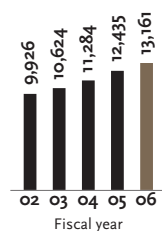
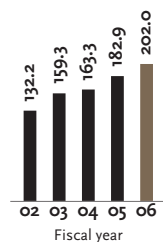


Management's Discussion and Analysis

Revenue
(\$ in millions)

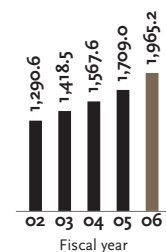


Operating Earnings⁽¹⁾
(\$ in millions)



(1) Earnings before capital gain (loss) and other items, net of tax

Shareholders' Equity
(\$ in millions)



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Management's Discussion and Analysis

Introduction

This Management's Discussion and Analysis ("MD&A") contains commentary from management on the consolidated financial condition and results of operations of Empire Company Limited ("Empire" or the "Company") for the 52-weeks ended May 6, 2006, as compared to the 53-weeks ended May 7, 2005. Management also provides an explanation of the Company's fourth quarter results, changes in accounting policies, critical accounting estimates and factors that the Company believes may affect its prospective financial condition, cash flows and results of operations. This MD&A also provides analysis of the operating performance of the Company's divisions as well as a discussion of cash flows, the impact of risks and the outlook for the business. Additional information about the Company, including the Company's Annual Information Form, can be found on SEDAR at www.sedar.com.

The discussion and analysis is the responsibility of management. The Board of Directors carries out its responsibility for review of this disclosure principally through its Audit Committee, comprised exclusively of independent directors. The Audit Committee has reviewed and approved this disclosure and it has also been approved by the Board of Directors.

This discussion and analysis should be read in conjunction with the audited annual consolidated financial statements of the Company and the accompanying notes for the 52-weeks ended May 6, 2006. The consolidated financial statements and accompanying notes have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and are reported in Canadian dollars.

In the fourth quarter of fiscal 2005, the Company adopted Accounting Guideline 15 "Consolidation of Variable Interest Entities" ("AcG-15"). AcG-15 required the Company to consolidate certain entities that were deemed to be subject to control of the Company on a basis other than through ownership of a voting interest in the entity. The guideline was adopted retroactively without restatement of prior periods. See Note 27 to the audited annual consolidated financial statements.

This results in 52 weeks of data being consolidated in fiscal 2006, for variable interest entities ("VIEs"), while there were only 14 weeks of data consolidated in fiscal 2005. There are 13 weeks and 14 weeks of data consolidated in the fourth quarter of fiscal 2006 and 2005, respectively. Please review the section titled "AcG-15, Consolidation of Variable Interest Entities" included in this MD&A for more information.

This discussion contains forward-looking statements which reflect management's expectations regarding the Company's objectives, plans, goals, strategies, future growth, results of operations, performance and business prospects and opportunities. Forward-looking statements are typically identified by words or phrases such as "anticipates", "expects", "believes", "estimates", "intends" and other similar expressions. These statements are based on management's assumptions and beliefs in light of the information currently available to them. These forward-looking statements are subject to inherent uncertainties, risks and other factors that could cause actual results to differ materially from such statements. These uncertainties and risks are discussed in the Company's materials filed with the Canadian securities regulatory authorities from time to time, including those in the Risk Management section of this MD&A.

When relying on forward-looking statements to make decisions, the Company cautions readers not to place undue reliance on these statements, as a number of important factors could cause actual results to differ materially from any estimates or intentions expressed in such forward-looking statements. The Company does not undertake to update any forward-looking statements that may be made from time to time by or on behalf of the Company.

There are measures included in this MD&A that do not have a standardized meaning under Canadian GAAP. Management includes these measures because it believes certain investors use these measures as a means of assessing relative financial performance. Additional information relating to non-GAAP financial measures is provided at the end of this MD&A.

Company Overview

Empire is a diversified Canadian company headquartered in Stellarton, Nova Scotia. Empire's key businesses are food retailing through a 70.3 percent ownership of Sobeys Inc. ("Sobeys"), real estate through two wholly-owned operating subsidiaries: Sobeys Leased Properties Limited ("SLP"), and ECL Properties Limited ("ECL"), formerly Crombie Properties Limited, including 35.7 percent ownership of Genstar Development Partnership ("Genstar") and a 48.3 percent ownership interest in Crombie Real Estate Investment Trust ("Crombie REIT"); and corporate investment activities and other operations which includes wholly-owned Empire Theatres Limited ("Empire Theatres") and a 27.6 percent ownership position in the Wajax Income Fund ("Wajax").

With approximately \$5.0 billion in assets, Empire employs approximately 37,000 people directly and through its subsidiaries.

Empire's primary goal is to grow long-term shareholder value through income and cash flow growth and equity appreciation. This is accomplished through direct ownership and equity participation in businesses that management believes have the potential for long-term growth and profitability.

Food Division

Sobeys is a leading national retail grocery and food distributor headquartered in Stellarton, Nova Scotia. Founded in 1907, Sobeys owns or franchises approximately 1,300 corporate and franchised food stores located in all 10 provinces under various retail banners including: Sobeys, IGA extra, IGA, and Price Chopper. Sobeys and its subsidiaries conduct business in four retail regions: Sobeys West, Sobeys Ontario, Sobeys Quebec, and Sobeys Atlantic.

Sobeys' strategy is focused on delivering the best food shopping experience to its customers in the right format, right-sized stores, supported by superior customer service. The five distinct store formats deployed by Sobeys to satisfy its customers' principal shopping requirements are the full service, fresh service, convenience service, community service and price service formats. Sobeys remains focused on improving the product, service and merchandising offerings within each format by realigning and renovating its current store base, while continuing to build new stores. Sobeys' four major banners are the primary focus of these format development efforts.

During the year, Sobeys opened, replaced, expanded, renovated, acquired and/or converted the banners in 83 stores (2005 – 98 stores). In fiscal 2006, Sobeys continued to execute against a number of initiatives in support of its food-focused strategy including productivity initiatives and business process and system upgrades.

In fiscal 2006, Sobeys continued the roll-out of the Sobeys banner in Western Canada with the introduction of two new Sobeys stores and one rebannered store in Alberta. The addition of the Alberta store brings the total Sobeys banner stores in Western Canada to 74.

Compliments, Sobeys' new private label brand, was launched in fiscal 2005, to contribute to growth of Company-wide profitability and earn a greater share of customers' food and grocery shopping requirements. The *Compliments* brand consists of three quality tiers: Value, Selection and Sensations. In addition, Sobeys introduced two sub-brands during fiscal 2006, *Compliments Organics* and *Compliments balance-équilibre*, an organic and a healthy line of products, respectively. By the end of fiscal 2006, Sobeys had launched approximately 3,700 *Compliments* products.

Sobeys remains focused on productivity and business process optimization initiatives designed to improve its processes and cost structure. A key productivity focus in fiscal 2006 was the continued roll-out of the first phase of Sobeys' SMART Retailing initiative. The first phase of SMART Retailing focused on continuous improvement processes that have resulted in improved labour productivity in the handling of back-shop inventories,

reduction in back room inventories and shrink reduction in produce, bakery, and meat departments. Sobeys completed the first phase of SMART Retailing during the year with the program implemented in 675 stores. The second phase of SMART Retailing began during fiscal 2006 and has been implemented in 425 stores to date. The second phase of SMART Retailing is focused on the implementation of a comprehensive store performance management process supported by tools to assist in the measurement of Sobeys' progress against targets and expectations. Phase two continues to support the ongoing implementation of SMART Retailing and focuses on customer satisfaction, sales growth and margin improvements. The third phase will see the extension of the process and productivity improvement across the store.

During fiscal 2006, Sobeys also made significant progress in the implementation of system-wide business process optimization initiatives that are designed to reduce complexity and improve processes throughout the food division. To this end, Sobeys continued the roll-out of a common point-of-sale ("POS") system. This common POS system provides improved customer information and enhanced customer service at store check-outs, and is a key enabler of other business process optimization initiatives currently underway.

Sobeys also completed the roll-out of a new scale networking system, which improved accuracy and productivity and has enabled full compliance with the new nutritional labeling requirements that came into effect on December 12, 2005.

As discussed in the fiscal 2005 MD&A, system and process complexities in the Ontario business negatively impacted earnings in that region. In fiscal 2006, Sobeys began its business process and information systems transformation plan by focusing on the significant opportunity to upgrade capabilities and improve efficiencies in the Ontario region. The system and processes that are being implemented have been developed over several years and are currently employed in Sobeys' Atlantic Region. The Ontario roll-out will standardize and streamline the "back shop" in support of Sobeys' food-focused strategy. This move will allow Sobeys to leverage technology investments, improve efficiencies and lower costs over the long-term. Costs associated with this initiative totalled \$0.19 per Sobeys' basic share in fiscal 2006. A similar transformation plan was initiated for the Western region in the fourth quarter of fiscal 2006. The anticipated costs for both these initiatives in fiscal 2007 will be \$0.27 to \$0.32 per Sobeys' share.

Real Estate Division

Empire's real estate division consists of wholly-owned SLP and ECL, which includes a 35.7 percent interest in Genstar, a residential land development business with operations primarily in Western Canada. ECL also owns various commercial properties held for redevelopment, a self-storage operation and a 48.3 percent ownership interest in Crombie REIT. Empire segments its real estate's financial results between commercial property operations, consisting of SLP and ECL, and residential property operations which consist of Genstar's financial results.

At the end of fiscal 2006, real estate operations had approximately 5.9 million square feet of commercial property rentable space, significantly lower than 12.9 million square feet at the end of last fiscal year. The decline in gross leaseable area is the result of 44 properties with 7.2 million of gross leaseable area being sold to Crombie REIT in connection with its initial public offering on March 23, 2006.

The remaining wholly-owned real estate operations are primarily focused on commercial property development. The strategic focus moving forward is to position ECL as the developer of choice for Crombie REIT.

Prior to the creation of Crombie REIT in March, 2006, the strategic focus of real estate operations was the ownership and management of a major commercial property portfolio, located primarily in Atlantic Canada. Within that focus, the real estate division had been pursuing a diversification strategy, targeting geographic expansion in Ontario, often in conjunction with Sobeys.

With the formation of Crombie REIT, Empire retains a significant interest in the portfolio, but now as an equity investor with a 48.3% ownership interest rather than as an operator. As contained in its initial public offering prospectus dated March 10, 2006, Crombie REIT has stated that its growth strategy will focus on generating greater rental income from its existing properties and also on accretive acquisitions of income producing retail properties primarily in Ontario and Western Canada.

Investments & Other Operations Division

The third component of Empire's business is its investments and other operations. Empire's investment portfolio consists of Canadian and U.S. common equity investments. At fiscal year-end, Empire's investments, excluding its investment in Genstar U.S. builder deals and in Crombie REIT, carried a market value of \$607.3 million consisting of Canadian common equity investments valued at \$432.3 million, foreign common equities (including the value of the forward contract hedges) valued at \$173.5 million in Canadian dollars, and other investments valued at \$1.5 million. The Canadian common equity investment market value includes the market value of Empire's equity accounted investment in Wajax Income Fund (approximately a 27.6 percent ownership position on a fully diluted basis) of \$193.0 million at fiscal year-end. All of Empire's portfolio investments are listed on a recognized public stock exchange.

Other operations consist of wholly-owned Empire Theatres, the second largest movie exhibitor in Canada which owns or has an interest in 57 locations representing 397 screens and Kepec Resources Limited ("Kepec"), a joint venture with APL Oil and Gas Limited which has ownership interests in various oil and gas properties in Alberta.

On September 30, 2005, Empire Theatres acquired 27 cinemas operating 202 screens in Ontario and Western Canada from Cineplex Galaxy LP. On October 21, 2005, Empire Theatres acquired an additional theatre with four screens in Western Canada.

Empire's Strategic Direction

Management's primary objective is to maximize the long-term sustainable value of Empire through enhancing the worth of the Company's net assets and in turn, having that value reflected in Empire's share price.

The strategic direction of the Company is to stay the course by continuing to direct its energy and capital towards growing the long-term sustainable value of each of its core operating businesses – food retailing, real estate and investment and other operations. While these respective core businesses are well established and profitable in their own right, the diversification they offer Empire by both business line and by market area served is considered by management to be an additional source of strength. Together, these core businesses reduce risk and volatility, thereby contributing to greater consistency in consolidated earnings growth over the long-term. Going forward, the Company intends to continue to direct its resources towards the most promising opportunities within these core businesses in order to maximize long-term shareholder value.

In carrying out the Company's strategic direction, Empire management defines its role as having four fundamental responsibilities: first, to support the development and execution of sound strategic plans for each of its operating companies; second, to regularly monitor the development and the execution of business plans within each operating company; third, to ensure that Empire is well governed as a public company; and fourth, to prudently manage a pool of investment capital in order to augment the growth in our core operating businesses.

The Company remains committed to holding an investment portfolio consisting largely of high quality common equities. A liquid investment portfolio provides Empire with the opportunity to augment earnings while waiting to make further investment in its core operations as attractive opportunities unfold. Historically, the Company has been successful in generating investment returns well in excess of the Company's cost of capital and well in excess of returns that would otherwise have been generated by either passively investing, using index-based investments, or from investing in money market investments.

Consolidated Operating Results

The consolidated financial overview presented below reports on the financial performance for fiscal 2006 relative to the last two fiscal years.

Summary Table of Consolidated Financial Results

(\$ in millions, except per share information)	52 Weeks Ended May 6, 2006	% of Revenue	53 Weeks Ended May 7, 2005	% of Revenue	52 Weeks Ended April 30, 2004 ⁽¹⁾	% of Revenue
Revenue						
Food ⁽¹⁾	\$ 12,853.3	97.66%	\$ 12,189.4	98.02%	\$ 11,061.4	98.03%
Real estate, net of inter-segment	185.0	1.41	171.4	1.38	158.2	1.40
Investments and other operations	122.8	0.93	74.4	0.60	64.4	0.57
Consolidated revenue	\$ 13,161.1	100.00%	\$ 12,435.2	100.00%	\$ 11,284.0	100.00%
Operating income						
Food	\$ 331.6		\$ 322.6		\$ 293.7	
Real estate, net of inter-segment	138.3		122.2		111.0	
Investments and other operations	21.5		18.9		18.1	
Consolidated operating income	\$ 491.4	3.73%	\$ 463.7	3.73%	\$ 422.8	3.75%
Interest expense	83.8	0.64	86.7	0.70	92.4	0.82
Income taxes (from operating activities)	138.7	1.05	130.5	1.05	108.6	0.96
Minority interest (from operating activities)	66.9	0.51	63.6	0.51	58.5	0.52
Operating earnings	\$ 202.0	1.53%	\$ 182.9	1.47%	\$ 163.3	1.45%
Capital gain and other items, net of tax	94.8	0.72	3.7	0.03	9.2	0.08
Net earnings	\$ 296.8	2.26%	\$ 186.6	1.50%	\$ 172.5	1.53%
Cash flows from operating activities	\$ 626.6	4.76%	\$ 486.4	3.91%	\$ 467.2	4.14%
Total assets	\$ 5,051.5		\$ 4,929.2		\$ 4,679.7	
Total long-term liabilities	\$ 1,561.5		\$ 1,552.3		\$ 1,696.7	
Basic earnings per share						
Operating earnings	\$ 3.08		\$ 2.79		\$ 2.48	
Capital gain and other items, net of tax	1.45		0.05		0.14	
Net earnings	\$ 4.53		\$ 2.84		\$ 2.62	
Basic weighted average number of shares outstanding (in millions)						
	65.5		65.5		65.5	
Diluted earnings per share						
Operating earnings	\$ 3.07		\$ 2.78		\$ 2.47	
Capital gain and other items, net of tax	1.44		0.05		0.14	
Net earnings	\$ 4.51		\$ 2.83		\$ 2.61	
Diluted weighted average number of shares outstanding (in millions)						
	65.7		65.7		65.8	
Dividends	\$ 0.56		\$ 0.48		\$ 0.40	

(1) Fiscal 2004 revenue includes a \$14.6 million gain on the sale of several real estate assets.

