

## Management's Statement of Responsibility for Financial Reporting

The management of Loblaw Companies Limited is responsible for the preparation, presentation and integrity of the accompanying consolidated financial statements, Management's Discussion and Analysis and all other information in the Annual Report. This responsibility includes the selection and consistent application of appropriate accounting principles and methods in addition to making the judgments and estimates necessary to prepare the consolidated financial statements in accordance with Canadian generally accepted accounting principles. It also includes ensuring that the financial information presented elsewhere in the Annual Report is consistent with that in the consolidated financial statements.

To provide reasonable assurance that assets are safeguarded and that relevant and reliable financial information is produced, management is required to design a system of internal controls and certify as to the design effectiveness of internal controls over financial reporting. Internal auditors, who are employees of the Company, review and evaluate internal controls on management's behalf. KPMG LLP, whose report follows, were appointed as independent auditors by a vote of the Company's shareholders to audit the consolidated financial statements.

The Board of Directors, acting through an Audit Committee comprised solely of directors who are independent of the Company, is responsible for determining that management fulfills its responsibilities in the preparation of the consolidated financial statements and the financial control of operations. The Audit Committee recommends the independent auditors for appointment by the shareholders. The Audit Committee meets regularly with senior and financial management, internal auditors and the independent auditors to discuss internal controls, auditing activities and financial reporting matters. The independent auditors and internal auditors have unrestricted access to the Audit Committee. These consolidated financial statements and Management's Discussion and Analysis have been approved by the Board of Directors for inclusion in the Annual Report based on the review and recommendation of the Audit Committee.

Toronto, Canada  
March 12, 2008

*[signed]*  
**Galen G. Weston**  
Executive Chairman

*[signed]*  
**Mark Foote**  
President and Chief Merchandising Officer

*[signed]*  
**William M. Wells**  
Chief Financial Officer

## Independent Auditors' Report


To the Shareholders of Loblaw Companies Limited:

We have audited the consolidated balance sheets of Loblaw Companies Limited as at December 29, 2007 and December 30, 2006, the consolidated statements of earnings (loss), changes in shareholders' equity, and the consolidated cash flow statements for the 52 week years then ended and the consolidated statement of comprehensive income for the 52 week year ended December 29, 2007. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 29, 2007 and December 30, 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

  
Toronto, Canada  
March 12, 2008

  
Chartered Accountants, Licensed Public Accountants

## Consolidated Statements of Earnings (Loss)

For the years ended December 29, 2007 and December 30, 2006

(\$ millions except where otherwise indicated)

	2007 (52 weeks)	2006 (52 weeks)
<b>Sales</b>	<b>\$ 29,384</b>	<b>\$ 28,640</b>
<b>Operating Expenses</b>		
Cost of sales, selling and administrative expenses (note 2)	27,838	26,917
Depreciation and amortization	588	590
Goodwill impairment (note 3)	-	800
Restructuring and other charges (note 4)	222	44
	<b>28,648</b>	<b>28,351</b>
<b>Operating Income</b>	<b>736</b>	<b>289</b>
Interest Expense (note 6)	252	259
<b>Earnings Before Income Taxes and Minority Interest</b>	<b>484</b>	<b>30</b>
Income Taxes (note 7)	150	248
<b>Net Earnings (Loss) Before Minority Interest</b>	<b>334</b>	<b>(218)</b>
Minority Interest	4	1
<b>Net Earnings (Loss)</b>	<b>\$ 330</b>	<b>\$ (219)</b>
<b>Net Earnings (Loss) Per Common Share</b> (\$) (note 8)		
Basic	<b>\$ 1.20</b>	<b>\$ (.80)</b>
Diluted	<b>\$ 1.20</b>	<b>\$ (.80)</b>

See accompanying notes to the consolidated financial statements.

## Consolidated Statements of Changes in Shareholders' Equity

For the years ended December 29, 2007 and December 30, 2006 (\$ millions except where otherwise indicated)	2007 (52 weeks)	2006 (52 weeks)
<b>Common Share Capital, End of Year</b> (note 19)	\$ 1,196	\$ 1,196
<b>Retained Earnings, Beginning of Year</b>	\$ 4,245	\$ 4,694
Cumulative impact of implementing new accounting standards (note 2)	(15)	-
Net earnings (loss)	330	(219)
Dividends declared per common share – 84¢ (2006 – 84¢)	(230)	(230)
<b>Retained Earnings, End of Year</b>	\$ 4,330	\$ 4,245
<b>Accumulated Other Comprehensive Income, Beginning of Year</b>	\$ -	
Cumulative impact of implementing new accounting standards (note 2)	16	
Other comprehensive income	3	
<b>Accumulated Other Comprehensive Income, End of Year</b> (note 20)	\$ 19	
<b>Total Shareholders' Equity</b>	\$ 5,545	\$ 5,441

See accompanying notes to the consolidated financial statements.

## Consolidated Statement of Comprehensive Income

For the year ended December 29, 2007 (\$ millions)	2007 (52 weeks)
Net earnings	\$ 330
Other comprehensive income	
Net unrealized loss on available-for-sale financial assets	(56)
Reclassification of loss on available-for-sale financial assets to net earnings	33
	(23)
Net gain on derivative instruments designated as cash flow hedges	57
Reclassification of gain on derivative instruments designated as cash flow hedges to net earnings	(31)
	26
Other comprehensive income	3
<b>Total Comprehensive Income</b>	\$ 333

See accompanying notes to the consolidated financial statements.

## Consolidated Balance Sheets

As at December 29, 2007 and December 30, 2006

(\$ millions)

	2007	2006
<b>Assets</b>		
Current Assets		
Cash and cash equivalents (note 9)	\$ 674	\$ 669
Short term investments	303	327
Accounts receivable (note 10)	885	728
Inventories (note 11)	2,032	2,037
Income taxes (note 7)	111	63
Future income taxes (note 7)	56	85
Prepaid expenses and other assets	32	39
<b>Total Current Assets</b>	<b>4,093</b>	<b>3,948</b>
Fixed Assets (note 12)	7,953	8,055
Goodwill (note 3)	806	794
Other Assets (note 13)	822	689
<b>Total Assets</b>	<b>\$ 13,674</b>	<b>\$ 13,486</b>
<b>Liabilities</b>		
Current Liabilities		
Bank indebtedness	\$ 3	\$ 1
Commercial paper	418	647
Accounts payable and accrued liabilities	2,769	2,598
Long term debt due within one year (note 16)	432	27
<b>Total Current Liabilities</b>	<b>3,622</b>	<b>3,273</b>
Long Term Debt (note 16)	3,852	4,212
Future Income Taxes (note 7)	180	234
Other Liabilities (note 17)	459	314
Minority Interest	16	12
<b>Total Liabilities</b>	<b>8,129</b>	<b>8,045</b>
<b>Shareholders' Equity</b>		
Common Share Capital (note 19)	1,196	1,196
Retained Earnings	4,330	4,245
Accumulated Other Comprehensive Income (notes 2 and 20)	19	-
<b>Total Shareholders' Equity</b>	<b>5,545</b>	<b>5,441</b>
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$ 13,674</b>	<b>\$ 13,486</b>

Contingencies, commitments and guarantees (note 23). Leases (note 18).

See accompanying notes to the consolidated financial statements.

Approved on Behalf of the Board

*[signed]*  
**Galen G. Weston**  
 Director

*[signed]*  
**Thomas C. O'Neill**  
 Director

## Consolidated Cash Flow Statements

For the years ended December 29, 2007 and December 30, 2006  
(\$ millions)

	2007 (52 weeks)	2006 (52 weeks)
<b>Operating Activities</b>		
Net earnings (loss) before minority interest	\$ 334	\$ (218)
Depreciation and amortization	588	590
Goodwill impairment (note 3)	-	800
Restructuring and other charges (note 4)	222	44
Future income taxes	(17)	(18)
Change in non-cash working capital	(43)	(69)
Other	161	51
<b>Cash Flows from Operating Activities</b>	<b>1,245</b>	<b>1,180</b>
<b>Investing Activities</b>		
Fixed asset purchases	(613)	(937)
Short term investments	(31)	(323)
Proceeds from fixed asset sales	223	99
Credit card receivables, after securitization (note 10)	(238)	(82)
Franchise investments and other receivables	19	(18)
Other	(31)	(47)
<b>Cash Flows used in Investing Activities</b>	<b>(671)</b>	<b>(1,308)</b>
<b>Financing Activities</b>		
Bank indebtedness	2	(29)
Commercial paper	(229)	211
Long term debt (note 16)		
Issued	25	29
Retired	(39)	(162)
Common share capital issued (notes 19 and 21)	-	4
Dividends	(230)	(173)
Other	(1)	-
<b>Cash Flows used in Financing Activities</b>	<b>(472)</b>	<b>(120)</b>
Effect of foreign currency exchange rate changes on cash and cash equivalents (note 9)	(97)	1
Change in Cash and Cash Equivalents	5	(247)
Cash and Cash Equivalents, Beginning of Year	669	916
<b>Cash and Cash Equivalents, End of Year</b>	<b>\$ 674</b>	<b>\$ 669</b>

See accompanying notes to the consolidated financial statements.

## Notes to the Consolidated Financial Statements

For the years ended December 29, 2007 and December 30, 2006  
(\$ millions except where otherwise indicated)

### Note 1. Summary of Significant Accounting Policies

The consolidated financial statements were prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and are reported in Canadian dollars.

**Basis of Consolidation** The consolidated financial statements include the accounts of Loblaw Companies Limited and its subsidiaries, collectively referred to as the "Company" or "Loblaw". The Company's interest in the voting share capital of its subsidiaries is 100%.

The Company also consolidates variable interest entities ("VIEs") pursuant to Canadian Institute of Chartered Accountants ("CICA") Accounting Guideline ("AcG") 15, "Consolidation of Variable Interest Entities" ("AcG 15"), that are subject to control by Loblaw on a basis other than through ownership of a majority of voting interest. AcG 15 defines a variable interest entity as an entity that either does not have sufficient equity at risk to finance its activities without subordinated financial support or where the holders of the equity at risk lack the characteristics of a controlling financial interest. AcG 15 requires the primary beneficiary to consolidate VIEs and considers an entity to be the primary beneficiary of a VIE if it holds variable interests that expose it to a majority of the VIE's expected losses or that entitle it to receive a majority of the VIE's expected residual returns or both.

**Fiscal Year** The fiscal year of the Company ends on the Saturday closest to December 31. As a result, the Company's fiscal year is usually 52 weeks in duration but includes a 53rd week every 5 to 6 years. The years ended December 29, 2007 and December 30, 2006 each contained 52 weeks.

**Revenue Recognition** Sales include revenues, net of estimated returns, from customers through corporate stores operated by the Company and independent franchisee stores that are consolidated by the Company pursuant to AcG 15. In addition, sales include sales to and service fees from associated stores and independent account customers and franchised stores excluding VIE stores net of sales incentives offered by Loblaw. The Company recognizes revenue at the time the sale is made to its customers.

**Earnings (Loss) per Share ("EPS")** Basic EPS is calculated by dividing the net earnings (loss) available to common shareholders by the weighted average number of common shares outstanding during the year. Diluted EPS is calculated using the treasury stock method, which assumes that all outstanding stock options with an exercise price below the average market price during the year are exercised and the assumed proceeds are used to purchase the Company's common shares at the average market price during the year.

**Cash, Cash Equivalents and Bank Indebtedness** Cash equivalents consist primarily of highly liquid marketable investments with a maturity of 90 days or less. The Company has the ability and intent to offset cash balances to reduce reported bank indebtedness, except for VIEs consolidated by the Company. Commencing December 31, 2006, cash equivalents are either designated as held-for-trading financial assets or classified as available-for-sale financial assets and are carried at quoted market value. See note 2 for more information.

Prior to December 31, 2006, cash equivalents were carried at the lower of cost or quoted market value.

**Short Term Investments** Short term investments consist primarily of government treasury bills, government-sponsored debt securities, corporate commercial paper and bank term deposits. Commencing December 31, 2006, short term investments are either designated as held-for-trading financial assets or classified as available-for-sale financial assets and are carried at quoted market value. See note 2 for more information.

Prior to December 31, 2006, short term investments were carried at the lower of cost or quoted market value.

**Credit Card Receivables** The Company, through *President's Choice Bank* ("PC Bank"), a wholly owned subsidiary of the Company, has credit card receivables that are stated net of an allowance for credit losses. Any credit card receivable with a payment that is contractually 180 days in arrears, or where the likelihood of collection is considered remote, is written off. Interest income on credit card receivables is recorded on an accrual basis and is recognized in operating income.

**Allowance for Credit Losses** PC Bank maintains an allowance for probable credit losses on aggregate exposures for which losses cannot be determined on an item-by-item basis. The allowance is based upon a statistical analysis of past and current performance, the level of allowance already in place and management's judgment. The allowance for credit losses is deducted from the credit card receivables balance. The net credit loss experience for the year is recognized in operating income.

