.5% in 2007. The increase is a result of the increase in operating income which is described above.

Outlook[2]

Loblaw remains confident in its approach and will continue to focus on making measured progress on its key transformation priorities, including food renewal, store enhancements, product innovation, infrastructure, and customer value. During 2009, Loblaw will step up investments in information technology and supply chain which will increase the associated expense by approximately $100 million. This investment, coupled with the continuing economic challenges and competitive pressures, are expected to challenge results in 2009.