(2) Fiscal 2004 has been restated to reflect retroactive adjustments related to lease accounting and EIC-144. Please see sections entitled "Lease Accounting" and EIC-144, "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor" in this fiscal 2006 MD&A.

Explanation of Fiscal 2006 Annual Results

The financial performance for each of the Company's businesses (food, real estate, and investments and other operations) is discussed in detail in further sections of this MD&A.

The following is a review of Empire's consolidated performance for the 52-weeks ended May 6, 2006 compared to the 53-weeks ended May 7, 2005.

Revenue

The following shows the fiscal 2006 revenue adjusted to eliminate the impact of VIE consolidation and the 53rd week of revenue included in fiscal 2005:

(\$ in millions)

Reported Revenue	Fiscal 2006		Reported Revenue	Fiscal 2005			Reported Growth Over 2005	Adjusted Growth Over 2005
	VIE Impact	Adjusted Revenue		VIE Impact	53rd Week Impact	Adjusted Revenue		
\$ 13,161	\$ (587)	\$ 12,574	\$ 12,435	\$ (137)	\$ (241)	\$ 12,057	5.8%	4.3%

Each of Empire's operating businesses contributed to growth in the Company's consolidated revenue in fiscal 2006 over the prior fiscal year; an increase of \$725.9 million or 5.8 percent. The revenue increase is largely attributed to an increase in food division revenues of \$663.9 million or 5.4 percent over the prior year. Growth in real estate revenues (net of inter-segment) totalled \$13.6 million or 7.9 percent, while investments and other operations recorded revenue growth of \$48.4 million or 65.0 percent, primarily as a result of the acquisition of 28 theatres acquired in the second quarter of fiscal 2006.

Fiscal 2006 contained 52 weeks of operations compared to 53 weeks in fiscal 2005. The additional week accounted for \$241 million of fiscal 2005 revenue. Also, the consolidation of VIEs occurred at the beginning of the fourth quarter of fiscal 2005,

therefore fiscal 2006 was positively impacted by a full year of VIEs' sales versus only the fourth quarter sales for fiscal 2005. Excluding the additional selling week from fiscal 2005 and the VIE consolidation from both fiscal 2006 and 2005, revenue growth in fiscal 2006 equalled 4.3 percent.

The year-over-year change in revenues for each division is explained in the section which follows, "Operating Performance by Division."



Operating Income

The year-over-year increase in operating income of \$27.7 million or 6.0 percent is the result of a \$16.1 million or 13.2 percent increase in operating income from the real estate division, a \$9.0 million or 2.8 percent increase in operating income contribution from the food division, and a \$2.6 million or 13.8 percent increase in operating income from investments and other operations. The year-over-year change in operating income for each division is explained in the section which follows, "Operating Performance by Division."

Interest Expense

The \$2.9 million decline in interest expense is largely attributed to reduced interest expense on long-term debt as a result of lower long-term debt levels in fiscal 2006 compared to the previous year.

The majority of the Company's debt is long-term and at fixed interest rates, accordingly there is limited exposure to interest rate volatility.

Income Taxes

The fiscal 2006 effective tax rate was 34.0 percent compared to 34.6 percent in fiscal 2005. The decrease in the effective tax rate for the year was the result of adjustments to future statutory rates applied to timing differences of future tax balances and a reduction in federal capital taxes.

Minority Interest

The Company incurs minority interest expense largely as a consequence of not owning 100 percent of Sobeys. Fiscal 2006 minority interest from operations equalled \$66.9 million, an increase of \$3.3 million or 5.2 percent from the \$63.6 million recorded in fiscal 2005. The increase in minority interest is primarily attributed to increased Sobeys' net earnings offset by an increase in Empire's ownership interest in Sobeys, from 68.4 percent last fiscal year to 70.3 percent at the end of fiscal 2006.

Empire purchased a total of 1,308,800 common shares of Sobeys in fiscal 2006 resulting in the increase in ownership interest. These share purchases totalled \$49.5 million and were funded largely from the proceeds received on the sale of 44 properties to Crombie REIT. Over the last three years Empire has purchased 5,142,200 common shares of Sobeys for a total cost of \$187.3 million.

Operating Earnings

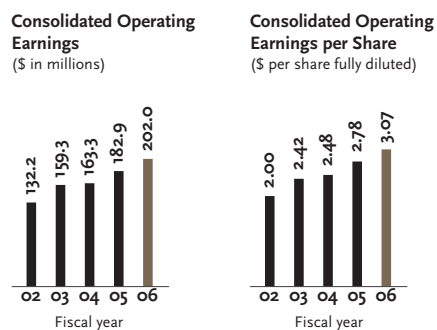
The \$19.1 million or 10.4 percent improvement in consolidated operating earnings (earnings before net capital gain and other items) over the prior year was the result of the \$27.7 million increase in operating income and the \$2.9 million reduction in interest expense partially offset by the \$8.2 million increase in income tax expense (from operating activities) and the \$3.3 million increase in minority interest (from operating activities) as previously discussed.

Capital Gain and Other Items

The capital gain and other items (net of tax) of \$94.8 million resulted primarily from the sale of 44 properties to Crombie REIT of \$76.2 million and a net gain on the sale of 2.875 million Wajax Income Fund units of \$23.5 million during the year, partially offset by a reduction of book value of real estate assets held for development of \$17.0 million, net of tax.

Net Earnings

The increase in consolidated net earnings of \$110.2 million or 59.1 percent from last fiscal year is the result of the \$19.1 million increase in operating earnings and the increase in net capital gain and other items (net of tax) over the prior year of \$91.1 million, as discussed.



Operating Performance by Division

Food Division

Highlights

- Sobeys achieved fiscal 2006 sales growth of \$663.9 million or 5.4 percent and same-store sales growth of 4.0 percent. Excluding the additional selling week in fiscal 2005 and the consolidation of variable interest entities, Sobeys' sales growth equalled 3.9 percent.
- EBITDA as a percentage of sales increased to 4.11 percent from 4.09 percent last year. EBITDA increased \$29.2 million or 5.9 percent to \$528.2 million.
- Sobeys contributed \$130.1 million in net earnings to Empire, a 5.7 percent increase over the prior year.
- Total capital expenditures equalled \$421.3 million (total company-wide capital expenditures, which includes franchisee and third party spending, equalled \$560.0 million).
- Opened or replaced 56 corporate and franchised stores, expanded 18 stores and rebannered 9 stores.

The following is a review of Sobeys' performance for the 52-week period ended May 6, 2006 compared to the 53-week period ended May 7, 2005.

Sales

Fiscal 2006 food division sales adjusted to eliminate the impact of VIE consolidation and the 53rd week of sales in fiscal 2005 were as follows:

(\$ in millions)

Reported Revenue	Fiscal 2006		Reported Revenue	Fiscal 2005			Adjusted Revenue	Reported Growth Over Fiscal 2005	Adjusted Growth Over Fiscal 2005
	VIE Impact	Adjusted Revenue		VIE Impact	53rd Week Impact	Adjusted Revenue			
\$ 12,853	\$ (587)	\$ 12,266	\$ 12,189	\$ (137)	\$ (241)	\$ 11,811	5.4%	3.9%	



In fiscal 2006, Sobeys achieved sales of \$12.85 billion, an increase of \$663.9 million or 5.4 percent over fiscal 2005. Fiscal 2006 contained 52 weeks of operations compared to 53 weeks in fiscal 2005. Also impacting Sobeys' sales growth in fiscal 2006 and the fourth quarter of fiscal 2005 was the consolidation of VIEs, which accounted for approximately \$587 million of sales in fiscal 2006 and \$137 million of sales in fiscal 2005. Adjusting for the 53rd week of operations and VIEs, Sobeys had sales growth of \$455 million or 3.9 percent over fiscal 2005.

Sales growth was also driven by Sobeys continued implementation of sales and merchandising initiatives across the country, coupled with the increased retail selling square footage resulting from the development of new stores and an ongoing program to enlarge and renovate existing store assets.

Store square footage increased by 1.6 percent in fiscal 2006 as a result of the opening of 56 new or replacement stores and the expansion of 18 stores, net of stores closed.

Sobeys' same-store sales (sales from stores in the same locations in both reporting periods) increased by 4.0 percent.

Sales growth was impacted by a year-over-year decline of approximately \$134.5 million in company-wide tobacco sales. Excluding this decline in the tobacco business, sales growth would have been 5.0 percent rather than the 3.9 percent discussed above.

Inflation was approximately 1.5 percent for the year, with variances by region.

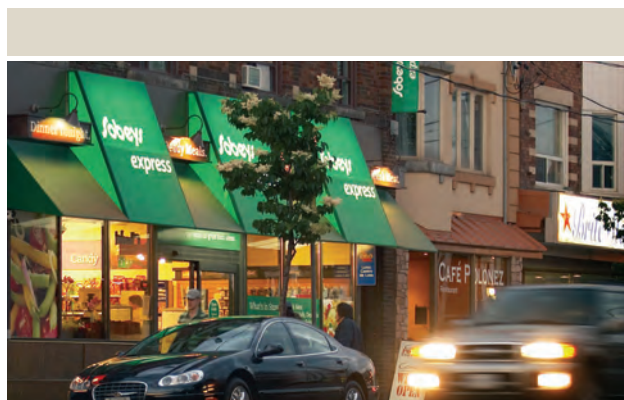
Sobeys expects sales growth to continue in fiscal 2007 as a result of ongoing capital investment in its retail store network, and continued offering, merchandising and pricing improvements across the country.

Earnings before Interest, Income Taxes, Depreciation and Amortization

Sobeys' fiscal 2006 EBITDA ("earnings before interest, income taxes, depreciation and amortization") increased \$29.2 million or 5.9 percent to \$528.2 million from \$499.0 million reported in fiscal 2005. EBITDA as a percentage of sales increased to 4.11 percent from 4.09 percent last year. Excluding VIEs, EBITDA as a percent of sales was 4.17 percent in fiscal 2006, a four basis point increase from fiscal 2005 EBITDA as a percent of sales.

For the 13-weeks and 52-weeks ended May 6, 2006, \$5.3 million and \$18.6 million, respectively, of pre-tax costs related to the Ontario business process and system initiative were incurred. These costs included the severance, labour, implementation and training costs associated with the Ontario systems implementation as well as the cost of writing off the Commisso's brand-name. As part of the transformation of the Ontario business, Sobeys is converting 12 Commisso's stores in Ontario to the Sobeys and Price Chopper banners. The conversions began in fiscal 2006 and will continue into the first half of fiscal 2007. Excluding these costs and the impact of VIEs, EBITDA increased 6.2 percent over fiscal 2005 and EBITDA as a percent of sales would have been 4.31 percent, an 18 basis point improvement over fiscal 2005.

Contributing to increased EBITDA was the growth in sales and an increase in gross margin, as a result of improved productivity initiatives and changes in mix, compared to the prior year.



Earnings before Interest, Income Taxes, Depreciation, Amortization and Rent

Sobeys' fiscal 2006 earnings before interest, income taxes, depreciation and amortization and rent ("EBITDAR") was \$863.2 million compared to \$774.9 million in fiscal 2005. Sobeys leases a substantial portion of its store network. Therefore, to arrive at a measure of operating performance excluding the impact of capital, gross rent expense of \$335.0 million in fiscal 2006 and \$275.9 million in fiscal 2005 is added to EBITDA to arrive at EBITDAR. As a percent of sales in fiscal 2006 EBITDAR was 6.72 percent compared to 6.36 percent in fiscal 2005.

Earnings before Interest and Income Taxes

Sobeys' EBIT increased to \$331.6 million in fiscal 2006, a 2.8 percent increase from the prior year, with an EBIT margin of 2.58 percent compared to 2.65 percent in fiscal 2005. Included in fiscal 2006 EBIT was a \$20.2 million increase in depreciation and amortization expense (\$196.6 million current year compared to \$176.4 million last year), reflecting Sobeys continued capital investments. Also included in EBIT are the Ontario business and system initiative costs as discussed. Adjusting for the Ontario business process and system initiative costs and the impact of the VIEs, EBIT would total \$338.8 million representing an EBIT margin of 2.76 percent. The 53rd week of operations in fiscal 2005 favourably impacted EBIT by approximately \$6.1 million or 2.1 percentage points, but had no impact on EBIT margin in the prior year.

Sobeys will continue to focus on disciplined cost management initiatives, supply chain and retail productivity improvements and migration of best practices across its four regions to continue to fuel and fund investments to drive sales, reduce costs and improve margins over time.

Net Earnings

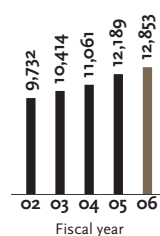
Sobeys' fiscal year 2006 net earnings were \$189.4 million compared with \$186.7 million last fiscal year, a \$2.7 million or 1.4 percent increase. Sobeys net earnings in fiscal 2005 were favourably impacted by approximately \$3.5 million as a result of the 53rd week of operations in the prior year.

Net earnings for the year ended May 6, 2006 included increased depreciation and amortization expense and Ontario business process and system initiative costs as mentioned.

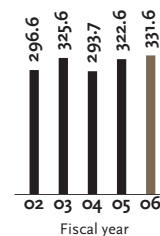
The consolidation of VIEs resulted in a \$0.3 million increase in net earnings for the 52-week period ended May 6, 2006 and a \$0.6 million decrease in net earnings for the prior fiscal year. The Ontario business process and system initiative costs reduced Sobeys' basic earnings per share by \$0.19 for the 52-weeks of fiscal 2006.

Excluding the Ontario process and system costs and the impact of VIEs, Sobeys' fiscal 2006 basic earnings per share would have been \$3.11 compared to basic earnings per share of \$2.84 in the prior year excluding the impact of VIEs and the 53rd week of operations. This would represent a 9.5 percent increase in Sobeys' basic earnings per share year-over-year.

Food Division Revenue
(\$ in millions)



Food Division Operating Income
(\$ in millions)



Real Estate Division

Highlights

- Formation of Crombie REIT through an initial public offering on March 23, 2006. Empire received cash proceeds of \$267.7 million or approximately \$155 million net of post closing obligations to Crombie REIT and retained a 48.3 percent ownership interest.
- The real estate division recorded a gain on the sale of assets to Crombie REIT of \$76.2 million partially offset by a reduction in book value of retained assets of \$17.0 million, both net of taxes.
- An exceptional year for residential operations with growth in net earnings contribution of \$11.6 million or 54.5 percent.
- Funds from operations increased 18.8 percent to \$76.5 million from \$64.4 million last year.