**Securitization** PC Bank securitizes credit card receivables through the sale of a portion of the total interest in these receivables to independent trusts and does not exercise any control over the trusts' management or assets. PC Bank does retain certain servicing and administrative responsibilities. The credit card receivables are removed from the consolidated balance sheet when PC Bank has surrendered control and are considered sold for accounting purposes pursuant to AcG 12, "Transfers of Receivables". When PC Bank sells credit card receivables in a securitization transaction, it has a retained interest in the securitized receivables represented by the rights to future cash flows after obligations to investors have been met. Although PC Bank remains responsible for servicing all credit card receivables, it does not receive additional compensation for servicing those credit card receivables sold to the trusts and accordingly a service liability is recorded. The service liability is recorded at fair value. In the absence of quoted market rates for servicing securitized assets, fees payable to a replacement servicer, in the event that a replacement servicer was to be appointed, formed the basis of determination of fair value of the servicing liability. Gains or losses on the sale of these receivables depends, in part, on the previous carrying amount of receivables involved in the securitization, allocated between the receivables sold and the retained interest, based on their relative fair values at the date of securitization. The fair value is determined as the best estimate of the net present value of expected future cash flows using management's best estimates of key assumptions such as monthly payment rates, weighted average life, expected annual credit losses and discount rates. Any gain or loss on a sale is recognized in operating income at the time of the securitization. Commencing December 31, 2006, retained interests are designated as held-for-trading financial assets (see note 2) and are recorded at fair value on the consolidated balance sheet. Prior to December 31, 2006 the carrying value of retained interests was periodically reviewed and when a decline in value was identified as other than temporary, the carrying value was written down to fair value.

**Vendor Allowances** The Company receives allowances from certain of its vendors whose products it purchases for resale. These allowances are received for a variety of buying and/or merchandising activities, including vendor programs such as volume purchase allowances, purchase discounts, listing fees and exclusivity allowances. Consideration received from a vendor is a reduction in the cost of the vendor's products or services and is recognized as a reduction in the cost of sales, selling and administrative expenses and the related inventory when recognized in the consolidated statement of earnings and the consolidated balance sheet. Certain exceptions apply if the consideration is a payment for assets or services delivered to the vendor or for reimbursement of selling costs incurred to promote the vendor's products, provided that these costs are separate, incremental and identifiable.

**Inventories** The Company utilizes the retail method for retail store inventories which are stated at the lower of cost and estimated net realizable value less normal gross profit margin. Distribution centre inventories and seasonal general merchandise inventories are stated at the lower of cost and estimated net realizable value. Cost is determined substantially using the first-in, first-out method.

**Fixed Assets** Fixed assets are recorded at cost including capitalized interest. Depreciation commences when the assets are put into use and is recognized on a straight-line basis to depreciate the cost of these assets over their estimated useful lives. Estimated useful lives range from 20 to 40 years for buildings, 10 years for building improvements and from 3 to 10 years for equipment and fixtures. Leasehold improvements are depreciated over their estimated useful lives and may include renewal options when an improvement is made after inception of the lease to a maximum of 25 years, which approximates economic life. Equipment under capital leases is depreciated over the term of the lease.

## Notes to the Consolidated Financial Statements

Fixed assets are reviewed for impairment when events or changes in circumstances indicate that the carrying value exceeds the sum of the undiscounted future cash flows expected from use and eventual disposal. These events or changes in circumstances include a commitment to close a store or distribution centre or to relocate or convert a store. Fixed assets are also reviewed for impairment annually. For purposes of annually reviewing store assets for impairment, asset groups are reviewed at their lowest level for which identifiable cash flows are largely independent of cash flows of other assets and liabilities. Therefore, store net cash flows are grouped together by primary market areas, where cash flows are largely dependent on each other. Primary markets are regional areas where a number of store formats operate within close proximity to one another. If an indicator of impairment exists, such as sustained negative operating cash flows of the respective asset group, then an estimate of undiscounted future cash flows of each such store within this group is prepared and compared to its carrying value. For purposes of annually reviewing distribution centre assets for impairment, distribution centre net cash flows are grouped with the respective net cash flows of the stores they service. An impairment in the store network serviced by the distribution centre would indicate an impairment in the distribution centre assets as well. If these assets are determined to be impaired, the impairment loss is measured as the excess of the carrying value over fair value. In addition, the carrying value of fixed assets is evaluated whenever events or changes in circumstances indicate that the carrying value of fixed assets may not be recoverable. These events or changes in circumstances include a commitment to close a store or distribution centre or to relocate or convert a store where the carrying value of its assets is greater than the expected undiscounted future cash flows.

**Deferred Charges** Deferred charges are amortized over the related assets' estimated useful lives, to a maximum of 15 years.

**Goodwill** Goodwill represents the excess of the purchase price of a business acquired over the fair value of the underlying net assets acquired at the date of acquisition. Goodwill is not amortized and is assessed for impairment at a minimum on an annual basis, at the reporting unit level. Any potential goodwill impairment is identified by comparing the fair value of a reporting unit to its carrying value. If the fair value of the reporting unit exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value of the reporting unit exceeds its fair value, a more detailed goodwill impairment assessment must be undertaken. A goodwill impairment charge is recognized to the extent that, at the reporting unit level, the carrying value of goodwill exceeds the implied fair value and is recorded in operating income.

The Company determines the fair value using a discounted cash flow model corroborated by other valuation techniques such as market multiples. The process of determining these fair values requires management to make estimates and assumptions including, but not limited to, projected future sales, earnings and capital investment, discount rates and terminal growth rates. Projected future sales, earnings and capital investment are consistent with strategic plans presented to the Company's Board of Directors. Discount rates are based on an industry weighted average cost of capital. These estimates and assumptions are subject to change in the future due to uncertain competitive and economic market conditions or changes in business strategies. Additional disclosure regarding the results of the goodwill impairment test is provided in note 3.

**Derivative Instruments** The Company uses financial derivative instruments in the form of cross currency basis swaps, interest rate swaps and equity forwards to manage its current and anticipated exposure to fluctuations in foreign currency exchange rates, interest rates and the market price of the Company's common shares. The Company uses financial and non-financial derivative instruments in the form of futures contracts, option contracts and forward contracts to manage its current and anticipated exposure to fluctuations in commodity prices. The Company does not enter into derivative agreements for trading or speculative purposes.

Commencing December 31, 2006, all financial derivative instruments are recorded at fair value on the consolidated balance sheet in accordance with CICA Section 3855 "Financial Instruments – Recognition and Measurement" ("Section 3855"). Non-financial derivative instruments, such as certain contracts that are linked to commodity prices, are recorded at fair value on the consolidated balance sheet unless they are exempt from this treatment based upon expected purchase, sale or usage requirements. Embedded derivative instruments are separated from their host contract and recorded on the consolidated balance sheet at fair value. Fair values are based on quoted market prices where available from active markets, otherwise fair values are estimated using valuation methodologies, primarily discounted cash flow analysis. Derivative instruments are recorded in current or non-current assets and liabilities based on their remaining terms to maturity. All changes in fair value of the derivative instruments are recorded in net earnings unless cash flow hedge accounting is applied.

The Company formally identifies, designates and documents the relationship between hedging instruments and hedged items including cross currency basis swaps and interest rate swaps as cash flow hedges against its exposure to fluctuations in the foreign currency exchange rate and variable interest rates on a portion of its United States dollar cash equivalents and short term investments. The Company assesses whether each derivative instrument continues to be highly effective in offsetting the change in the cash flows of hedged items. If and when a derivative instrument is no longer expected to be highly effective, hedge accounting is discontinued. Hedge ineffectiveness, if any, is included in current period net earnings.

Prior to December 31, 2006, all financial derivative instruments were recorded at fair value on the consolidated balance sheet with the exception of interest rate swaps which were designated in cash flow hedging relationships. These interest rate swaps were not recorded on the comparative period consolidated balance sheet. Non-financial derivative instruments and embedded derivative instruments were also not recorded on the comparative period consolidated balance sheet.

**Foreign Currency Translation** Assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the foreign currency exchange rate in effect at the balance sheet date. Commencing December 31, 2006, exchange gains or losses arising from the translation of these balances denominated in foreign currencies are recognized in operating income except for cross currency basis swaps and available-for-sale cash equivalents and short term investments denominated in United States dollars which are designated in a cash flow hedge and are deferred in accumulated other comprehensive income and reclassified to net earnings when realized. Prior to December 31, 2006, all exchange gains or losses arising from the translation of assets and liabilities denominated in foreign currencies are recognized in operating income. Revenues and expenses denominated in foreign currencies are translated into Canadian dollars at the average foreign currency exchange rate for the year.

**Income Taxes** The asset and liability method of accounting is used for income taxes. Under the asset and liability method, future income tax assets and liabilities are recognized for the future income tax consequences attributable to temporary differences between the financial statement carrying values of existing assets and liabilities and their respective income tax bases. Future income tax assets and liabilities are measured using enacted or substantively enacted income tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in income tax rates is recognized in income tax expense when enacted or substantively enacted. Future income tax assets are evaluated and a valuation allowance, if required, is recorded against any future income tax asset if it is more likely than not that the asset will not be realized.

**Employee Future Benefits** The Company sponsors a number of pension plans including registered funded defined benefit pension plans, defined contribution pension plans and supplemental unfunded arrangements providing pension benefits in excess of statutory limits. The Company also offers certain employee post-retirement and post-employment benefit plans and a long term disability benefit plan. Post-retirement and post-employment benefit plans are generally not funded, are mainly non-contributory and include health care, life insurance and dental benefits. The Company also contributes to various multi-employer pension plans which provide pension benefits.

*Defined Benefit Plans* The cost and accrued benefit plan obligations of the Company's defined benefit pension plans and other benefit plans, including post-retirement, post-employment and long term disability benefits, are accrued based on actuarial valuations. The actuarial valuations for the defined benefit plans are determined using the projected benefit method prorated on service and management's best estimate of the discount rate, the expected long term rate of return on plan assets, the rate of compensation increase, retirement ages, termination rates, mortality rates and expected growth rate of health care costs. Actuarial valuations are performed using a September 30 measurement date for accounting purposes. Market values used to value benefit plan assets are as at the measurement date. The discount rate used to value the accrued benefit plan obligation is based on market interest rates as at the measurement date, assuming a portfolio of Corporate AA bonds with terms to maturity that, on average, match the terms of the accrued benefit plan obligations.

## Notes to the Consolidated Financial Statements

Past service costs arising from plan amendments are amortized over the expected average remaining service period of the active employees. The unamortized net actuarial gain or loss that exceeds 10% of the greater of the accrued benefit plan obligation or the fair value of the benefit plan assets at the beginning of the year is amortized over the expected average remaining service period of the active employees for defined benefit pension and post-retirement benefit plans. The unamortized net actuarial gain or loss for post-employment and long term disability benefits is amortized over periods not exceeding three years. The expected average remaining service period of the active employees covered by the defined benefit pension plans ranges from 6 to 17 years, with a weighted average of 13 years. The expected average remaining service period of the employees covered by the post-retirement benefit plans ranges from 6 to 22 years, with a weighted average of 18 years.

The net accrued benefit plan asset or liability represents the cumulative difference between the cost and the funding contributions and is recorded in other assets and other liabilities.

*Defined Contribution and Multi-Employer Pension Plans* The costs of pension benefits for defined contribution pension plans and multi-employer pension plans are expensed as contributions are due.

**Stock Option Plan** The Company recognizes a compensation cost in operating income and a liability related to employee stock option grants that allow for settlement in shares or in the share appreciation value in cash at the option of the employee, using the intrinsic value method. Under the intrinsic value method, the stock-based compensation liability is the amount by which the market price of the common shares at the balance sheet date exceeds the exercise price of the stock options. A year-over-year change in the stock-based compensation liability is recognized in operating income on a prescribed vesting basis.

The Company accounts for stock options issued prior to December 30, 2001 that will be settled by issuing common shares as capital transactions. Consideration paid by employees on the exercise of this type of stock option is credited to common share capital. This type of option was last issued in 2001 and represents approximately 0.6% of all options outstanding at year end.

**Restricted Share Unit (“RSU”) Plan** The Company recognizes a compensation cost in operating income on a prescribed vesting basis for each RSU granted equal to the market value of a Loblaw common share at the date on which RSUs are awarded to each participant prorated over the performance period and adjusts for changes in the market value until the end of the performance date. The cumulative effect of the change in market value is recognized in operating income in the period of change.

**Employee Share Ownership Plan** The Company maintains an Employee Share Ownership Plan which allows employees to acquire the Company's common shares through regular payroll deductions of up to 5% of their gross regular earnings. The Company contributes an additional 25% of each employee's contribution to the plan, which is recognized in operating income as a compensation cost when the contribution is made.

**Deferred Share Units** Members of the Company's Board of Directors, who are not management of the Company, may elect annually to receive all or a portion of their annual retainer(s) and fees in the form of deferred share units, which are accounted for using the intrinsic value method. Under the intrinsic value method, the deferred share unit compensation liability is the amount by which the market price of the common shares at the balance sheet date exceeds the initial value of the deferred share unit. The year-over-year change in the deferred share unit compensation liability is recognized in operating income.

**Use of Estimates and Assumptions** The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts and disclosures made in the consolidated financial statements and accompanying notes. These estimates and assumptions are based on management's historical experience, best knowledge of current events and conditions and activities that may be undertaken in the future. Actual results could differ from these estimates.