During the current fiscal year, the real estate division sold 44 commercial real estate properties to Crombie REIT. Reflected in the sale proceeds is an ownership interest in Crombie REIT of 48.3 percent. The Company's interest in Crombie REIT is accounted using the equity method. See note 3 to the Consolidated Financial Statements for detail on this transaction.

The table below segments real estate division revenue, funds from operations and operating earnings for commercial and residential operations.

(\$ in millions)	52 weeks ended May 6, 2006	% Change over 2005	53 weeks ended May 7, 2005	% Change over 2004
Revenue				
Commercial	\$ 190.9	(1.7%)	\$ 194.2	7.7%
Residential	48.1	37.4	35.0	15.9
	\$ 239.0	4.3%	\$ 229.2	8.9%
Inter-segment	(54.0)	(6.6)	(57.8)	10.5
	\$ 185.0	7.9%	\$ 171.4	8.3%
Operating earnings				
Commercial	\$ 26.7	9.4%	\$ 24.4	(2.0%)
Residential	32.9	54.5	21.3	25.3
	\$ 59.6	30.4%	\$ 45.7	9.1%
Funds from operations				
Commercial	\$ 43.2	1.2%	\$ 42.7	4.7%
Residential	33.3	53.5	21.7	23.3
	\$ 76.5	18.8%	\$ 64.4	10.3%

Revenue

Commercial property related revenue decreased \$3.3 million or 1.7 percent primarily as a result of the sale of 44 properties to Crombie REIT nine days prior to the end of the fourth quarter for ECL.

Revenue from residential activities increased \$13.1 million or 37.4 percent largely as a result of stronger than expected lot sales in Genstar's Western Canadian operation, particularly in Calgary and Edmonton, Alberta markets. Genstar continued to benefit from strong housing markets in Western Canada.

Operating Income

The \$16.1 million or 13.2 percent increase in real estate division operating income in fiscal 2006 was the result of higher residential operations' operating income of \$18.2 million or 55.0 percent due primarily to the strong housing market in Western Canada as mentioned. The real estate division contributed 28.1 percent of Empire's total operating income in fiscal 2006 (2005 – 26.3 percent). The \$2.1 million decrease in commercial property operating income is primarily attributed to the revenue decline as mentioned.

Operating Earnings

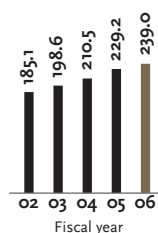
The \$13.9 million or 30.4 percent increase in real estate division operating earnings in fiscal 2006 was primarily the result of higher residential operations' operating earnings of \$11.6 million or 54.5 percent.

Net Earnings

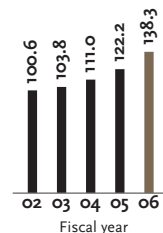
Real estate division contribution to Empire's fiscal 2006 net earnings was \$118.7 million, an increase of \$73.0 million or 159.7 percent from the \$45.7 million recorded in fiscal 2005. The increase is principally the result of the capital gain and other items (net of tax) of \$76.2 million on the sale of commercial properties to Crombie REIT, offset in part by a reduction of book value of real estate assets of \$17.0 million (net of tax).

Funds from operations (operating earnings plus depreciation and amortization) increased 18.8 percent to \$76.5 million from \$64.4 million last year primarily as a result of improved residential operating earnings performance.

Real Estate Division Revenue
(\$ in millions)



Real Estate Division Operating Income
(\$ in millions)



Investments and Other Operations Division

Highlights

- Formation of Wajax Income Fund in June 2005 with Empire selling 2.875 million units of Wajax resulting in a capital gain of \$25.6 million.
- Empire Theatres acquired 28 locations with 206 screens for a total cash consideration of \$87.8 million.
- Empire's liquid portfolio investments generated a 25.8 percent return in fiscal 2006, resulting in first quartile return performance.
- Four-year annualized return performance for Empire's portfolio investments was 17.6 percent compared to a 13.5 percent total return for the S&P/TSX Composite Index and a negative 3.0 percent total return for the S&P 500 Index, in Canadian dollars.

Investment Value

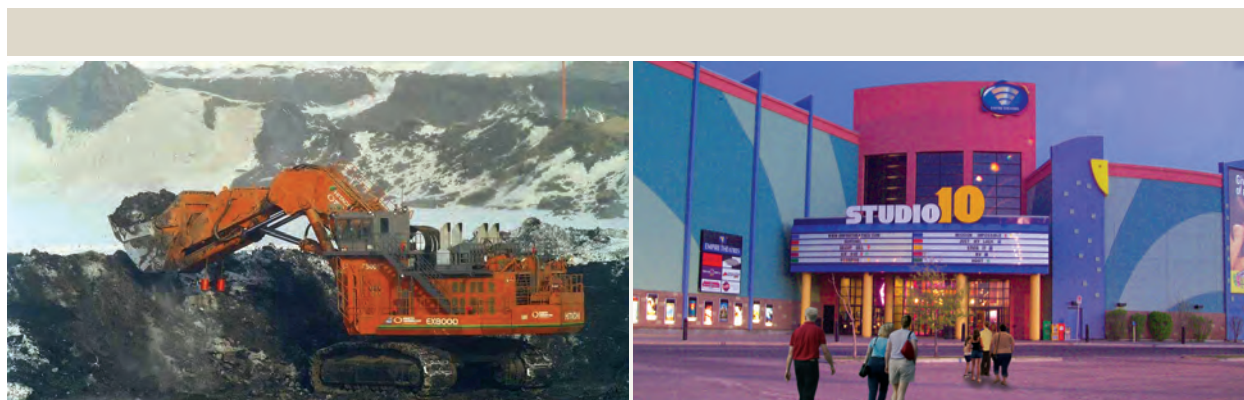
At fiscal year-end, Empire's total portfolio investments, excluding its ownership of 20.08 million units of Crombie REIT and Genstar U.S. builder deal investments, carried a market value of \$607.3 million (2005 – \$465.0 million) on a cost base of \$393.0 million (2005 – \$325.4 million), resulting in an unrealized gain of \$214.3 million. This compares to an unrealized gain of \$139.6 million at the end of fiscal 2005.

Portfolio Composition

At fiscal year-end, Empire's investment portfolio, excluding the investment in both Crombie REIT and Genstar U.S. builder deals consisted of:

(\$ in Canadian millions)	Market Value	% of Total	Cost	Unrealized Gain (Loss)
Canadian equities	\$ 239.3	39.4	\$ 170.5	\$ 68.8
U.S. equities	158.1	26.0	187.9	(29.8)
Wajax	193.0	31.8	33.1	159.9
Preferred shares & other	1.5	0.3	1.5	–
Hedge value ⁽¹⁾	15.4	2.5	–	15.4
Total	\$ 607.3	100.0	\$ 393.0	\$ 214.3

(1) On U.S. common equity investments, includes a deferred foreign exchange gain of \$10.2 million.



Empire's direct debt matched to these portfolio investments was \$71.2 million Canadian at fiscal year-end, equivalent to 11.7 percent of investment portfolio market value, including hedge value. Management considers a ratio of debt to investment value of no greater than 35 percent as prudent.

Revenue

Investments and other operations' revenue, primarily generated by Empire Theatres, reached \$122.8 million versus \$74.4 million last year. Revenue growth at Empire Theatres was primarily the result of the acquisition of the 27 movie theatres from Cineplex Galaxy LP on September 30, 2005. Empire Theatres owned or had an interest in 397 screens in operation at the end of fiscal 2006 compared to 176 at the end of the prior fiscal year.

Investment Return

The total return on the Empire investment portfolio, as independently benchmarked against over 100 North American equity fund managers, has provided first quartile return performance (i.e. in the top 25 percent of surveyed equity fund managers) over one, two, three, four and five-year trailing periods ended March 31, 2006, respectively.

Total Investment Returns

Annual Returns for Periods Ended March 31st	2006	2005	2004	2003	2002
Empire Investment Portfolio	25.8%	26.9%	63.4%	(25.6%)	18.2%
S&P/TSX Composite Index	28.4%	13.9%	37.7%	(17.6%)	4.9%
S&P 500 Index (in Cdn.\$)	7.8%	(1.5%)	20.5%	(30.7%)	1.4%

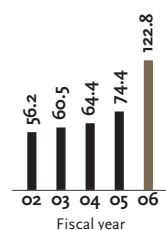
Total Investment Returns

Annualized Compound Returns for Periods Ended March 31, 2006	2-year	3-year	4-year	5-year
Empire Investment Portfolio	25.9%	37.1%	17.6%	18.1%
1st Quartile Manager Return	18.4%	23.9%	9.6%	12.6%
Median Manager Return	16.3%	21.5%	8.6%	11.4%
S&P/TSX Composite Index	20.9%	26.3%	13.5%	11.7%
S&P 500 Index (in Cdn.\$)	3.0%	8.6%	(3.0%)	(2.1%)

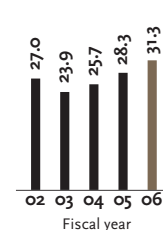
The median manager and first quartile manager returns as presented in the table above were calculated using Canadian and U.S. equity manager return data, as supplied by an independent analytical firm, multiplied by the respective Canadian and U.S. equity weights for the Empire investment portfolio.

Despite the volatility in equity markets, management continues to believe that equity market returns will be superior to either fixed income or money market investment returns over the long-term. Management remains committed to prudently

Investment and Other Operations Division Revenue
(\$ in millions)



Investment and Other Operations Division Operating Income*
(\$ in millions)



* before deducting corporate expenses

Total portfolio return for the twelve-month period ended March 31, 2006 was 25.8 percent. This compares to a 28.4 percent total return for the S&P/TSX Composite Index and a 7.8 percent total return for the S&P 500 Index in Canadian dollars over the same twelve-month period. Empire's investment return performance was ranked as being in the top quartile for the twelve-month period ended March 31, 2006.

The tables below present the return performance for Empire's investments, relative to Canadian and U.S. equity benchmarks over each of the last five years ended March 31st, as well as on a two, three, four and five-year annualized compounded basis. Investment returns are measured using a calendar quarter-end cycle, consistent with industry practice.

managing a high quality, liquid portfolio of common equities to augment the growth in the Company's core operating businesses.

Investment Portfolio Performance Attribution

The increase of \$74.7 million in investment market value over book cost in fiscal 2006 was primarily attributed to an increase in the unrealized gain position in the Wajax investment for the May 6, 2006 over the prior fiscal year-end.

Overall portfolio value also benefited from an increase in the value of a currency hedge put in place to protect U.S. equity portfolio investment value against a stronger Canadian dollar relative to the U.S. dollar.

Hedging Investment Currency Risk

At May 6, 2006, Empire had hedged approximately 95 percent of the market value of its U.S. based common equity investments by way of \$151 million notional of forward currency contracts. The average foreign exchange rate associated with these U.S. forward currency contracts is \$1.14269. The fair value of the hedge was \$5.2 million at the end of the fiscal year, consistent with last fiscal year, as a result of the foreign exchange rate equalling \$1.1070 at the end of the fiscal year. This hedge value is included in the \$214.3 million unrealized investment gain discussed above.

The \$151 million notional of forward currency contracts were put in place in late March/April 2006 as a replacement for U.S. dollar borrowings via bankers' acceptances which were repaid with a portion of the net cash proceeds from the closing of the Crombie REIT initial public offering on March 23, 2006. The repayment of the U.S. based borrowings resulted in a deferred hedge gain of \$10.2 million which will be realized on the eventual disposition of the underlying U.S. dollar portfolio investments.

The Company also had a \$12 million notional forward currency contract in place to hedge the value of Genstar – U.S. builder deal investments against a stronger Canadian dollar. The fair value of this hedge was \$0.3 million at the end of the fiscal year.

Capital Allocation from Investments

During fiscal 2006 Empire purchased 1,308,800 common shares of Sobeys for a total cost of \$49.5 million. The purchase price was funded by the net proceeds received on the sale of real estate assets to Crombie REIT. This resulted in an increase in Empire's ownership of Sobeys of 1.9 percentage points, with total interest of 70.3 percent at the end of fiscal 2006 versus 68.4 percent a year earlier. Also during fiscal 2006, Empire allocated \$40.0 million to assist in the funding of the 27 movie-theatres purchased by Empire Theatres from Cineplex Galaxy LP in September 2005.

Investment Income

Investment income generated by the investment portfolio, excluding equity earnings from Genstar U.S. builder deal investment equalled \$24.6 million in fiscal 2006, an increase of \$5.8 million or 30.8 percent over the prior year. The increase is the result of equity accounted earnings from Wajax being higher than last year by \$6.5 million combined with a decrease in dividend income of \$0.7 million. The decline in dividend income was expected as a result of changes in the investment portfolio mix. The growth in Wajax equity earnings was higher than expected and is largely the result of a strong resource sector in Western Canada which benefits Wajax sales of products and services.

Operating Earnings

Fiscal 2006 operating earnings from investments (net of corporate expenses) and other operations equalled \$12.7 million, a decrease of \$1.4 million or 9.9 percent from the prior year. Higher investment income was more than offset by a reduction in other operations' operating earnings and increased corporate expenses. Empire Theatres' earnings were negatively impacted by a combination of relatively weak movie product during the fiscal year and the effect of higher fixed costs resulting from the acquisition of 28 movie-theatres. The increase in corporate expenses was primarily attributed to higher interest expense as a result of higher average short-term borrowings relative to the prior year.

Capital Gain

Total capital gain (net of tax) from investments and other operations amounted to \$35.3 million in fiscal 2006 versus \$3.7 million last fiscal year. Capital gain (net of tax) realized on the sale of investments in fiscal 2006 equalled \$32.4 million including a net capital gain of \$23.5 million from the sale of 2.875 million units of Wajax. The remaining gain was due to the sale of other common equity investments. Empire Theatres recorded a net capital gain of \$2.9 million (2005 – nil) as a result of the sale of a joint venture theatre interest in Western Canada.

Net Earnings

Investments (net of corporate expenses) and other operations contributed \$48.0 million to Empire's consolidated net earnings. This compares to a \$17.8 million net earnings contribution last fiscal year. The growth was largely attributed to the increase in realized capital gains as discussed.

Quarterly Results of Operations

The following table is a summary of selected consolidated financial information from the Company's unaudited interim consolidated financial statements for each of the eight most recently completed quarters.