Certain estimates, such as those related to valuation of inventories, goodwill, income taxes, Goods and Services Tax and provincial sales taxes, fixed assets and employee future benefits, depend upon subjective or complex judgments about matters that may be uncertain, and changes in those estimates could materially impact the consolidated financial statements.

## Future Accounting Standards

*Capital Disclosures and Financial Instruments – Disclosure and Presentation* In December 2006, the CICA issued three new accounting standards: Section 1535 “Capital Disclosures” (“Section 1535”), Section 3862 “Financial Instruments – Disclosures” (“Section 3862”) and Section 3863 “Financial Instruments – Presentation” (“Section 3863”).

Section 1535 establishes guidelines for the disclosure of information regarding a company's capital and how it is managed. The standard requires enhanced disclosures with respect to (i) an entity's objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; and (iii) whether the entity has complied with any capital requirements, and if it has not complied, the consequences of such non-compliance.

Section 3862 and Section 3863 replace Section 3861, “Financial Instruments – Disclosure and Presentation”. Section 3862 requires increased disclosures regarding the risks associated with financial instruments such as credit risk, liquidity risk and market risks and the techniques used to identify, monitor and manage these risks. Section 3863 carries forward standards for presentation of financial instruments and non-financial derivative instruments and provides additional guidance for the classification of financial instruments, from the perspective of the issuer, between liabilities and equity.

These standards are effective for fiscal years beginning on or after October 1, 2007 and therefore the Company will implement them in the first quarter of 2008.

*Inventories* In June 2007, the CICA issued Section 3031, “Inventories”, that will replace existing Section 3030 of the same title. The new standard requires inventories to be measured at the lower of cost and net realizable value with more specific guidance of costs to include in the cost of inventory. Costs such as storage costs and administrative overhead that do not contribute to bringing inventories to their present location and condition are specifically excluded from the cost of inventories and expensed in the period incurred. Reversal of previous write-downs to net realizable value when there is a subsequent increase in the value of inventories is now required. The cost of the inventories should be based on a first-in, first-out or a weighted average cost formula. Techniques used for the measurement of cost of inventories, such as the retail method, may be used for convenience if the results approximate cost. The new standard also requires additional disclosures including the accounting policies used in measuring inventories, the carrying amount of the inventories, amounts recognized as an expense during the period, write-downs and the amount of any reversal of any write-downs recognized as a reduction in expenses.

This standard is effective for fiscal years beginning on or after January 1, 2008 and will be implemented by the Company in the first quarter of 2008 to the opening inventory for the period with an adjustment to opening retained earnings, net of income taxes, for the difference in measurement of the opening inventory with no prior periods restated. The Company expects to record, upon implementation of this standard, a decrease in the measurement of opening inventory of less than 4% of the inventory value with a corresponding decrease of less than \$50 to opening retained earnings net of income taxes.

In addition to the changes in the cost of inventory, the Company is reviewing the additional presentation and disclosure requirements which will be required in the consolidated financial statements and/or in the accompanying notes.

## Notes to the Consolidated Financial Statements

**Goodwill and Intangible Assets** In November 2007, the CICA issued amendments to Section 1000 “Financial Statement Concepts,” and AcG 11 “Enterprises in the Development Stage,” issued a new Handbook Section 3064 “Goodwill and Intangible Assets” (“Section 3064”) to replace Section 3062 “Goodwill and Other Intangible Assets”, withdrew Section 3450 “Research and Development Costs” and amended Emerging Issues Committee (“EIC”) Abstract 27 “Revenues and Expenditures During the Pre-operating Period” to not apply to entities that have adopted Section 3064. These amendments provide guidance for the recognition of internally developed intangible assets, including assets developed from research and development activities, ensuring consistent treatment of all intangible assets, whether separately acquired or internally developed. The amendments are effective for annual and interim financial statements relating to fiscal years beginning on or after October 1, 2008 and therefore the Company will implement them in the first quarter of 2009, retroactively with restatement of the comparative periods for the current and prior year. The impact of implementing these amendments on the Company's financial statements is currently being assessed.

**International Financial Reporting Standards (“IFRS”)** The Canadian Accounting Standards Board will require all public companies to adopt IFRS for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. Companies will be required to provide IFRS comparative information for the previous fiscal year. The convergence from Canadian GAAP to IFRS will be applicable for the Company for the first quarter of 2011 when the Company will prepare both the current and comparative financial information using IFRS. The Company expects the transition to IFRS to impact financial reporting, business processes and information systems. The Company will assess the impact of the transition to IFRS and will continue to invest in training and resources throughout the transition period to facilitate a timely conversion.

### Note 2. Implementation of New Accounting Standards

#### Accounting Standards Implemented in 2007

On December 31, 2006, the Company implemented the CICA Handbook Section 3855 “Financial Instruments – Recognition and Measurement”, Section 3865 “Hedges”, Section 1530 “Comprehensive Income”, Section 3251 “Equity” and Section 3861 “Financial Instruments – Disclosure and Presentation”. These standards have been applied without restatement of prior periods. The transitional adjustments resulting from these standards are recognized in the opening balances of retained earnings and accumulated other comprehensive income.

Section 3855 establishes guidance for recognizing and measuring financial assets, financial liabilities and non-financial derivative instruments. All financial instruments must be classified into a defined category, namely, held-for-trading financial assets or financial liabilities, held-to-maturity investments, loans and receivables, available-for-sale financial assets, or other financial liabilities. The standard requires that financial instruments within scope, including derivative instruments, be included on the Company's balance sheet and measured at fair value, except for loans and receivables, held-to-maturity financial assets and other financial liabilities which are measured at cost or amortized cost. Gains and losses on held-for-trading financial assets and financial liabilities are recognized in net earnings in the period in which they arise. Unrealized gains and losses, including changes in foreign exchange rates on available-for-sale financial assets are recognized in other comprehensive income until the financial asset is derecognized or impaired, at which time any unrealized gains or losses are recorded in net earnings. Transaction costs other than those related to financial instruments classified as held-for-trading, which are expensed as incurred, are amortized using the effective interest method.

Section 3855 allows management to elect to measure financial instruments that would not otherwise be accounted for at fair value as held-for-trading instruments with changes in fair value recorded in net earnings provided they meet certain criteria. Financial instruments must have been designated when the standard was implemented or when the new financial instrument was acquired and the designation is irrevocable.

Fair values are based on quoted market prices where available from active markets, otherwise fair values are estimated using valuation methodologies, primarily discounted cash flow analysis.

As a result of the implementation of Section 3855, the following classifications were assumed:

- Cash and cash equivalents and short term investments are designated as held-for-trading with the exception of certain United States dollar denominated cash equivalents and short term investments designated in a cash flow hedging relationship, which are classified as available-for-sale financial assets.
- Accounts receivable are classified as loans and receivables.
- Investments in equity instruments are classified as available-for-sale.
- Bank indebtedness, commercial paper, accounts payable and certain accrued liabilities, short term debt, long term debt and capital lease obligations have been classified as other financial liabilities.

The Company has not classified any financial assets as held-to-maturity.

The above classifications resulted in the following re-measurement impacts:

- The re-measurement of financial assets classified as available-for-sale at fair value resulted in an increase in other assets of \$9 with a corresponding increase in accumulated other comprehensive income of \$6 net of income taxes.
- As a result of classifying certain United States dollar denominated cash equivalents and short term investments designated in a cash flow hedging relationship as available-for-sale, the net unrealized gain previously recorded in retained earnings was reclassified to accumulated other comprehensive income for an amount of \$14 net of income taxes.
- The retained interest held by *PC* Bank in securitized receivables has been designated as held-for-trading and has resulted in an increase in other assets of \$2 with a corresponding increase in opening retained earnings of \$1 net of income taxes.
- The re-measurement of financial assets classified as loans and receivables and financial liabilities classified as other liabilities at amortized cost was insignificant.

Non-financial derivative instruments must be recorded at fair value on the consolidated balance sheet unless they are exempt from derivative instrument treatment based upon expected purchase, sale or usage requirements. All changes in their fair value are recorded in net earnings unless cash flow hedge accounting is applied, in which case changes in fair value are recorded in other comprehensive income for the effective portion of the hedge. As a result of re-measuring a non-financial derivative instrument at fair value an increase in other assets of \$7 and an increase in opening retained earnings of \$5 net of income taxes was recognized. The standard requires embedded derivative instruments to be separated from their host contract and fair valued if certain criteria are met. Under an election provided for by the standard, December 29, 2002 was elected as the transition date to apply this accounting treatment to embedded derivative instruments. The impact of this change in accounting treatment related to embedded derivative instruments was not significant.

Section 3855 also requires that obligations undertaken in issuing a guarantee that meets the definition of a guarantee pursuant to AcG 14, "Disclosure of Guarantees" be recognized at fair value at inception. No subsequent re-measurement at fair value is required unless the financial guarantee qualifies as a derivative instrument. As a result, a liability of \$7 related to the fair value of the standby letter of credit issued by a major Canadian chartered bank for the benefit of an independent funding trust which provides loans to the Company's independent franchisees was recognized, with a corresponding decrease of \$6 net of income taxes to opening retained earnings.

Section 3865, "Hedges" ("Section 3865") replaces AcG 13, "Hedging Relationships". The requirements for identification, designation, documentation and assessment of effectiveness of hedging relationships remain substantially unchanged. Section 3865 addresses the accounting treatment of qualifying hedging relationships and the necessary disclosures and also requires all derivative instruments in hedging relationships to be recorded at fair value.

Upon implementation of these requirements with respect to cash flow hedges, an increase in other assets of \$17 and an increase in other liabilities of \$34 related to the fair value of the interest rate swaps not previously recognized on the consolidated balance sheet and an increase in accumulated other comprehensive income of \$10 net of income taxes were recorded. A decrease in opening retained earnings of \$15 net of income taxes resulting from the financing element of off-market interest rate swaps was also recorded. In addition, a decrease in accumulated other comprehensive income of \$14 net of income taxes was recorded related to the effective portion of the unrealized gains and losses on the cross currency basis swaps previously recognized in retained earnings. The ineffective portion of the gains or losses on the derivatives within the hedging relationships was insignificant.

## Notes to the Consolidated Financial Statements

Section 1530, "Comprehensive Income" introduces a statement of comprehensive income, which is comprised of net earnings and other comprehensive income. Other comprehensive income represents the change in shareholders' equity from transactions and other events from non-owner sources and includes unrealized gains and losses on financial assets that are classified as available-for-sale, and changes in the fair value of the effective portion of cash flow hedging instruments. The Company has included in the consolidated financial statements a new consolidated statement of comprehensive income for the changes in these items, while the cumulative changes in other comprehensive income are included in accumulated other comprehensive income, which is presented as a new category of shareholders' equity on the consolidated balance sheet. See note 20 for further details of the accumulated other comprehensive income balance.

Section 3251, "Equity", which replaced Section 3250, "Surplus", establishes standards for the presentation of equity and changes in equity during the reporting period and requires the Company to present separately equity components and changes in equity arising from i) net earnings; ii) other comprehensive income; iii) other changes in retained earnings; iv) changes in contributed surplus; v) changes in share capital; and vi) changes in reserves. New consolidated statements of changes in shareholders' equity are included in the consolidated financial statements.

Section 3861, "Financial Instruments – Disclosure and Presentation", which replaces Section 3860, of the same title, establishes standards for presentation of financial instruments and non-financial derivatives, and identifies the information that should be disclosed about them.

The following tables summarize the transitional adjustments recorded upon implementation:

	Transitional Adjustments
<b>Consolidated Balance Sheet</b>	
Other assets	\$ 35
Future income taxes	(7)
Other liabilities	41
Retained earnings	(15)
Accumulated other comprehensive income	16

	Retained Earnings		Accumulated Other Comprehensive Income	
	Gross	Net of Income Taxes	Gross	Net of Income Taxes
Classification of financial assets as available-for-sale	\$ (14)	\$ (14)	\$ 23	\$ 20
Classification of financial assets as held-for-trading	2	1	-	-
Non-financial derivative instrument	7	5	-	-
Guarantees	(7)	(6)	-	-
Cash flow hedges	(9)	(1)	(8)	(4)
	\$ (21)	\$ (15)	\$ 15	\$ 16

## Accounting Standards Implemented in 2006

Effective January 1, 2006, the Company implemented EIC Abstract 156, "Accounting by a Vendor for Consideration Given to a Customer (Including a Reseller of the Vendor's Products)", ("EIC 156") issued by the CICA in September 2005. EIC 156 addresses cash consideration, including sales incentives, given by a vendor to a customer. This consideration is presumed to be a reduction of the selling price of the vendor's products and should therefore be classified as a reduction of sales in the vendor's statement of earnings.

## Note 3. Goodwill

In 2007, the Company performed its annual goodwill impairment test and determined that there was no impairment to the carrying value of goodwill.

In 2006, the Company performed the annual goodwill impairment test and it was determined that the carrying value of the goodwill established on the acquisition of Provigo Inc. in 1998 exceeded its respective fair value. As a result, in 2006 the Company recorded in operating income a non-cash goodwill impairment charge of \$800 relating to this goodwill. The Company had no income tax deduction from this non-cash goodwill impairment charge. The determination that the fair value of goodwill was less than its carrying value resulted from a decline in market multiples, both from an industry and Company perspective, and a reduction of fair value as determined using the discounted cash flow methodology, incorporating both current Company and market assumptions, which in combination resulted in the goodwill impairment. In the second quarter of 2007, the Company completed its work and finalized the non-cash goodwill impairment charge of \$800 that was recorded in 2006.

In the normal course of business, the Company may acquire from time to time franchisee stores and convert them to corporate stores. In 2007, the Company acquired 4 franchisee businesses (2006 – 7 franchisee businesses). The acquisitions were accounted for using the purchase method of accounting with the results of the business acquired included in the consolidated financial statements from the date of acquisition. The fair value of the net assets acquired consisted of fixed assets of \$3 (2006 – \$2), other assets principally inventory of \$1 (2006 – \$2) and goodwill of \$8 (2006 – \$7) for cash consideration of \$9 (2006 – \$9), net of accounts receivable due from the franchisees of \$3 (2006 – \$2).

The consolidated balance sheet as at year end 2007 includes goodwill of independent franchisees that were consolidated by the Company pursuant to the requirements of AcG 15.

The following table discloses the changes in goodwill over 2007 and 2006.

	2007	2006
Balance, beginning of year	\$ 794	\$ 1,587
Goodwill acquired	8	7
Goodwill impairment	-	(800)
Other	4	-
Balance, end of year	\$ 806	\$ 794

## Notes to the Consolidated Financial Statements

### Note 4. Restructuring and Other Charges

#### Project Simplify

During 2007, the Company approved and announced the restructuring of its merchandising and store operations into more streamlined functions as part of Project Simplify. In 2007, the Company recognized \$197 of restructuring costs resulting from this plan, comprised of \$139 for employee termination benefits including severance, additional pension costs resulting from the termination of employees and retention costs; and \$58 of other costs, primarily consulting directly associated with the restructuring. The total restructuring costs under this plan, comprised primarily of severance costs, are estimated to be approximately \$200 million, with the remaining costs to be expensed in 2008.

#### Store Operations

During 2007, the Company completed the previously announced restructuring of its store operations. The total restructuring costs under these plans was \$51 compared to the original estimate of \$54. Of the \$51 total costs, approximately \$8 was attributable to employee termination benefits which included severance resulting from the termination of employees, \$25 to fixed asset impairment and accelerated depreciation of assets relating to these restructuring activities and \$18 to site closing and other costs including lease obligations. In 2007, the Company recognized \$16 (2006 – \$35) of these restructuring costs, which relate to site closing and other costs including lease obligations. The components of the store operations restructuring plan are described below.

As part of a review of the Quebec store operations, the Company approved and communicated a plan in 2006 to close 19 underperforming stores, mainly within the *Provigo* banner. During 2007, the Company concluded that 16 stores, 3 less than originally planned, would close under this initiative. The closure of these 16 stores was completed in 2007. The total restructuring cost under this initiative was \$37 compared to the original estimate of \$40, of which \$9 (2006 – \$28) was recognized in 2007.

Based on the Company's review of the impact on the Cash & Carry and wholesale club network of the loss in tobacco sales following the decision by a major tobacco supplier to sell directly to certain customers of the Company, the Company approved and communicated a plan in 2006 to close 24 wholesale outlets which were impacted most significantly by this change. The total restructuring cost under this initiative was \$12 compared to the original estimate of \$10, of which \$6 (2006 – \$6) was recognized in 2007.

As part of a review of the Atlantic store operations, the Company approved and communicated a plan in 2006 to close 8 stores in the Atlantic region. The total restructuring cost under this initiative was \$2 compared to the original estimate of \$4, of which \$1 (2006 – \$1) was recognized in 2007.

#### Supply Chain Network

During 2005, the Company approved a comprehensive plan to restructure its supply chain operations nationally. The restructuring plan is expected to be completed by the first quarter of 2009 and the total restructuring costs under this plan is estimated to be approximately \$90. Of the \$90 total estimated costs, approximately \$57 is attributable to employee termination benefits which include severance and additional pension costs resulting from the termination of employees, \$13 to fixed asset impairment and accelerated depreciation of assets relating to this restructuring activity and \$20 to site closing and other costs directly attributable to the restructuring plan. In 2007, the Company recognized \$9 (2006 – \$8) of restructuring costs resulting from this plan which is composed of \$7 (2006 – \$4) for employee termination benefits resulting from planned involuntary terminations, nil (2006 – \$2) for fixed asset impairment and accelerated depreciation and \$2 (2006 – \$2) for other costs directly associated with those initiatives. At the end of the year, \$11 in estimated costs remain to be incurred and will be recognized as appropriate criteria are met.

### Office Move and Reorganization of the Operation Support Functions

In 2005, the Company consolidated several administrative and operating offices from across southern Ontario into a new national head office in Brampton, Ontario and reorganized the merchandising, procurement and operations groups which included the transfer of the general merchandise operations from Calgary, Alberta to the new office. All of the expected \$25 of costs related to these initiatives had been recognized by the end of 2006.

The following table provides a summary of the costs recognized and cash payments made, as well as the corresponding net liability as at December 29, 2007 and December 30, 2006:

	Employee Termination Benefits	Site Closing Costs and Other	2007 Total	2006 Total
Net liability, beginning of year	\$ 40	\$ -	\$ 40	\$ 41
Costs recognized:				
Project Simplify	\$ 139	\$ 58	\$ 197	\$ -
Store operations	(1)	17	16	35
Supply chain network	7	2	9	8
Office move and reorganization of the operation support functions	-	-	-	1
	\$ 145	\$ 77	\$ 222	\$ 44
Cash payments:				
Project Simplify	\$ 100	\$ 49	\$ 149	\$ -
Store operations	7	15	22	1
Supply chain network	4	1	5	6
Office move and reorganization of the operation support functions	-	-	-	2
	\$ 111	\$ 65	\$ 176	\$ 9
Charges against fixed assets	\$ -	\$ -	\$ -	\$ 27
Charges against other assets <sup>(1)</sup>	15	-	15	9
Net liability, end of year	\$ 59	\$ 12	\$ 71	\$ 40
Recorded in the consolidated balance sheet as follows:				
Accounts payable and accrued liabilities	38	12	50	19
Other liabilities (note 17)	21	-	21	21
Net liability, end of year	\$ 59	\$ 12	\$ 71	\$ 40

(1) Represents defined benefit pension plan cost applied to other assets. Charges against other assets relates to the contractual termination benefits cost recognized which reduced the accrued benefit plan asset.

## Notes to the Consolidated Financial Statements

### Note 5. Collective Agreement

During 2006, members of certain Ontario locals of the United Food and Commercial Workers union ratified a new four-year collective agreement. The new agreement enables the Company to convert 44 stores in Ontario to the *Real Canadian Superstore* banner or food stores with equivalent labour economics, and the flexibility to invest in additional store labour where appropriate. As a result of securing this agreement, the Company recognized a one-time charge in 2006 of \$84 in operating income, including a \$36 amount due to a multi-employer pension plan which was paid in 2007 (see note 14) and a payment of \$38 which was paid to employees in 2006 upon ratification.

### Note 6. Interest Expense

	2007	2006
Interest on long term debt	\$ 285	\$ 284
Interest expense on financial derivative instruments	12	7
Net short term interest income (note 9)	(23)	(11)
Capitalized to fixed assets	(22)	(21)
Interest expense	\$ 252	\$ 259

During 2007, net interest expense of \$261 was recorded related to the financial assets and financial liabilities not classified as held-for-trading. In addition, \$41 (2006 – \$40) of income from cash, cash equivalents and short term investments, held by Glenhuron Bank Limited (“Glenhuron”), a wholly owned subsidiary of the Company in Barbados, was recognized in net short term interest income (see note 9).

Interest paid in 2007 was \$403 (2006 – \$405), and interest received in 2007 was \$134 (2006 – \$127).

### Note 7. Income Taxes

The effective income tax rate in the consolidated statements of earnings is reported at a rate different than the weighted average basic Canadian federal and provincial statutory income tax rate for the following reasons:

	2007	2006
Weighted average basic Canadian federal and provincial statutory income tax rate	33.2%	33.7%
Net increase (decrease) resulting from:		
Earnings in jurisdictions taxed at rates different from the Canadian statutory income tax rates	1.4	(0.6)
Non-taxable amounts	(1.5)	(1.1)
Impact of statutory income tax rate changes on future income tax balances	(2.3)	(2.1)
Other	0.2	-
Effective income tax rate before impact of non-deductible goodwill impairment charge	31.0%	29.9%
Non-deductible goodwill impairment charge	-	796.8
Effective income tax rate	31.0%	826.7%

Net income taxes paid in 2007 were \$220 (2006 – \$325).

The cumulative effects of changes in Canadian federal and certain provincial statutory income tax rates on future income tax assets and liabilities are included in the consolidated financial statements at the time of substantive enactment. Accordingly, in 2007 an \$11 (2006 – \$16) net reduction to the future income tax expense was recognized as a result of the change in the Canadian federal and certain provincial statutory income tax rates.

The income tax effects of temporary differences that gave rise to significant portions of the future income tax assets (liabilities) were as follows:

	2007	2006
Accounts payable and accrued liabilities	\$ 47	\$ 55
Other liabilities	120	117
Fixed assets	(259)	(278)
Other assets	(89)	(103)
Losses carried forward (expiring 2008 to 2027)	41	20
Other	16	40
<b>Net future income tax liabilities</b>	<b>\$ (124)</b>	<b>\$ (149)</b>
	2007	2006
Recorded in the consolidated balance sheets as follows:		
Current future income tax assets	\$ 56	\$ 85
Non-current future income tax liabilities	(180)	(234)
<b>Net future income tax liabilities</b>	<b>\$ (124)</b>	<b>\$ (149)</b>

**Note 8. Basic and Diluted Net Earnings (Loss) per Common Share** (\$, except where otherwise indicated)

	2007	2006
Net earnings (loss) (\$ millions)	\$ 330	\$ (219)
Weighted average common shares outstanding (in millions) (note 19)	274.2	274.1
Dilutive effect of stock-based compensation (in millions)	-	.2
Diluted weighted average common shares outstanding (in millions)	274.2	274.3
Basic net earnings (loss) per common share	\$ 1.20	\$ (.80)
Dilutive effect of stock-based compensation per common share	-	-
<b>Diluted net earnings (loss) per common share</b>	<b>\$ 1.20</b>	<b>\$ (.80)</b>

Stock options outstanding with an exercise price greater than the market price of the Company's common shares at December 29, 2007 were not recognized in the computation of diluted net earnings (loss) per common share. Accordingly, for 2007, 6,390,459 (2006 – 4,027,406) stock options, with a weighted average exercise price of \$52.67 (2006 – \$61.55) per common share, were excluded from the computation of diluted net earnings (loss) per common share.

## Notes to the Consolidated Financial Statements

### Note 9. Cash and Cash Equivalents

The components of cash and cash equivalents as at December 29, 2007 and December 30, 2006 were as follows:

	2007	2006
Cash	\$ 61	\$ 89
Cash equivalents – short term investments with a maturity of 90 days or less:		
Bank term deposits	77	3
Government treasury bills	257	208
Government-sponsored debt securities	155	227
Corporate commercial paper	124	106
Bank-sponsored asset-backed commercial paper	–	36
<b>Cash and cash equivalents</b>	<b>\$ 674</b>	<b>\$ 669</b>

The Company recognized an unrealized foreign currency exchange loss of \$155 (2006 – gain of \$2) as a result of translating its United States dollar denominated cash, cash equivalents and short term investments, of which a loss of \$97 (2006 – income of \$1) related to cash and cash equivalents. The resulting loss or gain on cash, cash equivalents and short term investments is offset in operating income and accumulated other comprehensive income by the unrealized foreign currency exchange gain or loss on the cross currency basis swaps as described in note 22.

### Note 10. Accounts Receivable

	2007	2006
Credit card receivables	\$ 2,023	\$ 1,571
Amount securitized	(1,475)	(1,250)
Net credit card receivables	548	321
Other receivables	337	407
<b>Accounts receivable</b>	<b>\$ 885</b>	<b>\$ 728</b>

The Company, through *PC* Bank, securitizes certain credit card receivables by selling them to independent special purpose entities or trusts that issue interest bearing securities. When *PC* Bank sells credit card receivables, it retains servicing responsibilities, certain administrative responsibilities and the right to future cash flows after obligations to investors have been met. Commencing December 31, 2006, these retained interests have been designated as held-for-trading upon the implementation of Section 3855 and are carried at their fair value in other assets. The fair value of these retained interests was estimated using management's best estimate of the net present value of expected future cash flows using key assumptions. Prior to December 31, 2006 these retained interests were carried at their original carrying amount that was periodically reviewed and written down to fair value when there was an other than temporary decline in value. Although *PC* Bank remains responsible for servicing all credit card receivables, it does not receive additional compensation for servicing those credit card receivables sold to the trusts.