Results by Quarter

(\$ in millions, except per share information)	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
	(13 weeks) May 6, 2006	(13 weeks) Feb. 4, 2006	(13 weeks) Nov. 5, 2005	(13 weeks) Aug. 6, 2005	(14 weeks) May 7, 2005	(13 weeks) Jan. 29, 2005	(13 weeks) Oct. 30, 2004	(13 weeks) July 31, 2004
Revenue	\$ 3,249.4	\$ 3,264.4	\$ 3,285.6	\$ 3,361.7	\$ 3,360.2	\$ 2,978.5	\$ 3,022.8	\$ 3,073.7
Operating income	130.9	118.3	122.1	120.1	124.0	113.3	111.6	114.8
Operating earnings ⁽¹⁾	56.9	47.7	47.8	49.6	49.3	46.2	43.0	44.4
Capital gain (loss) and other items, net of tax	61.5	8.3	0.8	24.2	5.5	1.4	(3.0)	(0.2)
Net earnings	\$ 118.4	\$ 56.0	\$ 48.6	\$ 73.8	\$ 54.8	\$ 47.6	\$ 40.0	\$ 44.2
Per Share Information, fully diluted								
Operating earnings	\$ 0.87	\$ 0.72	\$ 0.73	\$ 0.75	\$ 0.75	\$ 0.70	\$ 0.66	\$ 0.66
Capital gain (loss) and other items, net of tax	0.93	0.13	0.01	0.37	0.08	0.02	(0.05)	—
Net earnings	\$ 1.80	\$ 0.85	\$ 0.74	\$ 1.12	\$ 0.83	\$ 0.72	\$ 0.61	\$ 0.66
Weighted average number of shares outstanding (in millions)	65.7	65.7	65.7	65.7	65.7	65.8	65.8	65.8

All quarters prior to the fourth quarter of fiscal 2005 have been restated to reflect retroactive adjustments related to lease accounting. Please see the section entitled "Accounting Standards – Lease Accounting" in this fiscal 2006 MD&A.

(1) Operating earnings is net earnings before capital gain (loss) and other items, net of tax.

Fourth Quarter Results

Summary Table of Consolidated Financial Results for the Fourth Quarter

(\$ in millions, except per share information)	13 Weeks Ended May 6, 2006		14 Weeks Ended May 7, 2005	
	\$	% of Revenue	\$	% of Revenue
Revenue	\$ 3,249.4	100.00%	\$ 3,360.2	100.00%
Operating income	130.9	4.03	124.0	3.69
Interest expense	19.1	0.59	23.3	0.69
Income taxes (from operating activities)	36.0	1.11	35.4	1.05
Minority interest (from operating activities)	18.9	0.58	16.0	0.48
Operating earnings	56.9	1.75	49.3	1.47
Capital gain and other items, net of tax	61.5	1.89	5.5	0.16
Net earnings	\$ 118.4	3.64%	\$ 54.8	1.63%
Basic earnings per share				
Operating earnings	\$ 0.87		\$ 0.75	
Capital gain and other items, net of tax	0.94		0.08	
Net earnings	\$ 1.81		\$ 0.83	
Basic weighted average number of shares outstanding (in millions)	65.5		65.5	
Diluted earnings per share				
Operating earnings	\$ 0.87		\$ 0.75	
Capital gain and other items, net of tax	0.93		0.08	
Net earnings	\$ 1.80		\$ 0.83	
Diluted weighted average number of shares outstanding (in millions)	65.7		65.7	
Dividends	\$ 0.56		\$ 0.48	

The following is a review of financial performance for the 13-week period ended May 6, 2006 compared to the 14-week period ended May 7, 2005.

Revenue

Revenue for the fourth quarter was \$3.25 billion compared to \$3.36 billion last year, a \$110.8 million or 3.3 percent decrease. The fourth quarter of fiscal 2006 contained 13 weeks of operations compared to 14 weeks in fiscal 2005 and this additional week accounted for approximately \$241 million in additional sales in the fourth quarter of fiscal 2005. Adjusting for the additional week, sales growth was 4.2 percent over the prior year. The consolidation of VIEs occurred at the beginning of the fourth quarter of fiscal 2005 and as a result did not impact the quarter-over-quarter growth.

The following table shows the fourth quarter revenues adjusted to eliminate the impact of the 14th week of sales included in the fourth quarter of fiscal 2005 (VIEs were consolidated in both the fourth quarter of fiscal 2005 and 2006):

(\$ in millions)

Fiscal 2006 Reported Revenue	Fiscal 2005			Reported Decline Over Fiscal 2005	Adjusted Growth Over Fiscal 2005
	Reported Revenue	53 rd Week Impact	Adjusted Revenue		
\$ 3,249	\$ 3,360	\$ (241)	\$ 3,119	(3.3%)	4.2%

The food division reported revenue of \$3.16 billion, a decrease of \$132.1 million or 4.0 percent. For the food division, the fourth quarter of fiscal 2006 contained 13 weeks of operations compared to 14 weeks in fiscal 2005. The additional week accounted for approximately \$241 million of the revenue decrease.

Food division same-store sales grew 3.9 percent during the fourth quarter of fiscal 2006. The growth in retail sales was a direct result of Sobeys' continued implementation of sales and merchandising initiatives across Sobeys and its ongoing financial commitment to upgrade and renovate existing store assets. Same-store sales growth outpaced overall Sobeys' sales growth as there was little growth in wholesale sales to independent customers in the fourth quarter this year compared to the fourth quarter last year. Tobacco sales have decreased in the current quarter and the disposition of Sobeys' Cash and Carry business in Ontario and Quebec in the quarter also had a negative impact on sales. Excluding the impact of the tobacco decline and the impact of the Cash and Carry disposition, sales growth would have been 6.1 percent on a comparable 13 week basis.

Real estate operations reported fourth quarter revenues (net of inter-company eliminations) of \$50.2 million, an increase of \$2.8 million or 5.9 percent over the fourth quarter last year. Commercial property revenue declined by \$2.1 million or 6.0 percent while revenue from residential operations increased \$4.9 million or 39.8 percent. The decline in commercial property revenues was primarily the result of the sale of 44 properties to Crombie REIT nine days prior to the end of the quarter for ECL. The increase in residential revenue from Genstar was the result of exceptionally strong lot sales, particularly in Calgary and Edmonton, Alberta markets.

Revenue from investments and other operations in the fourth quarter equalled \$36.6 million, an increase of \$18.5 million or 102.2 percent over the fourth quarter last year. This is primarily related to the revenue contribution from 28 acquired movie-theatres by Empire Theatres in the second quarter of fiscal 2006.

Operating Income

The \$6.9 million or 5.6 percent increase in consolidated operating income in the fourth quarter was attributed to: (i) an increase in operating income contribution from residential property operations of \$4.8 million, (ii) a \$0.8 million increase in operating income from investments and other operations (net of corporate expenses), (iii) a \$0.7 million increase in operating income from commercial property operations and (iv) a \$0.6 million increase in operating income from the food division compared to the fourth quarter last year.

Sobeys' EBITDA for the quarter ended May 6, 2006 was \$136.7 million; an increase of 2.7 percent or \$3.6 million versus the \$133.1 million recorded in the same quarter last year. EBITDA as a percentage of sales increased to 4.32 percent from 4.04 percent when compared to fourth quarter fiscal 2005 results. Sobeys experienced a modest increase in gross margin percentage compared to the same quarter last year as a result of the continued implementation of enhanced merchandising programs and store productivity initiatives.

Sobeys' EBIT for the fourth quarter increased \$0.6 million or 0.7 percent to \$85.2 million. The 14th week of operations in the fourth quarter last year positively impacted EBIT by approximately \$6.1 million. EBIT margin, which is EBIT divided by sales, for the fourth quarter increased to 2.69

percent from 2.57 percent in the same quarter last year. Sobeys fourth quarter EBIT included \$5.3 million of costs related to the Ontario business process and system initiative outlined previously.

Real estate division operating income grew by \$5.5 million or 15.6 percent over the fourth quarter last year. Commercial operations operating income increased \$0.7 million or 3.0 percent to \$23.7 million while residential operations operating income increased by \$4.8 million or 39.3 percent to reach \$17.0 million. This rate of growth in residential operations' operating income is not expected to be sustainable. Management recognizes that selling residential lots is a cyclical industry and that growth will likely soften as interest rates rise and/or other macroeconomic events dampen the demand for residential real estate.

Operating income from investments and other operations, net of corporate expenses, increased \$0.8 million or 19.0 percent to reach \$5.0 million. Higher investment income of \$1.8 million was more than offset by a reduction in operating income contribution for other operations as well as higher corporate expenses. Relatively weak movie product quality in the fourth quarter coupled with higher fixed costs as a result of acquiring 28 movie-theatres in the second quarter served to negatively impact Empire Theatres' growth in operating income.

Interest Expense

The \$4.2 million decrease in fourth quarter consolidated interest expense is primarily due to a \$3.6 million reduction in interest expense connected to long-term debt. At the end of the fiscal year, long-term debt was \$171.7 million lower than the prior year. Interest expense related to short-term debt also declined, by \$0.6 million, reflecting decreased bank loans in the fourth quarter as a result of using a portion of the cash proceeds received on the sale of property to Crombie REIT to reduce short-term indebtedness.

Income Taxes

The effective income tax rate for the fourth quarter was 32.2 percent compared to 35.2 percent in the fourth quarter last year. The decrease in the effective tax rate for the quarter was the result of adjustments to the statutory rates applied to timing differences of future tax balances and a reduction in federal capital taxes.

Minority Interest

The \$2.9 million increase in minority interest relative to the fourth quarter last year was the result of higher earnings from Sobeys offset by an increase in Empire's ownership interest. The purchase of 1.3 million Sobeys' shares during April 2006 served to increase Empire's interest in Sobeys from 68.4 percent to 70.3 percent.

Operating Earnings

The \$7.6 million or 15.4 percent increase in operating earnings over the fourth quarter last year is the result of a \$2.2 million increase in food distribution division earnings contribution; a 5.3 million increase in real estate division earnings contribution, and a \$0.1 million increase in earnings contribution from investments and other operations.

Capital Gain and Other Items

The capital gain and other items (net of tax) of \$61.5 million in the fourth quarter of fiscal 2006 compares to \$5.5 million in the fourth quarter of fiscal 2005. The increase in the capital gain (net of tax) of \$56.0 million is primarily the result of the sale of assets to Crombie REIT as discussed.

Net Earnings

Consolidated net earnings in the fourth quarter, including capital gains and other items (net of tax), totalled \$118.4 million or \$1.80 per share on a fully diluted basis versus \$54.8 million or \$0.83 per share in the fourth quarter last year, a \$63.6 million increase. The real estate division accounted for \$64.3 million of the increase in consolidated earnings. Real estate's earnings were favourably impacted by a net capital gain on the sale of properties to Crombie REIT of \$76.2 million which was partially offset by a reduction in the book value of retained real estate assets of \$17.0 million for a net impact of \$59.2 million. The food division contributed a \$2.6 million increase in net earnings while investments and other operations' net earnings contribution declined by \$3.3 million over the fourth quarter last year.

Financial Condition

Management believes that the Company's capital structure and financial condition can be evaluated based on a review of key financial condition measures contained in the table below.

(\$ in millions, except per share and ratio calculations)	May 6, 2006	May 7, 2005	April 30, 2004
Shareholders' equity	\$ 1,965.2	\$ 1,709.0	\$ 1,567.6
Book value per share	29.77	25.87	23.67
Minority interest	585.4	556.3	541.0
Bank indebtedness	98.6	219.4	140.8
Long-term debt, including current portion ⁽¹⁾	823.5	986.7	1,008.2
Funded debt to total capital	31.9%	41.4%	42.3%
Net debt to total capital ratio ⁽²⁾	22.8%	35.1%	37.7%
Adjusted debt to total capital ⁽³⁾	48.9%	53.7%	50.2%
Debt to EBITDA	1.35x	1.87x	1.98x
Interest coverage	5.86x	5.35x	4.58x
Total assets	\$ 5,051.5	\$ 4,929.2	\$ 4,679.7

(1) Includes long-term lease obligation.

(2) Net debt to total capital is calculated as funded debt less cash and cash equivalents divided by total capital, net of cash and cash equivalents.

(3) Adjusted debt includes capitalization of lease obligations based on six times net annual lease payments (gross lease payments net of expected sub-lease income).

Empire's financial condition continues to strengthen as evidenced by improvement in interest coverage, a reduction in debt ratios and an increase in book value per share. The sale of 44 commercial properties to Crombie REIT and corresponding equity accounting of Crombie REIT as a consequence of the 48.3 percent ownership level, had the effect of removing \$312.9 million of long-term debt from the consolidated balance sheet.

Shareholders' Equity

Total common shares outstanding at May 6, 2006 equalled 65,735,810, relatively unchanged from a year ago. There were 31,175,047 Non-Voting Class A shares outstanding and 34,560,763 Class B common shares outstanding at May 6, 2006. During fiscal 2006, there were no options exercised compared to 9,400 options exercised in fiscal 2005. At May 6, 2006, Empire had 27,674 options outstanding which are scheduled to expire in October, 2006.

Empire has a policy of repurchasing enough Class A Non-Voting shares to offset the dilutive effect of shares issued to fulfill the Company's obligation under its stock option and share purchase plans. During fiscal 2006 Empire purchased 20,254 Non-Voting Class A shares for cancellation versus 61,129 shares purchased for cancellation in fiscal 2005. Also, during fiscal 2005 Empire purchased for cancellation 100,000 series 2 preferred shares for \$2.5 million; none were purchased for cancellation in fiscal 2006.

At July 14, 2006, Empire had 65,766,602 shares outstanding, consisting of 31,205,839 Non-Voting Class A shares and 34,560,763 Class B common shares outstanding, along with 15,255 options outstanding expiring in October, 2006. Options allow the holder to purchase Non-Voting Class A shares at \$6.555 per share.

Dividends paid to common shareholders in fiscal 2006 amounted to \$36.7 million (\$0.56 per share) versus \$31.6 million (\$0.48 per share) last fiscal year.

Liabilities

Historically the Company has financed a significant portion of its investing activities, consisting primarily of purchases of property and equipment, through the use of funded debt (consisting of bank indebtedness, long-term debt, long-term debt due within one year, and long-term lease obligation), the majority of which is fixed-rate and long-term in nature. This trend is expected to continue.

Total fixed-rate, long-term debt (including the current portion of long-term debt) at fiscal year-end of \$587.1 million represents 63.7 percent of Empire's total funded debt of \$922.1 million. Long-term debt (including current portion and long-term lease obligations) segmented by division is detailed in the table below.

(\$ in millions)	May 6, 2006	May 7, 2005
Food	\$ 510.8	\$ 470.1
Real estate	253.9	512.2
Investments and other operations	58.8	4.4
Total	\$ 823.5	\$ 986.7

Of the total long-term debt outstanding at fiscal year-end, 62.0 percent was directly related to the food segment, 30.8 percent was directly related to the real estate segment, and 7.2 percent was related to investments and other operations. Empire finances its long-term assets predominately with fixed-rate long-term debt, thereby reducing both interest rate and refinancing risk. Because the investment segment's assets are short-term and liquid in nature, associated financing tends to be short-term in duration, primarily by way of one to three month bankers' acceptances.

Excluding long-term lease obligation, a total of \$324.4 million in long-term debt is due within the next five years, and a further \$478.3 million with longer maturities for a total of \$802.7 million (2005 - \$974.4 million). The fair value of the Company's long-term debt is estimated to be \$866.4 million. Long-term debt maturities, including capital leases, in fiscal 2007 and 2008 amount to \$95.4 million and \$51.6 million, respectively. The Company anticipates being able to fund these maturities through the following sources of cash: cash generated from operations, the utilization of short-term credit facilities and the issuance of additional long-term debt. Management monitors capital markets with a view to replacing maturing debt with new debt having long-term maturities.

At May 6, 2006, interest coverage (operating income divided by interest expense) improved to 5.86 times from the 5.35 times coverage reported as of May 7, 2005. The improvement in coverage is the result of the 5.9 percent increase in year-over-year operating income coupled with the 3.3 percent decrease in interest expense as discussed. The ratio of debt to

EBITDA also improved, from 1.87 times last fiscal year-end, to 1.35 times at the end of fiscal 2006. This is related to growth in EBITDA of 6.4 percent and a decrease in debt of 23.5 percent, primarily as a result of the formation of Crombie REIT. As mentioned, a portion of the proceeds received on the Crombie REIT closing were used to reduce bank indebtedness.

Largely as a consequence of the Crombie REIT transactions, the Company's debt to total capital ratio declined 9.5 percentage points in fiscal 2006 and the ratio of net debt (debt less cash and cash equivalents) to total capital ratio declined by 12.3 percentage points.

The Company also monitors adjusted debt to total capital, where net annual lease payments are capitalized at six times annual lease payments, and this capitalized lease obligation is then added to funded debt. Adjusted debt to capital at fiscal year-end was 49.9 percent versus 57.4 percent at the end of last fiscal year.

Empire's investment portfolio consisting of liquid publicly traded securities also strengthens the Company's financial position. At fiscal year-end May 6, 2006 the investment portfolio, including the market value of 20.07 million Crombie REIT units, carried a market value of \$824.2 million (2005 - \$483.3 million).

Through established credit ratings, Sobeys maintains access to the capital markets. Sobeys has a corporate unsecured debt rating of BBB- (stable trend) from Standard and Poor's and a debt rating of BBB high (negative trend) from Dominion Bond Rating Service.

Empire and its subsidiaries have provided covenants to its lenders in support of various financing facilities. All covenants were complied with in fiscal 2006 and fiscal 2005.

Empire anticipates ready availability of any required longer-term financing due to improvement in its financial condition and previous experience in the capital markets.

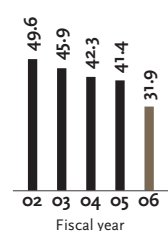
Sobeys filed a short-form base shelf prospectus, on October 21, 2005, providing for the issuance of up to \$500 million in unsecured medium term notes ("MTNs") over the next two years. On October 28, 2005, Sobeys issued \$175 million Series D MTN with a maturity date of October 29, 2035 (30 years) and an interest rate of 6.06 percent. The proceeds from this issuance were used to repay the Sobeys' Series A MTN which matured on November 1, 2005 and carried an interest rate of 7.60 percent. Through a bond forward Sobeys had locked in the rate on the underlying government of Canada 15 year yield for refinancing \$100 million of the November 2005 Series A MTN maturity. The settlement of this bond forward resulted in a \$4.4 million addition to deferred costs which Sobeys is amortizing to interest expense over the 30-year term of the related MTN.

Financial Instruments

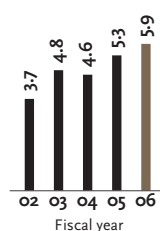
Empire utilizes interest rate instruments from time to time to prudently manage its exposure to interest rate volatility and also to fix future long-term debt maturities which are expected to be refinanced. At May 6, 2006, there were no interest rate hedges in place by Empire directly or with any of its operating companies.

To mitigate the currency risk associated with the Company's U.S. dollar investments, including its investment in Genstar – U.S. builder deals, Empire has entered into and designated \$163 million of forward currency contracts to act as a hedge against the effect of a stronger Canadian dollar relative to the U.S. dollar. The fair value of these currency forwards at May 6, 2006 was \$5.5 million. Approximately 95 percent of the market value of U.S. dollar common equities in the Empire investment portfolio are hedged at an average foreign exchange rate of 1.14269. These forward exchange contracts have variable maturities over the next year and are anticipated to be extended at maturity. Empire and its subsidiaries use hedging instruments to mitigate risk exposure, not for speculative purposes.

Funded Debt to Total Capital
(percentage)



Interest Coverage
(times)



Major Cash Flow Components

The table below highlights major cash flow components for the 13 and 52-weeks ended May 6, 2006 compared to the 14 and 53-weeks ended May 7, 2005.

(\$ in millions)	13 Weeks	14 Weeks	52 Weeks	53 Weeks
	May 6, 2006	May 7, 2005	May 6, 2006	May 7, 2005
Earnings for common shareholders	\$ 118.3	\$ 54.8	\$ 296.5	\$ 186.3
Items not affecting cash	45.1	95.0	254.4	315.8
Net change in non-cash working capital	163.4	149.8	550.9	502.1
Cash flows from operating activities	331.7	261.5	626.6	486.4
Cash flows used in investing activities	(26.9)	(205.7)	(472.9)	(447.0)
Cash flows (used in) from financing activities	(169.9)	34.9	(94.3)	7.2
Initial impact of VIEs	–	32.9	–	32.9
Increase in cash and cash equivalents	\$ 134.9	\$ 123.6	\$ 59.4	\$ 79.5

Liquidity and Capital Resources

Sources of Liquidity

Empire's liquidity remains strong as a result of the following sources of liquidity:

- Cash and cash equivalents on hand;
- Unutilized bank credit facilities;
- Availability of long-term debt financing;
- Empire's portfolio of liquid investments; and
- Cash generated from operating activities.

The Company anticipates that these sources of liquidity will be sufficient to meet expected cash outflows over the next year.

At May 6, 2006 cash and cash equivalents were \$341.1 million versus \$281.7 million at May 7, 2005.

On a non-consolidated basis, Empire maintains authorized bank lines for operating, general and corporate purposes of \$325.0 million, of which approximately 22 percent was utilized at fiscal year-end. On a consolidated basis, Empire's authorized bank credit facilities exceeded borrowings by \$626.4 million at May 6, 2006.

The Company normally refinances existing long-term debt as it matures, and maintains financial flexibility through its investment portfolio and access to the capital markets for additional long-term debt or equity financing. Longer-term financing is obtained by Sobeys primarily through Canadian public debt markets via Sobeys' established MTN program.

Sobeys also utilizes capital leases for the financing of selected properties and assets. The Company anticipates continued ready access to financing sources as a result of in-place investment grade credit ratings for Sobeys, as mentioned, and previous capital markets experience.

Operating Activities

Cash flows from operating activities amounted to \$331.7 million in the fourth quarter compared to \$261.5 million in the comparable quarter last year. The increase of \$70.2 million was the result of increased earnings for common shareholders of \$63.5 million, an increase in non-cash working capital of \$56.6 million partially offset by a decrease in items not affecting cash of \$49.9 million. Key factors resulting in the decrease in items not affecting cash in the fourth quarter were: the gain on sale of property to Crombie REIT of \$76.2 million and the reduction of book value of real assets of \$17.0 million.

Cash flows from operating activities on an annual basis amounted to \$626.6 million compared to \$486.4 million last fiscal year. The increase of \$140.2 million was the result of a \$110.2 million improvement in earnings for common shareholders, a \$91.4 million increase in non-cash working capital, partially offset by a \$61.4 million decrease in items not affecting cash. The decrease in items not affecting cash was primarily attributed to: (i) the real estate items as discussed above, (ii) a capital gain, net of tax, on the sale of Wajax Income Fund units equal to \$23.5 million, (iii) a decrease in future income taxes of \$21.6 million, and (iv) an increase in depreciation and amortization of \$24.3 million.

The following table presents non-cash working capital changes as compared to the third quarter of fiscal 2006 and to last fiscal year.

Major Components of Non-Cash Working Capital Including VIEs

(\$ in millions)	May 6, 2006	February 4, 2006	Quarter Increase (Decrease) in Cash Flows	May 7, 2005	Year-over-Year Increase (Decrease) in Cash Flows
Receivables	\$ 275.4	\$ 274.9	\$ (0.5)	\$ 257.8	\$ (17.6)
Inventories	694.3	726.6	32.3	639.6	(54.7)
Prepaid expenses	51.5	50.6	(0.9)	52.3	0.8
Accounts payable and accrued liabilities	(1,241.8)	(1,130.3)	111.5	(1,149.1)	92.7
Income taxes receivable (payable)	(35.8)	(1.2)	34.6	15.0	50.8
Total	\$ (256.4)	\$ (79.4)	\$ 177.0	\$ (184.4)	\$ 72.0

Inventory levels decreased \$32.3 million, accounts payable and accrued liabilities increased \$111.5 million and income taxes payable increased \$34.6 million compared to the third quarter of fiscal 2006. The decrease in inventory levels is consistent with trends in inventory levels in prior years. The increase in accounts payable and accrued liabilities was consistent with the prior year and can be attributed to a combination of higher trade payables and higher accrued liabilities such as construction costs and employee incentives.

Compared to May 7, 2005, accounts receivable increased \$17.6 million, inventories increased \$54.7 million, accounts payable and accrued liabilities increased \$92.7 million and income taxes payable increased \$50.8 million. The increase in inventory and the corresponding increase in trade accounts payable primarily reflects higher inventory levels to support Sobeys' expanded network and growing sales.

Investing Activities

Cash flows used in investing activities of \$26.9 million in the fourth quarter was \$178.8 million lower than in the fourth quarter of last fiscal year. The significant reduction is largely the result of proceeds of \$267.7 million on the sale of property to Crombie REIT, partially offset by a net increase in investments over the comparable quarter of the prior year of \$88.9 million.

On an annual basis, cash used in investing activities increased \$25.9 million to total \$472.9 million. This was primarily the result of: (i) a net increase in investments of \$135.0 million, (ii) an increase in purchases of property, equipment and other assets of \$174.4 million and (iii) an increase in business acquisitions (net of cash acquired) of \$73.2 million, offset by proceeds on the sale of property to Crombie REIT of \$267.7 million and net proceeds on the sale of Wajax Income Fund units of \$50.8 million. Also contributing to the fiscal 2006 increase in cash flows used in investing activities was the purchase of shares in Sobeys totalling \$49.5 million compared to \$93.5 million last fiscal year.

Consolidated on-balance sheet purchases of property equipment and other assets totalled \$546.4 million compared to \$372.0 million last fiscal year. The table below presents balance sheet capital expenditures over the last two years by division.

(\$ in millions)	May 6, 2006	May 7, 2005
Food	\$ 421.3	\$ 321.1
Real estate	67.9	33.2
Investments and other operations	57.2	17.7
Total	\$ 546.4	\$ 372.0

Food division company-wide capital investment which includes on-balance sheet capital expenditures, all known capital investments by franchise affiliates and capital investments by third-party landlords, totalled \$560 million in fiscal 2006, an increase of \$124 million from \$436 million recorded in the previous year. Sobeys remains committed to growing and improving its store network. During the fourth quarter, 12 corporate and franchised stores were opened or replaced compared to 13 corporate and franchised stores opened or replaced during the fourth quarter of last year. An additional four stores were expanded during the quarter compared to seven in the same time period last year. There were four stores rebannered in the current quarter compared to 16 for the same quarter last year.

On an annual basis, the food division opened or replaced 56 corporate and franchised stores compared to 41 corporate and franchised stores opened or replaced last year. An additional 18 stores were expanded in the year compared to 19 stores last year and nine stores were rebannered this year compared to 36 last year.

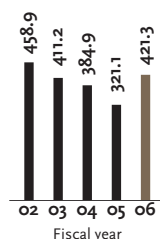
Net retail store square footage increased during the fourth quarter by 1,341 square feet (405,108 square feet opened, less 403,767 square feet closed). Net retail store additions for the year totalled 322,484 square feet (1,341,601 square feet opened less 1,019,117 square feet closed). At May 6, 2006, Sobeys' square footage totalled 25.4 million square feet, a 1.6 percent increase over May 7, 2005.

Sobeys continues to focus on growth through a combination of new store openings, renovations, replacements and enlargements and, where appropriate, through strategic acquisitions. It is expected that there will be a significant increase in capital expenditures for fiscal 2007. This will include a continued focus on the retail store network along with increased spending on landbank sites and logistics infrastructure. During fiscal 2007, the Company plans to open, expand, or renovate approximately 90 corporate and franchised stores across Canada, increasing square footage by approximately four percent.

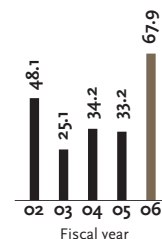
Capital expenditures for the real estate division equalled \$67.9 million in fiscal 2006 as a result of ongoing property developments and land additions.

Capital spending by investments and other operations equalled \$57.2 million in fiscal 2006 (\$17.7 million in 2005) as a result of expenditures to invest in selected oil and gas properties in Alberta through Kepec and to modernize various movie-theatre locations.

Food Division Capital Expenditures
(\$ in millions)



Real Estate Division Capital Expenditures
(\$ in millions)



Financing Activities

Financing activities during the fourth quarter used \$169.9 million in cash compared to cash generated of \$34.9 million in the comparable period of fiscal 2005. Net repayments of funded debt amounted to \$160.1 million in the fourth quarter (repayments of \$281.7 million net of issuances of \$121.6 million), compared to net issuances of \$43.9 million (repayments of \$14.3 million net of issuances of \$58.2 million) in the fourth quarter of fiscal 2005. In the fourth quarter of fiscal 2006, some of the proceeds from the sale of properties to Crombie REIT were used to pay down bank indebtedness, and also to purchase 1,308,800 common shares of Sobeys. In the fourth quarter of last year, the purchase of Sobeys' shares was financed by short-term bank indebtedness.

For the fiscal year, financing activities decreased cash by \$94.3 million compared to an increase of \$7.2 million in the prior fiscal year. Bank indebtedness decreased in fiscal 2006 by \$110.6 million compared to an increase in bank indebtedness in fiscal 2005 of \$78.6 million. As previously discussed, proceeds from the sale of properties to Crombie REIT were used to pay down short-term bank indebtedness and to purchase additional Sobeys' shares, whereas in fiscal 2005 Sobeys' share purchases were financed by short-term bank indebtedness.

As well, for the full fiscal year, the issuance of long-term debt at \$409.5 million and the repayment of long-term debt at \$362.5 million were significantly higher than last fiscal year, netting at a \$47.0 million source of cash. The long-term debt issuance largely reflects: (i) Sobeys repaying, on maturity, the \$175 million Series A MTN with proceeds from the issuance of a new Series D MTN; (ii) the entering into of \$144.2 million of commercial mortgage backed securities which were subsequently repaid on the formation of Crombie REIT; and (iii) notes payable to Crombie REIT in the amount of \$62.7 million in connection with capital expenditures, rental income subsidies, interest rate subsidies and tax subsidies as detailed in various commercial agreements between ECL and Crombie REIT. The repayment of long-term debt of \$362.5 million reflects the \$175 million MTN repayment as mentioned along with the assumption of long-term debt connected to the 44 commercial properties sold to Crombie REIT. See note 3 to the financial statements for details on the sale of these properties.