During 2007, \$225 (2006 – \$240) of credit card receivables were securitized through the sale of a portion of the total interest in these receivables to independent trusts, yielding \$1 gain (2006 – nominal net loss) on the initial sale inclusive of nil (2006 – nil) servicing liability. During 2007, *PC* Bank received income of \$141 (2006 – \$114) in securitization revenue from the independent trusts relating to the securitized credit card receivables. An increase in servicing liability of \$2 (2006 – nil) was recognized during the year on securitization and the fair value at year end of recognized servicing liabilities was \$10 (2006 – \$8). The trusts' recourse to *PC* Bank's assets is limited to *PC* Bank's retained interests and is further supported by the Company through a standby letter of credit for 9% (2006 – 9%) on a portion of the securitized amount (see note 23).

Net credit loss experience of \$11 (2006 – \$9) includes \$57 (2006 – \$45) of credit losses on the total portfolio of credit card receivables net of credit losses of \$46 (2006 – \$36) relating to securitized credit card receivables.

The following table displays the sensitivity of the current fair value of retained interests to an immediate 10% and 20% adverse change in the 2007 key economic assumptions. The sensitivity analysis provided in the table is hypothetical and should be used with caution. The sensitivities of each key assumption have been calculated independently of any changes in other key assumptions. Actual experience may result in changes in a number of key assumptions simultaneously. Changes in one factor may result in changes in another, which could amplify or reduce the impact of such assumptions.

	2007	Change in Assumptions	
		10%	20%
Carrying value of retained interests	\$ 8		
Payment rate (monthly)	43.0%		
Weighted average life (years)	0.7		
Expected credit losses (annual)	3.25%	\$ (0.9)	\$ (1.8)
Discount rate applied to residual cash flows (annual)	15.21%	\$ (0.02)	\$ (0.05)

The details on the cash flows from securitization are as follows:

	2007	2006
Proceeds from new securitizations	\$ 225	\$ 240
Net cash flows received on retained interests	\$ 143	\$ 116

#### Note 11. Inventory Liquidation

During 2007, the Company recognized a charge of \$15 in operating income, comprising mainly storage and shipping costs, related to certain excess inventory, primarily general merchandise, as a result of its decision in 2006 to proceed with the liquidation of this inventory. In 2006, the Company recognized a charge of \$68 to adjust inventory identified for liquidation to the lower of cost and net realizable value. The charge reflected the write-down of inventory to recovery values and the associated costs of facilitating the disposition incurred to the end of 2007. The excess inventory liquidation was completed in 2007.

## Notes to the Consolidated Financial Statements

### Note 12. Fixed Assets

	2007			2006		
	Cost	Accumulated Depreciation	Net Book Value	Cost	Accumulated Depreciation	Net Book Value
Properties held for development	\$ 525		\$ 525	\$ 500		\$ 500
Properties under development	89		89	226		226
Land	1,709		1,709	1,699		1,699
Buildings	5,292	\$ 1,254	4,038	4,955	\$ 1,012	3,943
Equipment and fixtures	4,108	2,857	1,251	3,788	2,475	1,313
Building and leasehold improvements	518	238	280	611	269	342
	<b>12,241</b>	<b>4,349</b>	<b>7,892</b>	11,779	3,756	8,023
Capital leases – buildings and equipment	164	103	61	129	97	32
	<b>\$ 12,405</b>	<b>\$ 4,452</b>	<b>\$ 7,953</b>	\$ 11,908	\$ 3,853	\$ 8,055

The following items were recognized in operating income during 2007: fixed asset impairment charge of \$33 (2006 – \$27), accelerated depreciation charge of \$3 (2006 – charge of \$5) and restructuring and other charges of a nominal amount (2006 – charge of \$27) (see note 4).

### Note 13. Other Assets

	2007	2006
Unrealized cross currency basis swaps receivable (note 22)	\$ 270	\$ 165
Franchise investments and other receivables	186	195
Accrued benefit plan asset (note 14)	181	182
Deferred charges and other	185	147
	<b>\$ 822</b>	<b>\$ 689</b>

Included in deferred charges and other above are \$9 (2006 – nil) of unrealized interest rate swap receivable and \$5 (2006 – nil) related to an electricity forward contract (see note 22).

## **Note 14. Employee Future Benefits**

### **Pension and Other Benefit Plans**

The Company sponsors a number of pension plans, including registered funded defined benefit pension plans, defined contribution pension plans and supplemental unfunded arrangements providing pension benefits in excess of statutory limits. Certain obligations of the Company to these supplemental pension arrangements are secured by a standby letter of credit issued by a major Canadian chartered bank. The Company's defined benefit pension plans are predominantly non-contributory and these benefits are, in general, based on career average earnings.

A new national defined contribution pension plan for salaried employees was introduced by the Company during 2006. All eligible salaried employees were given the option to join this new plan and convert their past accrued pension benefits or to remain in their existing defined benefit pension plans. All new salaried employees participate only in the new national defined contribution pension plan.

The Company also offers certain employee post-retirement and post-employment benefit plans and a long term disability benefit plan. Post-retirement and post-employment benefit plans are generally not funded, are mainly non-contributory and include health care, life insurance and dental benefits. Employees eligible for post-retirement benefits are those who retire at certain retirement ages and employees eligible for post-employment benefits are those on long term disability leave. The majority of post-retirement health care plans for current and future retirees include a limit on the total benefits payable by the Company.

The Company also contributes to various multi-employer pension plans that provide pension benefits.

The accrued benefit plan obligations and the fair value of the benefit plan assets were determined using a September 30 measurement date for accounting purposes.

### **Funding of Pension and Other Benefit Plans**

The most recent actuarial valuations of the defined benefit pension plans for funding purposes ("funding valuations") were performed as at December 31, 2006 for all plans, except two plans for which funding valuations are to be performed as at December 31, 2007 and were last performed as at December 31, 2004. The Company is required to file funding valuations at least every three years; accordingly, the next required funding valuations for the above mentioned plans will be performed no later than December 31, 2009 and 2010, respectively.

Total cash payments made by the Company during 2007, consisting of contributions to funded defined benefit pension plans, defined contribution pension plans, multi-employer pension plans, long term disability benefit plan and benefits paid directly to beneficiaries of the unfunded defined benefit pension plans and other benefit plans, were \$183 (2006 – \$166). In 2006, the Company accrued \$36 relating to a one-time contribution to a multi-employer pension plan which was paid in 2007 (see note 5).

During 2008, the Company expects to contribute approximately \$76 to its registered funded defined benefit pension 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 plans and other benefit plans.

## Notes to the Consolidated Financial Statements

### Pension and Other Benefit Plans Status

Information on the Company's defined benefit pension plans and other benefit plans, in aggregate, was as follows:

	2007			2006		
	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>	Total	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>	Total
<b>Benefit Plan Assets</b>						
Fair value, beginning of year	\$ 1,052	\$ 44	\$ 1,096	\$ 944	\$ 42	\$ 986
Actual return (loss) on plan assets	91	1	92	74	(1)	73
Employer contributions	77	10	87	90	21	111
Employee contributions	2	2	4	2	-	2
Benefits paid	(61)	(23)	(84)	(58)	(18)	(76)
Other	-	(1)	(1)	-	-	-
Fair value, end of year	\$ 1,161	\$ 33	\$ 1,194	\$ 1,052	\$ 44	\$ 1,096
<b>Accrued Benefit Plan Obligations</b>						
Balance, beginning of year	\$ 1,262	\$ 308	\$ 1,570	\$ 1,155	\$ 243	\$ 1,398
Current service cost	52	44	96	50	9	59
Interest cost	65	16	81	62	13	75
Benefits paid	(61)	(23)	(84)	(58)	(18)	(76)
Actuarial (gain) / loss	(87)	(22)	(109)	55	61	116
Contractual termination benefits <sup>(2)</sup>	7	-	7	-	-	-
Special termination benefits <sup>(2)</sup>	6	-	6	-	-	-
Curtailment gains <sup>(3)</sup>	(11)	(2)	(13)	-	-	-
Other	(1)	(2)	(3)	(2)	-	(2)
Balance, end of year	\$ 1,232	\$ 319	\$ 1,551	\$ 1,262	\$ 308	\$ 1,570
<b>Deficit of Plan Assets Versus Plan Obligations</b>						
Unamortized past service costs	\$ 2	(6)	(4)	5	(7)	(2)
Unamortized net actuarial loss	193	137	330	313	172	485
Net accrued benefit plan asset (liability)	\$ 124	\$ (155)	\$ (31)	\$ 108	\$ (99)	\$ 9
Recorded in the consolidated balance sheets as follows:						
Other assets (note 13)	\$ 170	\$ 11	\$ 181	\$ 145	\$ 37	\$ 182
Other liabilities (note 17)	(46)	(166)	(212)	(37)	(136)	(173)
Net accrued benefit plan asset (liability)	\$ 124	\$ (155)	\$ (31)	\$ 108	\$ (99)	\$ 9

(1) Other benefit plans include post-retirement, post-employment and long term disability benefit plans.

(2) Contractual and special termination benefits resulted from the 2007 Project Simplify, which involves the restructuring and streamlining of the Company's merchandising and store operations, were recorded in restructuring and other charges in 2007 (see note 4).

(3) Certain defined benefit pension plans and other benefit plans affected by the 2007 Project Simplify to restructure and streamline the Company's merchandising and store operations were remeasured as at March 31, 2007 and costs subsequent to April 1, 2007 were determined using a discount rate of 5.0%. This resulted in a nominal impact to 2007 net earnings and curtailment gains which were offset against unamortized net actuarial losses for those plans.

### Funded Status of Plans in a Deficit

Included in the accrued benefit plan obligations and the fair value of benefit plan assets at year end are the following amounts in respect of plans with accrued benefit plan obligations in excess of benefit plan assets:

	2007		2006	
	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>
Fair Value of Benefit Plan Assets	\$ 326	\$ 33	\$ 1,052	\$ 44
Accrued Benefit Plan Obligations	424	319	1,262	308
Deficit of Plan Assets versus Plan Obligations	\$ (98)	\$ (286)	\$ (210)	\$ (264)

(1) Other benefit plans include post-retirement, post-employment and long term disability benefit plans.

### Asset Allocations

The benefit plan assets are held in trust and at September 30 consisted of the following asset categories:

Percentage of Plan Assets	2007		2006	
	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>
Asset Category				
Equity securities	63%	– %	63%	–%
Debt securities	35%	91%	36%	93%
Cash and cash equivalents	2%	9%	1%	7%
Total	100%	100%	100%	100%

(1) Other benefit plans include post-retirement, post-employment and long term disability benefit plans.

Pension benefit plan assets include securities issued by the Company's majority shareholder, George Weston Limited ("Weston"), and by Loblaw having a fair value of \$5 and \$1 (2006 – \$3 and nil), respectively, as at September 30, 2007. Other benefit plan assets do not include any Weston or Loblaw securities.

## Notes to the Consolidated Financial Statements

### Pension and Other Benefit Plans Cost

The total net cost for the Company's benefit plans and multi-employer pension plans was as follows:

	2007		2006	
	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>
Current service cost, net of employee contributions	\$ 50	\$ 42	\$ 48	\$ 9
Interest cost on plan obligations	65	16	62	13
Actual (return) loss on plan assets	(91)	(1)	(74)	1
Actuarial (gain) loss	(87)	(22)	55	61
Contractual termination benefits <sup>(2)</sup>	7	-	-	-
Special termination benefits <sup>(2)</sup>	6	-	-	-
Curtailment loss <sup>(2)</sup>	2	-	-	-
Defined benefit plan (income) cost, before adjustments to recognize the long term nature of employee future benefit costs	(48)	35	91	84
Excess (shortfall) of actual return over expected return on plan assets	9	(1)	(1)	(4)
Excess (shortfall) of amortized net actuarial loss over actual actuarial loss on accrued benefit obligation	99	34	(43)	(40)
(Shortfall) excess of amortized past service costs over actual past service costs	-	(1)	1	-
Net defined benefit plan cost	60	67	48	40
Defined contribution plan cost	10	-	6	-
Multi-employer pension plan cost <sup>(3)</sup>	50	-	85	-
Net benefit plan cost	\$ 120	\$ 67	\$ 139	\$ 40
Recognized in the consolidated statements of earnings as follows:				
Pension and other benefit plan costs	\$ 105	\$ 67	\$ 139	\$ 40
Restructuring and other charges <sup>(2)</sup>	15	-	-	-
Net benefit plan cost	\$ 120	\$ 67	\$ 139	\$ 40

(1) Other benefit plans include post-retirement, post-employment and long term disability benefit plans.

(2) Contractual and special termination benefits and curtailment losses resulted from the 2007 Project Simplify, which involves the restructuring and streamlining of the Company's merchandising and store operations, were recorded in restructuring and other charges in 2007 (see note 4).

(3) Included in 2006 is a \$36 amount relating to a one-time contribution to a multi-employer pension plan which was paid in 2007 (see note 5).