The Company's share capital was comprised of the following at its fiscal year-end May 6, 2006:

Authorized	Number of Shares
Preferred shares, par value \$25 each, issuable in series	2,846,000
2002 Preferred shares par value \$25 each, issuable in series	992,000,000
Non-Voting Class A shares, without par value	259,154,492
Class B common shares, without par value, voting	40,800,000
Issued and Outstanding	Number of Shares
Preferred shares, Series 2 cumulative, redeemable, rate of 75% of prime	331,900
Non-Voting Class A shares	31,175,047
Class B common shares	34,560,763

Dividend Payments

Dividends of \$36.7 million (\$0.56 per share) were paid in fiscal 2006 on Empire's common shares, up from the \$31.6 million (\$0.48 per share) paid in fiscal 2005. The dividend rate increased from \$0.48 to \$0.56 per share. There was no material change in the number of common shares outstanding year-over-year.

Share Repurchases

During fiscal 2006, Empire repurchased 20,254 Non-Voting Class A shares (\$0.8 million) under a Normal Course Issuer Bid announced on July 26, 2005. The Company issued 20,254 Non-Voting Class A shares (\$0.8 million) to fulfill its obligation under its share purchase plan.

The Company anticipates that its sources of liquidity as discussed will meet its investing and financing requirements over the next year.

On July 26, 2006, Empire announced its intention to file a Normal Course Issuer Bid with the Toronto Stock Exchange to purchase for cancellation up to 623,200 common shares representing approximately 2.0 percent of the shares outstanding. The Board of Directors and Management of Empire believe that the repurchase of its shares at recent prevailing market prices is a worthwhile use of funds and in the best interests of the Company.

Accounting Policy Changes

Accounting Standards Implemented in Fiscal 2006 and 2005

EIC-144, Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor ("EIC-144")

In January 2004, the Canadian Institute of Chartered Accountants ("CICA") issued a new accounting standard, EIC-144 titled "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor". EIC-144 outlines that cash consideration received from a vendor is presumed to be a reduction in the prices of the vendor's products or services and should be accounted for as a reduction in cost of sales and related inventory, when recognized in the customer's income statement and balance sheet. Certain exceptions apply if the consideration is a payment for assets or services delivered to the vendor or for a reimbursement of costs incurred to sell the vendor's products, provided certain conditions are met. EIC-144 requires retroactive application to all financial statements for annual and interim periods ending after August 15, 2004. The Company adopted EIC-144 in November 2004, adjusting for it retroactively with restatement of the comparative periods.

The Company receives allowances from certain vendors, whose products are purchased for resale. Included in these vendor programs are allowances for volume purchases, exclusivity allowances, listing fees, and other allowances. Due to the retroactive implementation of EIC-144, the timing of recognition of certain vendor allowances has changed, resulting in the Company recording a decrease in opening retained earnings for fiscal 2005 of \$3.8 million (net of minority interest of \$2.1 million), and a decrease in inventory of \$9.3 million. The implementation of EIC-144 did not result in a material change in the annual net earnings for fiscal 2006 or fiscal 2005 or in fiscal 2006 or fiscal 2005 quarterly net earnings.

During fiscal 2006, the Company adopted the amendment to EIC-144 issued in January 2005. The amendment requires disclosure of the amount of vendor allowances that have been recognized in income but for which the full requirements for entitlement have not yet been met. Certain allowances from vendors are contingent on the Company achieving minimum purchase levels. The Company recognizes these allowances in income in accordance with EIC-144 when it is probable that the minimum purchase level will be met, and the amount of allowances can be estimated. As of the year ended May 6, 2006, the Company has recognized \$3.5 million of allowances in income where it is probable that the minimum purchase level will be met and the amount of the allowance can be estimated.

CICA Section 1100, Generally Accepted Accounting Principles

During fiscal 2004, the CICA introduced handbook section 1100, "Generally Accepted Accounting Principles", which deleted the reference to industry practice that had previously constituted a source for Canadian GAAP. The Company had been following industry practice with respect to depreciation and lease accounting. Section 1100 now requires the Company to recognize depreciation of real estate buildings, rental expense and income from tenant leases on a straight-line basis. Effective May 1, 2004, the Company adopted this handbook section prospectively without restatement.

Depreciation

The sinking fund method was used to record depreciation of the real estate buildings, calculated as an amount which, compounded annually at the rate of five percent, would have fully amortized the cost of the buildings over their estimated useful lives ranging from 20 to 40 years. Effective May 1, 2004, the straight-line method was adopted to record depreciation of the real estate buildings. Depreciation is determined with reference to each rental property's book value, its estimated useful life (not greater than 40 years) and its residual value. Adoption of the straight-line method resulted in additional depreciation of \$1.2 million during fiscal 2005.

Real Estate Leases

Rental expense was recognized in accordance with the lease agreements with landlords. Effective May 1, 2004, the Company has changed its policy to record real estate lease expense on a straight-line basis. Additional real estate lease expense of \$2.7 million was recorded in the 2005 fiscal year as a result of this policy change in the food reporting segment. Real estate revenue was recognized in accordance with the lease agreements with tenants. The Company has changed its policy to record income on a straight-line basis. Adoption of this policy resulted in recognition of additional straight-line real estate revenue of \$2.2 million during the 2005 fiscal year.

AcG-13, Hedging Relationships

Accounting guideline ("AcG") 13, "Hedging Relationships", came into effect during the prior fiscal year. This guideline addresses the identification, designation, documentation and effectiveness of hedging relationships for the purpose of applying hedge accounting and provides guidance with respect to the discontinuance of hedge accounting. The Company has applied this guideline prospectively and there was no effect on the company from the adoption of this guideline. Upon application of this guideline, if documentation and effectiveness requirements are met, gains and losses on derivative financial instruments used to hedge exposure

to foreign exchange, and interest rates are deferred and recognized in earnings in the same period the related hedged risk is realized. Amounts received or paid related to instruments used to hedge foreign exchange, including any gains and losses, are recognized in the cost of purchases. Amounts received or paid, including any gains and losses on instruments used to hedge interest rate risks are recognized over the term of the hedged item in interest expense. The derivatives are not recorded on the balance sheet.

CICA Section 3110, Asset Retirement Obligations

Beginning in fiscal 2005, CICA Handbook Section 3110, “Asset Retirement Obligations,” was adopted retroactively. This section establishes standards for the recognition, measurement, and disclosure of legal obligations associated with the costs to retire long-lived assets. A liability associated with the retirement of long-lived assets is recorded in the period in which the legal asset is capitalized as part of the related asset and depreciated over its useful life. Subsequent to the initial measurement of the asset retirement obligation, the obligation is adjusted to reflect the passage of time and changes in the estimated future costs underlying the obligation. There has been no impact on the Company from the adoption of this section.

Lease Accounting

On February 7, 2005, the Office of the Chief Accountant of the U.S. Securities and Exchange Commission (“SEC”) issued a clarification in respect of accounting for various components of property leases and leasehold improvements on which U.S. and Canadian accounting governing bodies had been largely silent. As a result of the SEC clarification, in fiscal 2005, the Company has adopted the following two accounting policies. Lease inducements received as a reimbursement for leasehold improvement costs are amortized over the term of the lease and lease expense related to a store fixturing period is expensed during the fixturing period. A store fixturing period varies by store but is generally considered to be one month prior to the store opening. The Company adopted this guideline retroactively with restatement in fiscal 2005.

The Company reviewed its practices related to lease accounting and has determined that adjustments were required to align to the recent clarification of lease accounting guidelines. The first adjustment relates to lease allowances and incentives. Historically the Company classified lease allowances as a reduction of the related capital assets, which effectively reduced the depreciation expense over the expected life of the asset. The guideline clarification suggests these lease allowances

should be recorded as a deferred credit and amortized as a reduction of lease expense over the term of the lease. The second adjustment relates to rent expense to be recorded during a store’s fixturing period. The Company is often granted a fixturing period during which rent is not charged. The fixturing is generally considered to be one month prior to the store opening. Historically, when the Company was granted a fixturing period, rent expense was not recorded as none was being charged and the store was not yet open. The clarification of the accounting guidance however requires that the fixturing period be considered a free-rent period that should be included in the term of the lease. Since lease expense must be recognized on a straight-line basis over the lease term, an appropriate portion of the straight-line expense must be recorded for the fixturing period. The third adjustment relates to the capitalization of long-term leases. An evaluation was completed in the fourth quarter of fiscal 2005 and certain long-term leases were identified as capital leases. These changes have been accounted for on a retroactive basis with restatement resulting in the Company recording a decrease in opening retained earnings for fiscal 2005 of \$5.4 million (net of minority interest of \$2.9 million).

These lease accounting adjustments did not have any material impact on the Company’s current or prior year net earnings.

AcG-15, Consolidation of Variable Interest Entities

Variable interest entities are defined under AcG-15 as entities that do not have sufficient equity at risk to finance their activities without additional subordinated financial support, or where the equity holders lack the overall characteristics of a controlling financial interest. The guideline requires that the VIE be consolidated with the financial results of the entity deemed to be the primary beneficiary of the VIE’s expected losses and its expected residual returns.

The Company implemented AcG-15 during the fourth quarter ended May 7, 2005 retroactively without restatement of prior periods. Entities that have been identified as meeting the characteristics of a VIE have been consolidated in the Company’s results effective for the fourth quarter of fiscal 2005.

The Company has identified the following entities as VIEs:

Franchise Affiliates

The Company has identified 300 (May 7, 2005 – 287) franchise stores whose franchise agreements result in the Company being deemed the primary beneficiary of the entity according to AcG-15. The results for these entities were consolidated with the results of the Company pursuant to AcG-15.

Management's Discussion and Analysis

Warehouse and Distribution Agreement

The Company has an agreement with an independent entity to provide warehouse and distribution services for one of its distribution centres. The terms of the agreement with this entity require the Company to consolidate its results with those of the Company pursuant to AcG-15.

The Company has consolidated the results of these franchise affiliates and the entity providing warehouse and distribution services effective for the fourth quarter of fiscal 2005.

Impact of the Consolidation of VIEs

Balance Sheet as at May 6, 2006:

(\$ in millions)	Before AcG-15 Impact	Impact of the Implementation of AcG-15	After AcG-15 Impact
Assets			
Current			
Cash and cash equivalents	\$ 301.8	\$ 39.3	\$ 341.1
Receivables	317.6	(42.2)	275.4
Inventories	571.4	122.9	694.3
Prepaid expenses	46.4	5.1	51.5
	1,237.2	125.1	1,362.3
Investments, at cost (quoted market value \$398.9)	359.9	–	359.9
Investments, at equity (realizable value \$425.3)	157.5	–	157.5
Property and equipment	2,112.2	31.4	2,143.6
Assets held for sale	23.1	–	23.1
Other assets	360.0	(86.7)	273.3
Goodwill	731.8	–	731.8
	\$ 4,981.7	\$ 69.8	\$ 5,051.5
Liabilities			
Current			
Bank indebtedness	\$ 98.6	\$ –	\$ 98.6
Accounts payable and accrued liabilities	1,219.6	22.2	1,241.8
Income taxes payable	33.6	2.2	35.8
Future income taxes	46.1	–	46.1
Long-term debt due within one year	94.3	1.1	95.4
Liabilities relating to assets held for sale	7.1	–	7.1
	1,499.3	25.5	1,524.8
Long-term debt	690.6	16.7	707.3
Long-term lease obligation	16.6	4.2	20.8
Other liabilities	18.9	–	18.9
Employee future benefits obligation	97.3	–	97.3
Future income taxes	133.1	(1.3)	131.8
Minority interest	547.2	38.2	585.4
	3,003.0	83.3	3,086.3
Shareholders' Equity			
Capital stock	195.1	–	195.1
Contributed surplus	0.2	–	0.2
Retained earnings	1,784.5	(13.5)	1,771.0
Cumulative translation adjustment	(1.1)	–	(1.1)
	1,978.7	(13.5)	1,965.2
	\$ 4,981.7	\$ 69.8	\$ 5,051.5

The impact of implementation of AcG-15 on the consolidated balance sheet of the Company can be explained as follows:

Accounts receivable and long-term notes receivable due from the franchise affiliates were eliminated upon consolidation. Cash, inventories, fixed assets, accounts payable and debt financing of the fixed assets have been consolidated.

A charge of \$9.5 million (net of minority interest of \$5.0 million) has been recorded to opening retained earnings to reflect:

- (i) The reduction of inventory values of the franchise affiliates that include charges from the Company for distribution costs and vendor allowances that are not recognized by the Company until final sale to customers, and

- (ii) Goodwill that is carried on the accounts of the stores determined to be VIEs has been assessed as being impaired with no fair market value, and as such, has been eliminated.

It has been determined that a charge of \$3.7 million (net of minority interest of \$2.0 million) to retained earnings was required in the second quarter of fiscal 2006 to reflect additional minority interest in the VIEs. Additional adjustments of \$0.1 million (net of minority interest of \$0.1 million) to retained earnings are reflective of changes in the amount of VIE entities required to be consolidated.

Minority interest represents the equity in the VIEs held by the common shareholders.

Consolidated Statement of Earnings for the 52 weeks ended, May 6, 2006:

(\$ in millions)	Before AcG-15 Impact	Impact of the Implementation of AcG-15	After AcG-15 Impact
Revenue	\$ 12,573.9	\$ 587.2	\$ 13,161.1
Operating expenses			
Cost of sales, selling and administrative expenses	11,905.7	570.0	12,475.7
Depreciation and amortization	220.0	5.8	225.8
	448.2	11.4	459.6
Investment income	31.8	-	31.8
Operating income	480.0	11.4	491.4
Interest expense			
Long-term debt	74.5	1.1	75.6
Short-term debt	8.2	-	8.2
	82.7	1.1	83.8
	397.3	10.3	407.6
Capital gain and other items	109.4	-	109.4
Earnings before income taxes and minority interest	506.7	10.3	517.0
Income taxes	150.3	2.8	153.1
Earnings before minority interest	356.4	7.5	363.9
Minority interest	59.8	7.3	67.1
Net earnings	\$ 296.6	\$ 0.2	\$ 296.8
Earnings per share			
Basic	\$ 4.53	\$ -	\$ 4.53
Diluted	\$ 4.51	\$ -	\$ 4.51

The impact of implementation of AcG-15 on the consolidated income statement of the Company can be explained as follows:

Franchise affiliate retail sales are recorded and sales from the Company's distribution centres and cost of goods sold to the franchise affiliates have been eliminated. The impact on all other financial statement line items including net earnings is immaterial.

EIC-150, Determining Whether an Arrangement Contains a Lease ("EIC-150")

EIC-150 addresses arrangements comprising a transaction or a series of transactions that do not take the legal form of a lease but convey a right to use a tangible asset in return for a payment or a series of payments. EIC-150 provides guidance for determining whether these types of arrangements contain a lease within the scope of handbook section 3065, "Leases", and should be accounted for accordingly. The assessment should be based on whether the fulfillment of the arrangement is dependent on the use of specific tangible assets and whether the arrangement conveys the right to control the use of the tangible assets. This assessment should be made at the inception of the arrangement and only reassessed if certain conditions are met. EIC-150 is effective for arrangements entered into or modified during the fourth quarter of fiscal 2005 and did not have any impact during fiscal 2005 or 2006. The Company will continue to monitor whether EIC-150 is applicable to transactions undertaken by the Company.