## Plan Assumptions

The significant annual weighted average actuarial assumptions used in calculating the Company's accrued benefit plan obligations as at the measurement date of September 30 and the net defined benefit plan cost for the year were as follows:

	2007		2006	
	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>	Pension Benefit Plans	Other Benefit Plans <sup>(1)</sup>
Accrued Benefit Plan Obligations				
Discount rate	5.5%	5.3%	5.0%	5.0%
Rate of compensation increase	3.5%		3.5%	
Net Defined Benefit Plan Cost				
Discount rate <sup>(2)</sup>	5.0%	5.0%	5.25%	5.2%
Expected long term rate of return on plan assets	7.75%	5.0%	8.0%	5.0%
Rate of compensation increase	3.5%		3.5%	

(1) Other benefit plans include post-retirement, post-employment and long term disability benefit plans.

(2) Certain defined benefit pension plans and other benefit plans affected by the 2007 Project Simplify to restructure and streamline the Company's merchandising and store operations were remeasured as at March 31, 2007 and costs subsequent to April 1, 2007 were determined using a discount rate of 5.0%. This resulted in a nominal impact to 2007 net earnings and curtailment gains which were offset against unamortized net actuarial losses for those plans.

The growth rate of health care costs, primarily drug and other medical costs for other benefit plans, was estimated at 10.0% (2006 – 10.0%) and is assumed to gradually decrease to 5.0% by 2015 (2006 – 5.0% by 2014), remaining at that level thereafter.

## Sensitivity of Key Assumptions

The following table outlines the key assumptions for 2007 and the sensitivity of a 1% change in each of these assumptions on the accrued benefit plan obligations and on the benefit plan cost for defined benefit pension plans and other benefit plans. The table reflects the impact on the current service and interest cost components for the discount rate and expected growth rate of health care costs assumptions.

The sensitivity analysis provided in the table is hypothetical and should be used with caution. The sensitivities of each key assumption have been calculated independently of any changes in other key assumptions. Actual experience may result in changes in a number of key assumptions simultaneously. Changes in one factor may result in changes in another, which could amplify or reduce the impact of such assumptions.

	Pension Benefit Plans		Other Benefit Plans <sup>(1)</sup>	
	Accrued Benefit Plan Obligations	Benefit Plan Cost <sup>(2)</sup>	Accrued Benefit Plan Obligations	Benefit Plan Cost <sup>(2)</sup>
Expected long term rate of return on plan assets		7.75%		5.0%
Impact of: 1% increase	n/a	\$ (11)	n/a	\$ -
1% decrease	n/a	\$ 11	n/a	\$ -
Discount rate	5.5%	5.0%	5.3%	5.0%
Impact of: 1% increase	\$ (174)	\$ (9)	\$ (37)	\$ (4)
1% decrease	\$ 203	\$ 10	\$ 42	\$ 4
Expected growth rate of health care costs <sup>(3)</sup>			10.0%	10.0%
Impact of: 1% increase	n/a	n/a	\$ 31	\$ 5
1% decrease	n/a	n/a	\$ (27)	\$ (5)

n/a – not applicable

(1) Other benefit plans include post-retirement, post-employment and long term disability benefit plans.

(2) Discount rate and expected growth rate of health care costs sensitivity is for current service and interest costs only.

(3) Gradually decreasing to 5.0% by 2015 for the accrued benefit plan obligation and the benefit plan cost, and remaining at that level thereafter.

## Notes to the Consolidated Financial Statements

### Note 15. Short Term Debt

During 2007, the Company entered into a 364-day revolving committed credit facility of \$500 million, which matures in March 2008 and has no financial covenants. Borrowings are based on short term floating interest rates. At December 29, 2007, nil was drawn on this facility. Subsequent to December 29, 2007, the Company obtained a 60-day extension of the facility extending the maturity date to May 2008.

### Note 16. Long Term Debt

	2007	2006
<b>Loblaw Companies Limited Notes</b>		
6.00%, due 2008	\$ 390	\$ 390
5.75%, due 2009	125	125
7.10%, due 2010	300	300
6.50%, due 2011	350	350
5.40%, due 2013	200	200
6.00%, due 2014	100	100
7.10%, due 2016	300	300
6.65%, due 2027	100	100
6.45%, due 2028	200	200
6.50%, due 2029	175	175
11.40%, due 2031		
– principal	151	151
– effect of coupon repurchase	(44)	(34)
6.85%, due 2032	200	200
6.54%, due 2033	200	200
8.75%, due 2033	200	200
6.05%, due 2034	200	200
6.15%, due 2035	200	200
5.90%, due 2036	300	300
6.45%, due 2039	200	200
7.00%, due 2040	150	150
5.86%, due 2043	55	55
Other at a weighted average interest rate of 9.57%, due 2008 to 2043	17	21
VIE loans payable (i) (see note 26)	153	124
Capital lease obligations (i) (see note 18)	62	32
<b>Total long term debt</b>	<b>4,284</b>	<b>4,239</b>
<b>Less amount due within one year</b>	<b>432</b>	<b>27</b>
	<b>\$ 3,852</b>	<b>\$ 4,212</b>

(i) Pursuant to the requirements of AcG 15, the consolidated balance sheet as at December 29, 2007 includes \$183 (2006 – \$156) of loans payable and capital lease obligations of VIEs consolidated by the Company, \$32 (2006 – \$23) of which is due within one year.

The schedule of repayment of long term debt, inclusive of VIE and other debt, based on maturity is as follows: 2008 – \$432; 2009 – \$149; 2010 – \$326; 2011 – \$376; 2012 – \$24; thereafter – \$2,977.

During 2006, the Company repaid its \$125 of 8.70% Series 1996 Provigo Inc. Debenture as it matured.

The VIE loans payable of \$153 (2006 – \$124) represent financing obtained by eligible independent franchisees through a structure involving independent trusts to facilitate the purchase of the majority of their inventory and fixed assets, consisting mainly of fixtures and equipment. The loans payable, which have an average term to maturity of 7 years (2006 – 8 years), are due and payable on demand under certain predetermined circumstances and are secured through a general security agreement made by the independent franchisees in favour of the independent funding trust. Interest is charged on a floating rate basis and prepayment of the loans may be made without penalty. The independent funding trust within the structure finances its activities through the issuance of short term asset-backed commercial paper (“ABCP”) to third-party investors. The independent funding trust has a global style liquidity agreement from a major Canadian chartered bank in the event that it is unable to issue short term ABCP. As disclosed in note 23, a standby letter of credit has been provided by a major Canadian chartered bank for the benefit of the independent funding trust equal to approximately 10% of the total principal amount of the loans outstanding at any point in time. The Company has agreed to reimburse the issuing bank for any amount drawn on the standby letter of credit. In the event of a default by an independent franchisee and the Company has not, within a specified time period assumed the loan, or the default is not otherwise remedied, the independent funding trust shall assign the loan to the Company and draw upon the standby letter of credit (see note 26).

The fair value of long term debt issues at year end 2007 is \$4,216 (2006 – \$4,798). The fair values were estimated based on the discounted cash flows of the debt at the Company’s estimated incremental borrowing rates for debt of the same remaining maturities.

#### Note 17. Other Liabilities

	2007	2006
Accrued benefit plan liability (note 14)	\$ 212	\$ 173
Unrealized equity forwards payable (note 22)	91	13
Unrealized interest rate swap liability (note 22)	28	–
Goods and services tax and provincial sales tax	23	14
Restructuring and other charges (note 4)	21	21
Stock-based compensation (note 21)	10	17
Other	74	76
	<b>\$ 459</b>	<b>\$ 314</b>

#### Note 18. Leases

##### As Lessee

Future minimum lease payments relating to the Company’s operating leases are as follows:

	Payments due by year						2007 Total	2006 Total
	2008	2009	2010	2011	2012	Thereafter to 2046		
Operating lease payments	\$ 192	\$ 172	\$ 150	\$ 128	\$ 108	\$ 673	<b>\$ 1,423</b>	\$ 1,492
Expected sub-lease income	(37)	(31)	(26)	(20)	(16)	(42)	<b>(172)</b>	(188)
Net operating lease payments	\$ 155	\$ 141	\$ 124	\$ 108	\$ 92	\$ 631	<b>\$ 1,251</b>	\$ 1,304

## Notes to the Consolidated Financial Statements

### Capital Leases

Capital lease obligations of \$62 (2006 – \$32) are included in the consolidated balance sheet as at year end (see note 16). The capital lease obligations are related primarily to equipment of the third-party VIE that provides distribution and warehousing services. The amount due within one year is \$9 (2006 – \$4).

### Sale-Leaseback

In 2007, the Company completed a sale-leaseback transaction of property and a partially constructed building (“Property”) for a total purchase price of \$109, subject to a vendor take back mortgage of \$27 which bears interest at 6% due in 2009. There was no gain or loss recorded on the sale of the Property. The Company has leased back the Property for a term of 20 years, with options to renew for an additional 20 years, and in turn subleased the Property to a third-party logistics provider. The leaseback was accounted for as an operating lease and commences in 2008. The Company also entered into a warehousing and distribution agreement with the third-party logistics provider, which will use this Property to provide services to Loblaw.

### Note 19. Common Share Capital (authorized – unlimited)

The changes in the common shares issued and outstanding during the year were as follows:

	2007		2006	
	Number of Common Shares	Common Share Capital	Number of Common Shares	Common Share Capital
Issued and outstanding, beginning of year	274,173,564	\$ 1,196	274,054,814	\$ 1,192
Stock options exercised for shares (note 21)	–	–	118,750	4
Issued and outstanding, end of year	274,173,564	\$ 1,196	274,173,564	\$ 1,196
Weighted average outstanding	274,173,564		274,066,885	

**Normal Course Issuer Bids (“NCIB”)** The Company intends to renew its NCIB to purchase on the Toronto Stock Exchange or enter into equity forwards to purchase up to 5% of its common shares outstanding. The Company, in accordance with the rules and by-laws of the Toronto Stock Exchange, may purchase its shares at the then market price of such shares. The Company did not purchase any shares under its NCIB during 2007 or 2006.

## Note 20. Accumulated Other Comprehensive Income

The following table provides further detail regarding the composition of accumulated other comprehensive income for the year ended December 29, 2007:

	Cash Flow Hedges	Available- for-sale Assets	Total
Balance, beginning of year	\$ -	\$ -	\$ -
Cumulative impact of implementing new accounting standards (net of income taxes of \$1) (note 2)	(4)	20	16
Net unrealized loss on available-for-sale financial assets (net of income taxes of \$5)	-	(56)	(56)
Reclassification of loss on available-for-sale financial assets (net of income taxes of nil)	-	33	33
Net gain on derivatives designated as cash flow hedges (net of income taxes of \$2)	57	-	57
Reclassification of gain on derivatives designated as cash flow hedges (net of income taxes of \$1)	(31)	-	(31)
Balance, end of year	\$ 22	\$ (3)	\$ 19

An estimated net gain of \$18 recorded in accumulated other comprehensive income related to the cash flow hedges as at December 29, 2007, is expected to be reclassified to net earnings during the next 12 months. This will be offset by the estimated loss on available-for-sale financial assets that are hedged. Remaining amounts will be reclassified to net earnings over periods up to 4 years.

## Note 21. Stock-Based Compensation (\$, except where otherwise indicated)

The Company maintains various types of stock-based compensation plans, which are described below.

The Company's net stock-based compensation cost recognized in operating income related to its stock option plan and the associated equity forwards and the restricted share unit plan was as follows:

(\$ millions)	2007	2006
Stock option plan income	\$ -	\$ (11)
Equity forwards loss (note 22)	67	32
Restricted share unit plan expense	5	16
Net stock-based compensation cost	\$ 72	\$ 37

**Stock Option Plan** The Company maintains a stock option plan for certain employees. Under this plan, the Company may grant options for up to 20.4 million common shares; however, the Company has set a guideline which limits the number of stock option grants to a maximum of 5% of outstanding common shares at any time. Stock options have up to a seven-year term, vest 20% cumulatively on each anniversary date of the grant and are exercisable at the designated common share price, which is 100% of the market price of the Company's common shares on the last trading day prior to the effective date of the grant. Each stock option is exercisable into one common share of the Company at the price specified in the terms of the option, or option holders may elect to receive in cash the share appreciation value equal to the excess of the market price at the date of exercise over the specified option price.

During 2007, the Company granted 4,368,980 (2006 – 189,354) stock options with a weighted average exercise price of \$47.28 (2006 – \$55.30) per common share under its existing stock option plan, which allows for settlement in shares or in the share appreciation value in cash at the option of the employee.

## Notes to the Consolidated Financial Statements

In 2007, the share appreciation value of a nominal amount (2006 – \$11 million) was paid on the exercise of 108,000 (2006 – 815,403) stock options. The Company issued nil (2006 – 118,750) common shares on the exercise of stock options and received cash consideration of nil (2006 – \$4 million) for which it had recorded a stock-based compensation liability of nil (2006 – \$0.1 million).

At year end, a total of 6,532,756 (2006 – 4,084,646) stock options were outstanding, and represented approximately 2.4% (2006 – 1.5%) of the Company's issued and outstanding common shares, which was within the Company's guideline of 5%. Of the 6,532,756 (2006 – 4,084,646) outstanding options, 6,491,516 (2006 – 4,043,406) relate to stock option grants that allow for settlement in shares or in the share appreciation value in cash at the option of the employee and 41,240 (2006 – 41,240) relate to stock option grants, issued prior to December 30, 2001 that will be settled by issuing common shares.

A summary of the status of the Company's stock option plan and activity was as follows:

	2007		2006	
	Options (number of shares)	Weighted Average Exercise Price/Share	Options (number of shares)	Weighted Average Exercise Price/Share
Outstanding options, beginning of year	4,084,646	\$ 61.36	5,305,422	\$ 56.98
Granted	4,368,980	\$ 47.28	189,354	\$ 55.30
Exercised	(108,000)	\$ 48.75	(934,153)	\$ 35.18
Forfeited/cancelled	(1,812,870)	\$ 60.69	(475,977)	\$ 61.56
Outstanding options, end of year	6,532,756	\$ 52.34	4,084,646	\$ 61.36
Options exercisable, end of year	1,314,278	\$ 59.00	1,544,232	\$ 57.37

Range of Exercise Prices	2007 Outstanding Options			2007 Exercisable Options	
	Number of Options Outstanding	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price/Share	Number of Exercisable Options	Weighted Average Exercise Price/Share
\$ 33.03 – \$ 49.11	4,077,233	6	\$ 47.16	47,240	\$ 48.50
\$ 50.80 – \$ 55.50	1,332,112	3	\$ 53.56	817,675	\$ 53.73
\$ 69.63 – \$ 72.95	1,123,411	4	\$ 69.69	449,363	\$ 69.69

**Restricted Share Unit ("RSU") Plan** The Company maintains a RSU plan for certain senior employees. The RSUs entitle employees to a cash payment after the end of each performance period, of up to 3 years, following the date of award. The RSU payment will be an amount equal to the weighted average price of a Loblaw common share on the last three trading days preceding the end of the performance period for the RSUs multiplied by the number of RSUs held by the employee.

During 2007, the Company granted 335,056 (2006 – 691,001) RSUs to 349 (2006 – 238) employees, 161,621 (2006 – 211,526) RSUs were cancelled and 154,700 (2006 – 112,707) were paid out in the amount of \$8 million (2006 – \$6 million). At year end, a total of 768,687 (2006 – 749,952) RSUs were outstanding.

**Employee Share Ownership Plan (“ESOP”)** The Company maintains an ESOP which allows employees to acquire the Company's common shares through regular payroll deductions of up to 5% of their gross regular earnings. The Company contributes an additional 25% (2006 – 25%) of each employee's contribution to the plan. The ESOP is administered through a trust which purchases the Company's common shares on the open market on behalf of employees. A compensation cost of \$6 million (2006 – \$6 million) related to this plan was recognized in operating income.

**Deferred Share Units (“DSUs”) Plan** Members of the Company's Board of Directors, who are not management of the Company, may elect annually to receive all or a portion of their annual retainer(s) and fees in the form of DSUs, the value of which is determined by the market price of the Company's common shares at the time the director's annual retainer(s) or fees are earned. Upon termination of Board service, the common shares due to the director, as represented by the DSUs, will be purchased on the open market on the director's behalf. At year end, 56,082 (2006 – 44,397) DSUs were outstanding. The year-over-year change in the deferred share unit compensation liability was minimal and was recognized in operating income.

## Note 22. Financial Instruments

A summary of the Company's outstanding financial derivative instruments is as follows:

	Notional Amounts Maturing						2007	2006
	2008	2009	2010	2011	2012	Thereafter	Total	Total
Cross currency basis swaps	\$ 140	\$ 31	\$ 174	\$ 56	\$ 166	\$ 533	\$ 1,100	\$ 1,060
Interest rate swaps receivable	\$ 240	\$ 140	\$ 50	\$ 200	\$ –	\$ –	\$ 630	\$ 630
Interest rate swaps payable	\$ –	\$ –	\$ –	\$ –	\$ –	\$ 150	\$ 150	\$ 150
Equity forwards	\$ –	\$ –	\$ 124	\$ 35	\$ 25	\$ 70	\$ 254	\$ 247
Electricity forward contract	\$ 9	\$ 8	\$ 8	\$ 8	\$ –	\$ –	\$ 33	\$ 42

Notional amounts do not represent assets or liabilities and are therefore not recorded on the consolidated balance sheet. The notional amounts are used in order to calculate the payments to be exchanged under the contracts.

**Cross Currency Basis Swaps** The Company enters into cross currency basis swaps to manage its exposure to fluctuations in the foreign currency exchange rate on a portion of its United States dollar denominated cash, cash equivalents and short term investments.

The Company entered into cross currency basis swaps to exchange United States dollars for \$1.1 billion (2006 – \$1.1 billion) Canadian dollars, which mature by 2017. Cross currency basis swaps totalling \$590 are designated in a cash flow hedge and the remaining undesignated \$510 are classified as held-for-trading financial assets. Currency adjustments receivable or payable arising from these swaps are settled in cash on maturity. A cumulative unrealized foreign currency exchange rate receivable of \$270 (2006 – \$165) was recorded in other assets.

**Interest Rate Swaps** The Company enters into interest rate swaps to manage a portion of its exposure to fluctuations in interest rates. The Company's interest rate swaps convert a notional \$630 (2006 – \$630) of its floating rate available-for-sale cash equivalents and short term investments to average fixed rate investments at 5.60% (2006 – 5.60%), which mature by 2011. At year end, the fair value of these interest rate swaps of \$9 was recorded in other assets and the unrealized fair value gain of \$9 is deferred, net of tax, in accumulated other comprehensive income. When realized, these unrealized gains are reclassified to net earnings. Prior to December 31, 2006, these unrealized gains or losses were not recognized on the Company's balance sheet.

## Notes to the Consolidated Financial Statements

During 2007, the Company terminated hedge accounting for its interest rate swaps previously designated as a cash flow hedge of the variable interest rate exposure on commercial paper. These interest rate swaps converted a notional \$150 (2006 – \$150) of floating rate commercial paper debt to an average fixed rate debt of 8.37% (2006 – 8.37%) which matures by 2013. As a result of this termination, the cumulative loss of \$2, net of income taxes, in accumulated other comprehensive income was reclassified to net earnings. At year end, the fair value of these interest rate swaps of \$28 was recorded in other liabilities. Prior to December 31, 2006, these unrealized gains or losses were not recognized on the Company's balance sheet.

**Equity Forwards (\$, except where otherwise indicated)** The Company enters into equity forwards to manage its exposure to fluctuations in its stock-based compensation cost as a result of changes in the market price of its common shares. At year end 2007, the Company had cumulative equity forwards to buy 4.8 million (2006 – 4.8 million) of its common shares at a cumulative average forward price of \$53.14 (2006 – \$51.43) including \$8.27 (2006 – \$6.56) per common share of interest expense net of dividends that has been recognized in net earnings and will be paid at termination. The equity forwards allow for settlement in cash, common shares or net settlement. They change in value as the market price of the Company's common shares changes and provide a partial offset to fluctuations in Loblaw's stock-based compensation cost, including RSU plan expense. The partial offset between the Company's stock-based compensation costs, including RSU plan expense, and the equity forwards is effective when the market price of the Company's common shares exceed the exercise price of the related employee stock options. When the market price of the common shares is lower than the exercise price of the related employee stock options, only RSUs will provide a partial offset to these equity forwards. The amount of net stock-based compensation cost recorded in operating income is mainly dependent upon the number of unexercised stock options and RSUs and their vesting schedules relative to the number of underlying common shares on the equity forwards and the level of and fluctuations in the market price of the underlying common shares. The Company has included a cumulative unrealized market loss, interest and dividends of \$91 million (2006 – \$13 million) in other liabilities relating to these equity forwards.

**Electricity Forward Contract** The Company entered into an electricity forward contract to minimize price volatility and to maintain a portion of the Company's electricity costs in Alberta, Canada at approximately 2006 rates. This electricity forward contract has an initial term of five years and expires in December 2011. Commencing December 31, 2006, Loblaw is required to measure its electricity forward contract at fair value in accordance with Section 3855. At year end, the fair value of this forward contract of \$5 was recorded in other assets. During 2007, a loss in value of \$2 was recorded in operating income. Prior to December 31, 2006, this non-financial derivative instrument was not recognized on the comparative period consolidated balance sheet and therefore gains and losses due to fair value changes in the contract were also not recognized in the Company's statement of earnings.

**Fair Value of Derivative Instruments** The fair value of derivative instruments is the estimated amount that the Company would receive or pay to terminate the instrument agreement at the reporting date. The fair values have been determined by reference to prices available from the markets on which the instruments trade and prices provided by counterparties. Commencing December 31, 2006, the fair value of all derivative instruments approximated their carrying value and are recorded in other assets or other liabilities. Prior to December 31, 2006, the interest rate swaps were not recorded on the comparative consolidated balance sheet. The unrecorded unrealized interest rate swap receivable was \$17, as at December 30, 2006.

The following table summarizes the change in fair value of financial assets and financial liabilities, including non-financial derivatives, classified as held-for-trading, recognized in net earnings in 2007, before income taxes and minority interest.

	52 Weeks Ended December 29, 2007	
	Designated as held-for-trading	Required to be classified as held-for-trading
Cash equivalents and short term investments	\$ 76	\$ –
Electricity forward	–	2
Interest rate swaps	–	5
Cross currency basis swaps	–	(79)
Equity forwards associated with stock-based compensation	–	79
Fair value loss	\$ 76	\$ 7

**Fair Value of Other Financial Instruments** The fair values of accounts receivable, bank indebtedness, commercial paper, accounts payable and accrued liabilities and short term debt approximate their carrying values given their short term maturities. See note 16 for carrying and fair values of long term debt.

The equity investment in franchises is measured at cost because there is no quoted market prices in an active market and these investments are classified as available-for-sale.

**Foreign Currency Exchange Rate Risk** The Company is exposed to foreign currency exchange rate variability on its cash, cash equivalents and short term investments. At year end, the Company had \$801 (2006 – \$864) in cash, cash equivalents and short term investments held by Glenhuron. To manage this risk, the company designates a portion of its cross currency basis swaps in a cash flow hedge of the exposure to fluctuations in the foreign currency exchange rate on a portion of its United States dollar denominated cash equivalents and short term investments. The remaining undesignated cross currency basis swaps economically hedge exposure to fluctuations in the foreign currency exchange rate on the remaining United States dollar denominated cash, cash equivalents and short term investments.

During the year, the unrealized foreign currency exchange loss of \$79, related to the cash equivalents and short term investments classified as available-for-sale is recognized in other comprehensive income and was partially offset by the unrealized foreign currency exchange rate gain of \$72 before income taxes relating to the designated cross currency basis swaps also deferred in other comprehensive income. The unrealized foreign currency exchange loss of \$76 on the designated held-for-trading cash, cash equivalents and short term investments is partially offset in operating income by the unrealized foreign currency exchange rate gain of \$79 relating to the cross currency basis swaps which are not designated in a cash flow hedge. During the year, the Company realized a foreign currency exchange gain of \$46 relating to cross currency basis swaps that matured or were terminated.

**Credit Risk** The Company is exposed to credit risk resulting from the possibility that counterparties may default on their financial obligations, or if there is a concentration of transactions carried out with the same counterparty or of financial obligations which have similar economic characteristics such that they could be similarly affected by changes in economic conditions. Exposure to credit risk relates to derivative instruments, cash equivalents and short term investments, *PC* Bank's credit card receivables and accounts receivable from independent franchisees, associates and independent accounts.

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

Credit risk associated with the Company's cash equivalents and short term investments results from the possibility that a counterparty may default on the repayment of a security. The Company attempts to mitigate this risk through policies and guidelines that require issuers of permissible investments to have at minimum a long term "A" credit rating from a recognized credit rating agency and that specify minimum and maximum exposures to specific issuers, and that specify the type of instruments to be held by the Company.

Credit risk from *PC* Bank's credit card receivables and receivables from independent franchisees, associates and independent accounts results from the possibility that customers may default on their payment obligation. *PC* Bank manages the credit card receivable risk by employing stringent credit scoring techniques and actively monitoring the credit card portfolio and reviewing techniques and technology that can improve the effectiveness of the collection process. In addition, these receivables are dispersed among a large, diversified group of credit card customers.

Accounts receivable from independent franchisees, associates and independent accounts are actively monitored on an ongoing basis and settled on a frequent basis in accordance with the terms specified in the applicable agreements.

## Notes to the Consolidated Financial Statements

### Note 23. Contingencies, Commitments and Guarantees

The Company is involved in and potentially subject to various claims by third parties arising out of the normal course and conduct of its business including, but not limited to, product liability, labour and employment, regulatory and environmental claims. In addition, the Company is involved in and potentially subject to regular audits from federal and provincial tax authorities relating to income, capital and commodity taxes and as a result of these audits may receive assessments and reassessments.

Although such matters cannot be predicted with certainty, management currently considers the Company's exposure to such claims and litigation, to the extent not covered by the Company's insurance policies or otherwise provided for, not to be material to these consolidated financial statements, with the exception of the items disclosed in legal proceedings below.

At year end, the Company has committed approximately \$113 (2006 – \$153) with respect to capital investment projects such as the construction, expansion and renovation of buildings and the purchase of real property.