EIC-154, Accounting for Pre-Existing Relationships Between the Parties of the Business Combination ("EIC-154")

EIC-154 issued on May 31, 2005, requires that a business combination occurring after May 31, 2005 between parties that have a pre-existing relationship be evaluated to determine if a settlement of the pre-existing contract has occurred which would require separate accounting from the business combination. The settlement of the pre-existing contract should be measured at the settlement amount as defined within the standard. In addition, EIC-154 requires that certain reacquired rights, including the rights to the acquirer's trade name under a franchise agreement, be recognized as an intangible asset separate from goodwill.

The Company has determined that its acquisitions of franchised, associated and independent stores could be within the scope of EIC-154. The adoption of EIC-154 by the Company on a prospective basis did not impact net earnings and the Company will continue to monitor whether EIC-154 is applicable to transactions undertaken by the Company.

EIC-159, Accounting for Conditional Asset Retirement Obligations ("EIC-159")

This abstract provides guidance on when a conditional asset retirement obligation should be recognized in accordance with CICA 3110, Asset Retirement Obligations. The abstract is to be applied on a retroactive basis effective in the fourth quarter of fiscal 2006. The abstract requires an entity to recognize a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. A conditional asset retirement obligation refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and/or method of settlement.

There was no effect on the Company of adopting this guideline and the Company will continue to monitor whether EIC-159 is applicable to future transactions.

Future Accounting Standards

EIC-156, Accounting for Consideration by a Vendor to a Customer (Including a Reseller of the Vendor's Products) ("EIC-156")

Issued in September 2005, EIC-156 addresses cash consideration, including a sales incentive, 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 income statement. These recommendations are effective for all interim and annual financial statements for fiscal years beginning on or after January 1, 2006. The Company is currently assessing the impact of these recommendations and will implement them in the first quarter of fiscal 2007.

The following standards are effective for interim and annual financial statements for fiscal years beginning on or after October 1, 2006. The Company is currently assessing the impact of these recommendations.

CICA Section 3855, Financial Instruments – Recognition and Measurement

CICA Section 3855 "Financial Instruments – Recognition and Measurement" establishes standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. All financial instruments must be classified into defined categories. This classification will determine how each instrument is measured and how gains and losses are recognized. In addition, the recommendations define derivatives and embedded derivatives which meet certain criteria.

CICA Section 3865, Hedges

CICA Section 3865 “Hedges” will replace AcG-13, “Hedging Relationships” and the guidance formerly in CICA Section 1650, “Foreign Currency Translation”. The recommendations of this section are optional and are only required if the entity is applying hedge accounting. This section establishes standards for the accounting treatment of qualifying hedge relationships and the necessary disclosures.

CICA Section 1530, Comprehensive Income

CICA Section 1530, “Comprehensive Income” introduces a statement of comprehensive income in the full set of interim and annual financial statements. Comprehensive income will temporarily present certain gains and losses outside net income.

CICA Section 3070, Deferred Charges

CICA Section 3070 “Deferred Charges” will be withdrawn with the introduction of CICA Sections 3855, 3865, and 1530 as discussed above.

Critical Accounting Estimates

The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts and disclosures made in the consolidated financial statements and accompanying notes. Management continually evaluates the estimates and assumptions it uses. Actual results could differ from these estimates.

Pension, Post-Retirement and Post-Employment Benefits

Certain estimates and assumptions are used in actuarially determining the Company’s defined pension and employee future benefits obligation.

Significant assumptions used to calculate the pension and employee future benefits obligation are the discount rate, the

expected long-term rate of return on plan assets and expected growth rate of health care costs. The Company has also assumed the completion of a pending plan merger. These assumptions depend on various underlying factors such as economic conditions, investment performance, employee demographics, mortality rates and regulatory approval. These assumptions may change in the future and may result in material changes in the pension and employee benefit plans expense. The magnitude of any immediate impact, however, is mitigated by the fact that net actuarial gains and losses in excess of 10 percent of the greater of the accrued benefit plan obligation and the market value of the benefit plan assets are amortized on a straight-line basis over the average remaining service period of the active employees. Changes in financial market returns and interest rates could also result in changes in funding requirements for the Company’s defined benefit pension plans.

The discount rate is based on current market interest rates, assuming a portfolio of Corporate AA bonds with terms to maturity that, on average, match the terms of the obligation. The appropriate discount rate is determined on April 30th every year. For fiscal 2006, the discount rate used for calculation of pension and other benefit plan expense was 5.5 percent consistent with fiscal 2005. The expected long-term rate of return on plan assets for pension benefit plans for each of fiscal 2006 and 2005 was 7.0 percent. The expected growth rate in health care costs is 10.0 percent for fiscal 2006. The cumulative growth rate to 2012 is expected to be 6.0 percent. The expected future growth rate is evaluated on an annual basis.

The table below outlines the sensitivity of the fiscal 2006 key economic assumptions used in measuring the accrued benefit plan obligations and related expenses of the Company’s pension and other benefit plans. The sensitivity of each key assumption has been calculated independently. Changes to more than one assumption simultaneously may amplify or reduce the impact on the accrued benefit obligations or benefit plan expenses.

Management's Discussion and Analysis

(\$ in millions)	Pension Plans		Other Benefit Plans	
	Benefit Obligations	Benefit Cost ⁽¹⁾	Benefit Obligations	Benefit Cost ⁽¹⁾
Expected long-term rate of return on plan assets		7.0%		
Impact of: 1% increase	\$	(2.6)		
Impact of: 1% decrease	\$	2.6		
Discount rate	5.5%	5.5%	5.5%	5.5%
Impact of: 1% increase	\$ (30.5)	\$ 0.3	\$ (17.5)	\$ (0.9)
Impact of: 1% decrease	\$ 34.4	\$ (0.6)	\$ 21.1	\$ 1.0
Growth rate of health care costs ⁽²⁾			10.0%	10.0%
Impact of: 1% increase			\$ 18.0	\$ 2.1
Impact of: 1% decrease			\$ (14.7)	\$ (1.6)

(1) Reflects the impact on the current service cost, the interest cost and the expected return on assets.

(2) Gradually decreasing to 6.0 percent in 2012 and remaining at that level thereafter.

The Company has also assumed that a pending merger of pension plans will be completed. If this merger is not completed, the valuation of the transitional pension asset included in other assets on the balance sheet may need to be re-evaluated.

Goodwill and Long-Lived Assets

Goodwill is not amortized and is assessed for impairment at the reporting unit level at least annually. 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, potential goodwill impairment has been identified and must be quantified by comparing the estimated fair value of the reporting unit's goodwill to its carrying value. Any goodwill impairment will result in a reduction in the carrying value of goodwill on the consolidated balance sheet and in the recognition of a non-cash impairment charge in operating income.

The Company periodically assesses the recoverability of long-lived assets when there are indications of potential impairment. In performing these analyses, the Company considers such factors as current results, trends and future prospects, current market value and other economic factors.

A substantial change in estimated undiscounted future cash flows for these assets could materially change their estimated fair values, possibly resulting in additional impairment. Changes which may impact future cash flows include, but are not limited to, competition and general economic conditions and unrecoverable increases in operating costs.

Income Taxes

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 assets and liabilities and their respective income tax bases. Future income tax assets or 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 calculation of current and future income taxes requires management to make estimates and assumptions and to exercise a certain amount of judgment. The financial statement carrying values of assets and liabilities are subject to accounting estimates inherent in those balances. The income tax bases of assets and liabilities are based upon the interpretation of income tax legislation across various jurisdictions. The current and future income tax assets and liabilities are also impacted by expectations about future operating results and the timing of reversal of temporary differences as well as possible audits of tax filings by the regulatory authorities. Management believes it has adequately provided for income taxes based on current available information.

Changes or differences in these estimates or assumptions may result in changes to the current or future income tax balances on the consolidated balance sheet. A charge or credit to income tax expense may result in cash payments or receipts.

Valuation of Inventories

Certain retail store inventories are stated at the lower of cost and estimated net realizable value less normal gross profit margin. Significant estimation or judgment is required in the determination of (i) inventories counted and adjusted to cost and (ii) estimated inventory reductions due to spoilage, shrinkage and allowances, occurring between the last physical inventory count and the balance sheet date.

Inventory shrinkage, which is calculated as a percentage of sales, is evaluated throughout the year and provides for estimated inventory shortages from the last physical count to the balance sheet date. To the extent that actual losses experienced vary from those estimated, both inventories and operating income may be impacted.

Changes or differences in these estimates may result in changes to inventories on the consolidated balance sheet and a charge or credit to operating income in the consolidated statement of earnings.

Disclosure Controls

Based on an evaluation of the Company's disclosure controls and procedures, the Company's Chief Executive Officer and Chief Financial Officer have concluded as of May 6, 2006 that these controls and procedures operated effectively.

Related Party Transactions

The Company rents premises from Crombie REIT. In addition, Crombie REIT provides administrative and management services to the Company. The rental payments are at fair value and the charges incurred for administrative and management services are on a cost recovery basis. The Company has non-interest bearing notes payable to Crombie REIT in the amount of \$62.7 million.

Contingencies

On June 21, 2005, Sobeys received a notice of reassessment from Canada Revenue Agency ("CRA") for the fiscal years 1999 and 2000 related to the Goods and Services Tax ("GST"). CRA asserts that Sobeys was obliged to collect GST on the sales of these tobacco products to status Indians. The total tax, interest and penalties in the proposed reassessment was \$13.6 million. Sobeys has reviewed this matter, has received legal advice and believes it was not required to collect GST. During the second quarter of fiscal 2006, Sobeys filed a Notice of Objection with CRA. Accordingly, Sobeys has not recorded in its statement of earnings any of the tax, interest or penalties set-out in the notice of reassessment. Sobeys has deposited with CRA funds to cover the total tax, interest and penalties in the reassessment and has recorded this amount as a long-term receivable from CRA pending resolution of the matter.

On January 19, 2006, E.C.L. Investments Limited (a subsidiary of the Company) received a notice from CRA that it is proposing a reassessment for fiscal year 2001 related to the disposition of its shares in Hannaford Bros. Co. The Company has signed a waiver that effectively postpones the issuance of the reassessment. Due to the complexity of the matter, it is not possible to determine the amounts that may ultimately be assessed against the Company. Management believes that it has recorded adequate accruals in relation to the matter. Any settlement in excess of these accruals will be charged to earnings.

The Company has entered into an agreement with Crombie REIT to fund certain property redevelopments and has issued and recorded a note payable to Crombie REIT in the amount of \$39.6 million related thereto. The Company has agreed to pay for all additional costs and expenses required for the redevelopment of those properties. In the event that the redevelopment costs are less than \$39.6 million, the savings will be paid to the Company.

The Company has agreed to indemnify its directors and officers and particular employees in accordance with the Company's policies. The Company maintains insurance policies that may provide coverage against certain claims.

There are various claims and litigation which the Company is involved with, arising out of the ordinary course of business operations. The Company's management does not consider the exposure to such litigation to be material, although this cannot be predicted with certainty.

Guarantees and Commitments

The table below illustrates the Company's significant contractual obligations.

(\$ in millions)	2007	2008	2009	2010	2011	Thereafter	Total
Long-term debt	\$ 86.7	\$ 44.4	\$ 84.4	\$ 39.0	\$ 38.7	\$ 460.3	\$ 753.5
Capital leases	8.7	7.2	6.6	6.0	2.7	18.0	49.2
Operating leases	231.9	205.9	183.7	168.3	149.7	1,365.2	2,304.7
Total contractual obligations	\$ 327.3	\$ 257.5	\$ 274.7	\$ 213.3	\$ 191.1	\$ 1,843.5	\$ 3,107.4

Operating leases, net of lease income received by the Company, are as follows:

(\$ in millions)	2007	2008	2009	2010	2011	Thereafter	Total
	\$ 160.1	\$ 141.6	\$ 126.6	\$ 117.3	\$ 104.6	\$ 1,073.4	\$ 1,723.6

Franchise Affiliates

Sobeys has guaranteed certain bank loans contracted by franchisees. At May 6, 2006, these loans amounted to approximately \$1.3 million (2005 - \$2.4 million).

Sobeys also has guaranteed certain equipment leases of its franchise affiliates. Under the terms of the guarantee should a franchise affiliate be unable to fulfill its lease obligation, Sobeys would be required to fund the difference of the lease commitments up to a maximum of \$100.0 million on a cumulative basis. Sobeys approves each of the contracts.

The aggregate, annual, minimum rent payable under the guaranteed equipment leases for fiscal 2007 is approximately \$21.1 million. The guaranteed lease commitments over the next five fiscal years are:

(\$ in millions)	Guaranteed Lease Commitments
2007	\$ 21.1
2008	23.2
2009	18.9
2010	15.9
2011	11.1
Thereafter	9.8

Other

At May 6, 2006, the Company was contingently liable for letters of credit issued in the aggregate amount of \$47.6 million (2005 - \$44.0 million).

Upon entering into the lease of its new Mississauga distribution centre in March 2000, Sobeys guaranteed to the landlord the performance, by SERCA Foodservice, of all of its obligations under the lease. The remaining term of the lease is 14 years with an aggregate obligation of \$43.3 million (2005 - \$46.2 million). At the time of the sale of assets of SERCA Foodservice to Sysco Corporation, the lease of the Mississauga distribution centre was assigned to and assumed by a subsidiary of the purchaser and Sysco Corporation agreed to indemnify and hold Sobeys harmless from any liability it may incur pursuant to its guarantee.

Risk Management

Through its operating companies and its investment portfolio, Empire is exposed to a number of risks in the normal course of business that have the potential to affect operating performance. The Company has operating and risk management strategies and insurance programs to help minimize these operating risks.

Competition

Empire's food retail business, through Sobeys, operates in a dynamic and competitive market. Other national and regional food distribution companies along with non-traditional competitors, such as mass merchandisers and warehouse clubs, represent a competitive risk to Sobeys' ability to attract customers and operate profitably in its markets.

Sobeys maintains a strong national presence in the Canadian retail food and food distribution industry through regionally managed operations. The most significant risk to Sobeys is the potential for reduced revenues and profit margins as a result of increased competition. To mitigate this risk, Sobeys' strategy is to be geographically diversified with the benefits of national scale, to be customer and market-driven, to be focused on superior execution, and to have efficient, cost effective operations. Sobeys reduces its exposure to competitive or economic pressures in any one region of the country by operating in each region of Canada through a network of corporate, franchised, and affiliated stores, and through servicing the needs of thousands of independent, wholesale accounts. Sobeys approaches the market with five distinct formats, sizes, and banners, to meet anticipated needs of its customers in order to enhance profitability by region and by target market.

Empire's real estate operations, through ECL, compete with numerous other developers, managers, and owners of real estate properties in seeking tenants and new properties for future development. The existence of competing developers, managers, and owners could affect our real estate group's ability to lease space in its properties and on rents charged or concessions granted. Commercial property revenue is also dependent on the renewal of lease arrangements by key tenants. These factors could adversely affect revenues and cash flows. Other than space leased to affiliated companies, no one tenant accounts for more than 5.0 percent of real estate division total base rental income.