The Company establishes standby letters of credit used in connection with certain obligations mainly related to real estate transactions and benefit programs. The aggregate gross potential liability related to these standby letters of credit is approximately \$221 (2006 – \$221). Other standby letters of credit related to the financing program for the Company's independent franchisees and securitization of PC Bank's credit card receivables have been identified as guarantees and are discussed further in the Guarantees section below.

**Guarantees** The Company has provided to third parties the following significant guarantees as defined pursuant to AcG 14, "Disclosure of Guarantees":

**Independent Funding Trust** Independent franchisees of the Company may obtain financing through a structure involving independent trusts, which were created to provide loans to the independent franchisees to facilitate their purchase of inventory and fixed assets, consisting mainly of fixtures and equipment. These trusts are administered by a major Canadian chartered bank. The independent funding trust within the structure finances its activities through the issuance of short term ABCP to third-party investors. The independent funding trust has a global style liquidity agreement from a major Canadian chartered bank in the event that it is unable to issue short term ABCP. The gross principal amount of loans issued to the Company's independent franchisees outstanding as of December 29, 2007 was \$418 (2006 – \$419) including \$153 (2006 – \$124) of loans payable by VIEs consolidated by the Company in 2007 (see note 26). Based on a formula, the Company has agreed to provide credit enhancement in the form of a standby letter of credit for the benefit of the independent funding trust equal to approximately 10% of the principal amount of the loans outstanding at any point in time, \$44 (2006 – \$44) as of December 29, 2007 (see note 26). This credit enhancement allows the independent funding trust to provide favorable financing terms to the Company's independent franchisees. As well, each independent franchisee provides security to the independent funding trust for its obligations by way of a general security agreement. In the event that an independent franchisee defaults on its loan and the Company has not, within a specified time period, assumed the loan or the default is not otherwise remedied, the independent funding trust shall assign the loan to the Company and draw upon this standby letter of credit. The Company has agreed to reimburse the issuing bank for any amount drawn on the standby letter of credit. As a result of implementing Section 3855 (see note 2), a liability of \$7 related to the fair value of this standby letter of credit was recognized.

Neither the independent funding trust nor the Company can voluntarily terminate the agreement prior to December 2009, and following that date only upon six months' prior notice. Automatic termination of the agreement can only occur if specific, predetermined events occur and are not remedied within the time periods required including downgrades of the Company below a long term credit rating of "A (low)" or a short term credit rating of "R-1 (low)" as issued by Dominion Bond Rating Service ("DBRS"). On February 7, 2008, DBRS downgraded the Company's long term credit rating to "BBB (high)" from "A (low)" and also lowered the Company's short term credit rating to "R-2 (high)" from "R-1 (low)". Subsequent to the DBRS downgrades, the Company was notified that an Event of Termination of the independent funding trust agreement for the Company's franchisees had occurred as a result of the credit rating downgrades. The \$44 (2006 – \$44) standby letter of credit provided to the independent funding trust by the Company has not been drawn upon. If such an event were to occur, long term debt in the amount of \$126 would need to be reclassified to short term liabilities. This amount relates to certain franchisees that are VIEs that the Company currently consolidates. The Company is currently in the process of securing alternative financing with a syndicate of banks in the form of a 364-day committed credit facility for the benefit of its franchisees to address this issue. Any new alternative financing structure, which

might be implemented, would need to be reviewed to determine if there are any implications with respect to the consolidation of VIEs. In accordance with Canadian GAAP, the financial statements of the independent funding trust are not consolidated with those of the Company.

**Standby Letter of Credit** A standby letter of credit for the benefit of an independent trust with respect to the credit card receivables securitization program of *PC* Bank has been issued by a major Canadian chartered bank. This standby letter of credit could be drawn upon in the event of a major decline in the income flow from or in the value of the securitized credit card receivables. The Company has agreed to reimburse the issuing bank for any amount drawn on the standby letter of credit. The aggregate gross potential liability under this arrangement, which represents 9% (2006 – 9%) on a portion of the securitized credit card receivables amount, is approximately \$89 (2006 – \$68) (see note 10).

**Lease Obligations** In connection with historical dispositions of certain of its assets, the Company has assigned leases to third parties. The Company remains contingently liable for these lease obligations in the event any of the assignees are in default of their lease obligations. The estimated amount for minimum rent, which does not include other lease related expenses such as property tax and common area maintenance charges, is in aggregate \$79 (2006 – \$111).

**Indemnification Provisions** The Company from time to time enters into agreements in the normal course of its business, such as service and outsourcing arrangements and leases, in connection with business or asset acquisitions or dispositions. These agreements by their nature may provide for indemnification of counterparties. These indemnification provisions may be in connection with breaches of representation and warranty or with future claims for certain liabilities, including liabilities related to tax and environmental matters. The terms of these indemnification provisions vary in duration and may extend for an unlimited period of time. Given the nature of such indemnification provisions, the Company is unable to reasonably estimate its total maximum potential liability as certain indemnification provisions do not provide for a maximum potential amount and the amounts are dependent on the outcome of future contingent events, the nature and likelihood of which cannot be determined at this time. Historically, the Company has not made any significant payments in connection with these indemnification provisions.

**Legal Proceedings** During 2007, the Company was one 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 the Company's employees 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 the 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 the Company, may be entitled to indemnification from the Company.

In addition to the claim described above, the Company is the subject of various legal proceedings and claims that arise in the ordinary course of business. The outcome of all of these proceedings is uncertain. However, based on information currently available, these claims, individually and in the aggregate, are not expected to have a material impact on the Company.

#### **Note 24. Variable Interest Entities (“VIEs”)**

Pursuant to AcG 15, the Company consolidates all VIEs for which it is the primary beneficiary. AcG 15 defines a VIE as an entity that either does not have sufficient equity at risk to finance its activities without subordinated financial support or where the holders of the equity at risk lack the characteristics of a controlling financial interest. AcG 15 requires the primary beneficiary to consolidate VIEs and considers an entity to be the primary beneficiary of a VIE if it holds variable interests that expose it to a majority of the VIE's expected losses or that entitle it to receive a majority of the VIE's expected residual returns or both. The Company has identified the following significant VIEs:

**Independent Franchisees** The Company enters into various forms of franchise agreements that generally require the independent franchisee to purchase inventory from the Company and pay certain fees in exchange for services provided by the Company and for the right to use certain trademarks and licenses owned by the Company. Independent franchisees generally lease the land and building from

## Notes to the Consolidated Financial Statements

the Company, and when eligible, may obtain financing through a structure involving independent trusts to facilitate the purchase of the majority of their inventory and fixed assets, consisting mainly of fixtures and equipment. These trusts are administered by a major Canadian chartered bank. Under the terms of certain franchise agreements, the Company may also lease equipment to independent franchisees. Independent franchisees may also obtain financing through operating lines of credit with traditional financial institutions or through issuing preferred shares or notes payable to the Company. The Company monitors the financial condition of its independent franchisees and provides for estimated losses or write-downs on its accounts and notes receivable or investments when appropriate.

As at year end 2007, 137 (2006 – 123) of the Company's independent franchise stores met the criteria for a VIE and were consolidated pursuant to AcG 15.

**Warehouse and Distribution Agreement** The Company has warehouse and distribution agreements with third-party entities to provide to the Company distribution and warehousing services from dedicated facilities. The Company has no equity interest in these third-party entities; however, the terms of the agreement with the third-party entities are such that the Company has determined that the third-party entities meet the criteria for a VIE that requires consolidation by the Company. The impact of the consolidation of the warehouse and distribution entities were not material.

Accordingly, the Company has included the results of these independent franchisees and these third-party entities that provide distribution and warehousing services in its consolidated financial statements. The consolidation of these VIEs by the Company does not result in any change to its tax, legal or credit risks, nor does it result in the Company assuming any obligations of these third parties.

**Independent Trust** The Company has also identified that it holds a variable interest, by way of a standby letter of credit, in an independent trust which is used to securitize credit card receivables for *PC* Bank. In these securitizations, *PC* Bank sells a portion of its credit card receivables to the independent trust in exchange for cash. Although this independent trust has been identified as a VIE, it was determined that the Company is not the primary beneficiary and therefore this VIE is not subject to consolidation by the Company. The Company's maximum exposure to loss as a result of its involvement with this independent trust is disclosed in notes 10 and 23.

In 2006, *PC* Bank restructured its credit card securitization program. Eagle Credit Card Trust ("Eagle"), a previously established independent trust, issued \$500 of five year senior notes and subordinated notes due in 2011 at a weighted average rate of 4.5% to finance the purchase of credit card receivables previously securitized by *PC* Bank through an independent trust. The subordinated notes provide credit support to those notes which are more senior. *PC* Bank will continue to service the credit card receivables on behalf of Eagle, but will not receive any fee for its servicing obligations and has a retained interest in the securitized receivables represented by the right to future cash flows after obligations to investors have been met. In accordance with Canadian GAAP, the financial statements of Eagle are not consolidated with those of the Company. The restructuring of the portfolio yielded a nominal net loss.

### Note 25. Related Party Transactions

The Company's majority shareholder, George Weston Limited and its affiliates other than Loblaw ("Weston"), are related parties. It is the Company's policy to conduct all transactions and settle all balances with related parties on market terms and conditions. Related party transactions include:

**Inventory Purchases** Purchases of inventory from related parties for resale in the distribution network represented approximately 3% (2006 – 3%) of the cost of sales, selling and administrative expenses.

**Cost Sharing Agreements** Weston has entered into certain contracts with third parties for administrative and corporate services, including telecommunication services and information technology related matters on behalf of the Company. Through cost sharing agreements that have been established between the Company and Weston concerning these costs, the Company has agreed to be responsible to Weston for its proportionate share of the costs incurred on its behalf. Payments by the Company pursuant to these cost sharing agreements in 2007 were approximately \$27 (2006 – \$25).

**Real Estate Matters** The Company leases certain properties from an affiliate of Weston, namely office space for approximately \$2 (2006 – \$4). During 2006, the Company purchased from an affiliate of Weston, a property designated for future development for consideration of \$8, which was prepaid in accordance with a former ground lease between the parties.

**Borrowings/Lendings** The Company, from time to time, may borrow funds from or may lend funds to Weston on a short term basis at short term market borrowing rates. There were no such amounts outstanding as at year end.

**Income Tax Matters** From time to time, the Company and Weston and its affiliates may make elections that are permitted or required under applicable income tax legislation with respect to affiliated corporations and, as a result, may enter into agreements in that regard. These elections and accompanying agreements did not have any material impact on the Company.

**Management Agreements** The Company has entered into an agreement with Weston to provide certain administrative services by each company to the other. The services to be provided under this agreement include those related to commodity management, pension and benefits, tax, medical, travel, information system, risk management, treasury and legal. Payments are made quarterly based on the actual costs of providing these services. Where services are provided on a joint basis for the benefit of the Company and Weston together, each party pays the appropriate proportion of such costs. Net payments under this agreement in 2007 were \$9. Fees paid under this agreement are reviewed each year by the Audit Committee.

The Company, through Glenhuron, manages certain United States cash, cash equivalents and short term investments for wholly owned non-Canadian subsidiaries of Weston and management fees earned are based on market rates. Glenhuron has an agreement with a subsidiary of Weston for the administration of a loan portfolio of third-party long term loans receivable.

#### **Note 26. Subsequent Events**

On February 7, 2008, the Company's Medium Term Notes, other notes and debentures, and commercial paper ratings were downgraded by DBRS and Standard & Poor's ("S&P"). DBRS downgraded the Company's long term credit rating to "BBB (high)" from "A (low)" and also lowered Loblaw's short term credit rating to "R-2 (high)" from "R-1 (low)". In addition, S&P downgraded Loblaw commercial paper rating to "A-2" from "A-1 (low)". As a result of the DBRS downgrade of the short term credit rating, the Company has limited access to commercial paper. The Company has entered into discussions, which have not yet been finalized, with a syndicate of banks to secure short term funding to replace its existing 364-day revolving committed credit facility of \$500, as described in note 15, with a new, longer term committed credit facility of a higher amount.

Subsequent to the DBRS downgrades, the Company was notified that an Event of Termination of the independent funding trust agreement for the Company's franchisees had occurred as a result of the credit rating downgrades. The \$44 standby letter of credit provided to the independent funding trust by the Company has not been drawn upon. If such an event were to occur, long term debt in the amount of \$126 would need to be reclassified to short term liabilities. This amount relates to certain franchisees that are VIEs that the Company currently consolidates. The gross principal amount of the franchisee loans outstanding at the end of 2007 was \$418 (2006 - \$419), including \$153 (2006 - \$124) of loans payable of VIEs consolidated by the Company in 2007. The Company is currently in the process of securing alternative financing with a syndicate of banks, in the form of a 364-day committed credit facility for the benefit of its franchisees to address this issue. Any new alternative financing structure which may be implemented would need to be reviewed to determine if there are any implications with respect to the consolidation of VIEs.

#### **Note 27. Other Information**

**Segment Information** The only reportable operating segment is merchandising, which includes primarily food as well as general merchandise and drugstore products and services. All sales to external parties were generated in Canada and all fixed assets and goodwill were attributable to Canadian operations.