Continued growth of rental income is dependent on renewing expiring leases and finding new tenants to fill vacancies at market rental rates, thereby ensuring an attractive return on our investment. The success of the real estate portfolio is also subject to general economic conditions, the supply and demand for rental property in key markets served, and the availability of attractive financing to expand the real estate portfolio where deemed prudent. During fiscal 2006, our real estate operations encountered generally positive economic conditions with relatively stable occupancy levels and healthy rental renewal rates.

Financial

Empire and its operating companies have adopted a number of financial policies to manage interest rate risk and foreign exchange risk. Risks can also arise from changes in the rules or standards governing accounting or financial reporting. The Company employs numerous professionally accredited accountants throughout its finance group.

In the ordinary course of managing its debt, the Company utilizes financial instruments from time to time to manage the volatility of borrowing costs. Financial instruments are not used for speculative purposes.

Interest Rate Risk

Interest rate risk is the potential for financial loss arising from changes in interest rates. The Company's long-term debt is generally at a fixed interest rate, and therefore, the Company's exposure to interest rate cash flow risk during the term of the debt is minimal.

Insurance

Empire and its subsidiaries are self-insured on a limited basis with respect to certain operational risks and also purchase excess insurance coverage from financially stable third-party insurance companies. In addition to maintaining comprehensive loss prevention programs, the Company maintains management programs to mitigate the financial impact of operational risks.

Human Resources

Empire is exposed to the risk of labour disruption in its operating companies. Labour disruptions pose a moderate operational risk, as Sobeys operates an integrated network of more than 21 distribution centres across the country for the food division. Sobeys has good relations with its employees and unions and does not anticipate any material labour disruptions in fiscal 2007. However, Sobeys has stated that it will accept the short-term costs of a labour disruption to support a steadfast commitment to building and sustaining a competitive cost structure for the long-term.

Effective leadership is very important to the growth and continued success of the Company. The Company develops and delivers training programs at all levels across its various operating regions in order to improve employee knowledge and to better serve its customers. The ability of the Company to properly develop and retain its employees could affect the Company's future performance.

Business Continuity

The Company is subject to unexpected events and natural hazards which could cause sudden or complete cessation of its day-to-day operations.

Management's Discussion and Analysis

One such unexpected event and natural hazard is the risk of a pandemic. Sobeys is working with industry and government sources to develop a pandemic preparedness plan.

Responsibility for business continuity planning has been designated to Sobeys' Leadership Committee.

Environmental, Health and Safety

The Company is continually enhancing its programs in areas of environmental, health and safety and is in compliance with relevant legislation. Employee awareness and training programs are conducted and environmental, health and safety risks are reviewed on a regular basis.

Any environmental site remediation is completed using appropriate, qualified internal and external resources and health and safety issues are proactively dealt with. The Board of Directors receives regular reports which review outstanding matters, identify new legislation and outline new programs being implemented across the Company to positively impact the environment and employee health and safety. Existing environmental protection regulatory requirements are not expected to have a material financial or operational effect on the capital expenditures, earnings or competitive position of the Company during the current fiscal year or in future years.

Sobeys has developed programs to promote a healthy and safe workplace, as well as progressive employment policies focused on the well being of the thousands of employees who work in its stores, distribution centres and offices. These policies and programs are reviewed regularly by the Human Resources Committee of the Board.

Each operating business conducts an ongoing, comprehensive environmental monitoring process and the Company is unaware of any material environmental liabilities in any of its operating companies. Empire's Board of Directors receives quarterly reports that review any outstanding issues including plans to resolve them.

Food Safety

Sobeys is subject to potential liabilities connected with its business operations, including potential liabilities and expenses associated with product defects, food safety and product handling. Such liabilities may arise in relation to the storage, distribution and display of products and, with respect to private label products, in relation to the production, packaging and design of products.

A large majority of Sobeys' sales are generated from food products and Sobeys could be vulnerable in the event of a significant outbreak of food-borne illness or increased public health concerns in connection with certain food products. Such an event could materially affect financial performance. Procedures are in place to manage food crises, should they occur. These procedures identify risks, provide clear communication to employees and consumers and ensure that potentially harmful products are removed from inventory immediately. Food safety related liability exposures are insured by the Company's insurance program. In addition, Sobeys has food safety procedures and programs, which address safe food handling and preparation standards. Sobeys employs best practices for storage and distribution of food products.

Technology

The Company and each of its operating companies are committed to improving their respective operating systems, tools and procedures in order to become more efficient and effective. The implementation of major information technology projects carries with it various risks that must be mitigated by disciplined change management and governance processes. Sobeys has a business process optimization team staffed with knowledgeable internal and external resources that is responsible for implementing the various initiatives. Sobeys' Board of Directors have also created an oversight committee to ensure appropriate governance of these change initiatives is in place and this committee receives regular reports from the Company's management.

Real Estate

The Company utilizes a capital allocation process which is focused on obtaining the most attractive real estate locations for its retail grocery stores as well as for its commercial property operations and residential development operations, with direct Company ownership being an important, but not overriding, consideration. Sobeys develops certain retail store locations on owned sites, however, the majority of its store development is done in conjunction with external developers. The availability of high potential new store sites and/or the ability to expand existing stores is therefore in large part contingent upon successful negotiation of operating leases with these developers and Sobeys ability to purchase high potential sites.

Legal, Taxation and Accounting

Changes to any of the various federal and provincial laws, rules and regulations related to the Company's business could have a material impact on its financial results. Compliance with any proposed changes could also result in significant cost to the Company. Failure to fully comply with various laws, rules and regulations may expose the Company to proceedings which may materially affect its performance.

Similarly, income tax regulations and/or accounting pronouncements may be changed in ways which could negatively affect the Company.

Operations

The success of Empire is closely tied to the performance of Sobeys' retail stores. Franchise affiliates operate approximately 58 percent of these retail stores. Sobeys relies on the franchise affiliates and corporate store management to successfully execute retail programs and strategies.

To maintain controls over Sobeys' brands and the quality and range of products and services offered at its stores, each franchise affiliate agrees to purchase merchandise from Sobeys. In addition, each store agrees to comply with the policies, marketing plans and operating standards prescribed by Sobeys. These obligations are specified under franchise agreements which expire at various times for individual franchisees. As well, Sobeys maintains head lease control, or has long-term buying agreements, to control the vast majority of its retail locations.

Supply Chain

Sobeys is exposed to potential supply chain disruptions that could result in shortages of merchandise in its retail store network. Sobeys mitigates this risk through effective supplier selection and procurement practices along with a reliance on the efficient maintenance and evolution of its supply and logistics chain to sustain and meet growth objectives.

Seasonality

The Company's operations as they relate to food, specifically inventory levels, sales volume and product mix, are impacted to some degree by certain holiday periods in the year.

Utility and Fuel Prices

The Company is a significant consumer of electricity, other utilities and fuel. Unanticipated cost increases in these items could negatively affect the Company's financial performance. The Company has various consumption and procurement programs in place to minimize utility risk.

Foreign Operations

Empire does not directly carry out foreign operations, however, Sobeys and ECL do have certain foreign operations. Sobeys' foreign operations are limited to a small number of produce brokerage offices based in the United States.

ECL, through its interest in Genstar, has certain residential land development in the California market but on a limited scale. These foreign operations are relatively small and are not considered material to Empire on a consolidated basis, as such, the Company does not have any material risks associated with foreign operations.

Foreign Currency

The Company conducts the majority of its operating business in Canadian dollars and its foreign exchange risk is limited to currency fluctuations between the Canadian and U.S. dollar. U.S. dollar purchases of product by the food division represent approximately three percent of Sobeys' total annual purchases. Sobeys has processes in place to use forward contracts with high quality counter-parties to fix the exchange rate on some of its expected requirements for U.S. dollars for periods of not more than 30 days.

With respect to portfolio investments denominated in U.S. dollar currency, to mitigate exposure to currency fluctuations, the Company has hedged a portion of its foreign currency exposure through the use of U.S. forward currency contracts. At May 6, 2006 the ratio of U.S. dollar debt to the market value of U.S. equities was approximately 95.0 percent.

Ethical Business Conduct

Any failure of the Company to adhere to its policies, the law or ethical business practices could significantly affect its reputation and brands and could therefore, negatively impact the Company's financial performance. The Company's framework for managing ethical business conduct includes the adoption of a Code of Business Conduct which employees of the Company are required to acknowledge and agree to on a regular basis and as part of an independent audit and security function, maintenance of a whistle-blowing hotline.

Equity Price Risk

The carrying values of the investments in Empire's investment portfolio are based on cost; however the realizable value of each investment and therefore the portfolio is based on market prices and is subject to market price fluctuations. Empire has a disciplined, long-term approach to selecting quality investments and has been successful in generating above market portfolio returns. While portfolio returns may not match those of the prior year, or exceed median manager returns, management will continue to manage the portfolio prudently to ensure appropriate diversification and liquidity.

Outlook

Management's primary objective will continue to be to maximize the long-term sustainable value of Empire through enhancing the worth of the Company's net assets and in turn, having that value reflected in Empire's share price.

The Company will continue to direct its energy and capital towards growing the long-term sustainable value of each of its divisions – food, real estate and investments and other operations. While the Company's core businesses are well established and profitable in their own right, the diversification they offer Empire by both business line and by market area served is considered by management to be an additional source of strength. Going forward, the Company intends to continue to direct its resources towards the most promising opportunities within these core businesses in order to maximize long-term shareholder value. Comments with respect to the outlook for each of the Company's divisions are noted below.

Food Division

Sobeys will continue to invest in infrastructure and productivity improvements in a manner consistent with its expressed intention to build a healthy and sustainable retail business and infrastructure for the long-term.

The disposition of Sobeys' cash and carry business in Ontario and Quebec, as discussed, will negatively impact sales growth by approximately \$200 million in fiscal 2007 compared to fiscal 2006. The Company also expects to experience continued declines in company-wide tobacco sales during fiscal 2007.

In fiscal 2007, Sobeys will advance its business process and information systems transformation plan by focusing on the significant opportunity to upgrade information processing and decision support capabilities and improve efficiencies in its Ontario and Western regions. The system and processes that are being implemented have been developed over several years and are currently employed in the food division's Atlantic Region. The Ontario and Western initiatives will simplify, standardize and streamline the "back shop", in support of Sobeys' food focused strategy. These efforts will leverage technology investments, improve efficiency and lower costs over the long term.

The approach taken for this set of initiatives was guided and informed by Sobeys' previous experience. The complexity of this comprehensive set of initiatives, which impacts every aspect of the business, requires that a significant investment be made to manage the risk of implementation but also to prepare employees to secure and sustain the benefits of more efficient processes and systems after they have been implemented. The necessary re-training of thousands of employees in Ontario has just begun and will continue through the first six months of fiscal 2007. The implementation costs as well as training costs for thousands of employees in the Western region will be completely incurred during fiscal 2007. The total anticipated cost of the Ontario and Western initiatives is expected to approximate \$0.27 to \$0.32 per Sobeys share in fiscal 2007.

Real Estate Division

Over the next year, Empire's real estate management group will continue its policy of maximizing and prudently reinvesting its cash flow to further strengthen and diversify its portfolio of residential and commercial properties.

Empire's real estate management group expects overall retail occupancy levels to remain strong during fiscal 2007 as a result of the diligence of the leasing team and general economic conditions. Management looks forward to continuing its strong relationship with Sobeys and to pursuing attractive opportunities to jointly develop locations with Sobeys.

Investments and Other Operations Division

Growth in the Company's investment portfolio will be dependent on a number of factors including investor sentiment in the U.S. and Canada. Equity markets may continue to remain volatile. Management remains committed to maintaining a portfolio of high quality, liquid common equity investments as a pool of capital to augment the growth in its core operating companies as attractive opportunities arise.

With respect to Empire Theatres' outlook, management recognizes that future growth will remain highly dependent on a steady supply of quality product. Based on the quality of film releases expected in fiscal 2007, an experienced operations team, and planned screen development, management looks forward to continued revenue growth in this business.

Non-GAAP Financial Measures

There are measures included in this MD&A that do not have a standardized meaning under GAAP and therefore may not be comparable to similarly titled measures presented by publicly traded companies. The Company includes these measures because it believes certain investors use these measures as a means of assessing financial performance. Empire's definition of the non-GAAP terms are as follows:

- Operating income or EBIT is calculated as operating earnings before minority interest, interest expense and income taxes.
- EBITDA is calculated as operating income plus depreciation and intangible amortization.

- EBITDAR is calculated as EBITDA plus gross rent expense.
- Operating earnings is calculated as net earnings before capital gains (losses) and other items.
- Funds from operations is calculated as operating earnings plus depreciation and amortization.
- Interest coverage is calculated as operating income divided by interest expense.
- Funded debt is all interest bearing debt, which includes bank loans, bankers' acceptances, long-term debt and long-term lease obligations.
- Net debt is calculated as funded debt less cash and cash equivalents.
- Adjusted debt is funded debt plus the capitalized value of net operating leases payments, which is calculated as six times net annual operating lease payments.
- Total capital is calculated as funded debt plus shareholders' equity.
- Company-wide capital investment includes on-balance sheet capital expenditures, all known capital investments by franchise affiliates and capital investments by third-party landlords.
- Same-store sales are sales from stores in the same locations in both reporting periods.

Management's Discussion and Analysis

The following table reconciles the food division's EBITDA and EBITDAR to GAAP measures as reported in Sobey's audited statement of earnings for the period ended May 6, 2006 and May 7, 2005, respectively:

(\$ in millions)	13 Weeks	14 Weeks	52 Weeks	53 Weeks
	Ended May 6, 2006	Ended May 7, 2005	Ended May 6, 2006	Ended May 7, 2005
EBIT	\$ 85.2	\$ 84.6	\$ 331.6	\$ 322.6
Depreciation	50.8	47.7	192.8	174.5
Amortization of intangibles	0.7	0.8	3.8	1.9
EBITDA	136.7	133.1	528.2	499.0
Gross rent	84.3	71.6	335.0	275.9
EBITDAR	\$ 221.0	\$ 204.7	\$ 863.2	\$ 774.9

The following table reconciles Empire's funded debt and total capital to GAAP measures reported in the audited balance sheets as at May 6, 2006 and May 7, 2005, respectively:

(\$ in millions)	May 6, 2006	May 7, 2005	April 30, 2004
Bank indebtedness	\$ 98.6	\$ 219.4	\$ 140.8
Long-term debt due within one year	95.4	247.0	82.7
Long-term debt	707.3	727.4	913.0
Long-term lease obligation	20.8	12.3	12.8
Funded Debt	922.1	1,206.1	1,149.0
Total Shareholders' Equity	1,965.2	1,709.0	1,567.6
Total Capital	\$ 2,887.3	\$ 2,915.1	\$ 2,716.6

Additional financial information relating to Empire, including the Company's Annual Information Form, can be found on the Company's website or on the SEDAR website for Canadian regulatory filings at www.sedar.com.

June 29, 2006
Stellarton, Nova Scotia, Canada