

## Quarterly Report to Shareholders

Empire is a diversified Canadian company headquartered in Stellarton, Nova Scotia. Empire's key businesses are retail food distribution (through 68.3% ownership of Sobeys Inc. ("Sobeys"), real estate (through two wholly-owned operating subsidiaries: Sobeys Leased Properties Limited ("SLP"), and Crombie Properties Limited ("Crombie"), including 35.7% ownership of Genstar Development Partnership ("Genstar"), and corporate investment activities and other operations (which includes wholly-owned Empire Theatres Limited ("Empire Theatres"). With \$5.2 billion in assets, Empire employs approximately 37,000 people directly and through its subsidiaries.

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Copies of this report are available on the Company's website ([www.empireco.ca](http://www.empireco.ca)) or by contacting the Vice President, Investor Relations at (902) 928-1725. A copy has also been filed on SEDAR.

The Company provided additional details concerning its first quarter results on a conference call held on Wednesday, December 14, 2005. Replay of the call is available on the Company's website ([www.empireco.ca](http://www.empireco.ca)).

### Forward-looking Information

*This quarterly report contains certain forward-looking information that is subject to risks and uncertainties that may cause actual results or events to differ materially from the results or events predicted in this discussion. In addition to the risks outlined in our Risk Management section of our fiscal 2005 Annual Report, factors which could cause actual results or events to differ include, but are not limited to: the ability to execute on operating company strategic initiatives; the impact of competition; general economic conditions; interest rate and currency exchange rate fluctuations; conditions affecting the North American equity markets; conditions affecting the growth and development of our real estate property portfolio; the ability of our operating companies to attract and retain quality employees and franchisees; the availability of capital and the associated cost of capital. As a result of these risk factors and others, no guarantee can be given that the results implied by any forward-looking statements will necessarily materialize.*

## Letter to Shareholders

On December 14, 2005, Empire announced operating earnings for its second quarter ended November 5, 2005 of \$47.8 million or \$0.73 per share compared to \$43.0 million or \$0.66 per share in the second quarter last year.

Net earnings amounted to \$48.6 million or \$0.74 per share versus \$40.0 million or \$0.61 per share last year, a 21.5 percent increase. The Company realized a net capital gain on the sale of investments and other items of \$0.8 million in the second quarter as compared to a net capital loss of \$3.0 million realized on the sale of investments in the second quarter last year.

### Second Quarter Highlights

- Revenue of \$3.28 billion, up \$262.8 million or 8.7 percent over the second quarter last year.
- Earnings before net capital gain (loss) and other items of \$47.8 million, up \$4.8 million or 11.2 percent over the second quarter last year.
- Capital gain and other items, net of tax, of \$0.8 million in the quarter versus a \$3.0 million net capital loss in the second quarter last year.
- Net earnings of \$48.6 million, up \$8.6 million or 21.5 percent from \$40.0 million reported in the second quarter last year.

### Financial Performance

(\$ in millions)	Reported Revenue Fiscal 2006	Reported Growth over Fiscal 2005	VIE Impact	Adjusted Revenue Fiscal 2006	Reported Revenue Fiscal 2005	Adjusted Growth over Fiscal 2005
Second Quarter	\$3,285	8.7%	\$150	\$3,135	\$3,023	3.7%
Fiscal Year-to-Date	\$6,647	9.0%	\$311	\$6,336	\$6,096	3.9%

Revenue for the second quarter was \$3.28 billion compared to \$3.02 billion last year, an 8.7 percent increase. The food division generated sales of \$3.22 billion, an increase of \$251.7 million or 8.5 percent over the second quarter last year. Impacting sales growth in the second quarter of fiscal 2006 was the consolidation of Variable Interest Entities ("VIEs"), which accounted for approximately \$150 million or 5.0 percentage points of the increase in Empire's revenue over the second quarter last year. Excluding the impact of VIEs, revenue grew by 3.7 percent in the second quarter over the same period last year.

In the second quarter, 12 new and replacement corporate and franchised stores were opened and three stores were expanded. At the end of the second quarter Sobeys had 25.0 million square feet of retail space, a 3.3 percent increase over the end of the second quarter last year. Sobeys' same-store sales increased by 3.6 percent during the second quarter.

Empire's ownership interest in Sobeys was 68.3 percent at the end of the second quarter compared to 65.9 percent a year earlier.

Real estate operations reported revenue (net of inter-segment revenues) of \$46.4 million, an increase of \$6.9 million or 17.5 percent over the second quarter last year. Commercial property revenues were unchanged from the prior year at \$34.0 million while revenue from residential operations, through a 35.7 percent interest in Genstar Development Partnership ("Genstar"), increased \$6.9 million. The increase in residential revenue from our interest in Genstar reflects very strong residential lot sales in Western Canada.

Revenue from other operations, primarily Empire Theatres, amounted to \$20.8 million, an increase of \$4.2 million over the second quarter last year. Revenue in the second quarter of fiscal 2006 benefited from five weeks of operations of the 27 movie-theatres acquired from Cineplex Galaxy LP on September 30, 2005.

Consolidated operating income (operating earnings before minority interest plus interest and income taxes) in the second quarter totalled \$122.1 million, an increase of \$10.5 million or 9.4 percent compared to the second quarter last year.

The food division contributed operating income of \$84.1 million, an increase of \$2.9 million or 3.6 percent compared to the second quarter last year. Second quarter operating margin, which is operating income divided by revenue, was 2.61 percent in the second quarter of fiscal 2006 compared to 2.74 percent in the second quarter last year. Impacting operating income growth was a \$6.0 million increase in food division depreciation and amortization expense, reflecting Sobeys continued capital investments. Also included in food division operating income are business process and system initiative costs in the Ontario region amounting to \$4.6 million.

The real estate division contributed operating income of \$35.6 million, an increase of \$9.0 million or 33.8 percent from the \$26.6 million recorded in the second quarter last year. Operating income generated from commercial properties was relatively unchanged while operating income from residential operations increased \$9.2 million over the second quarter last year, reflecting continued strong performance in Western Canada and from U.S. joint venture activities.

Trailing (last four quarters) funds from operations (net earnings plus depreciation) for the real estate division now equals \$73.0 million versus \$60.5 million for the prior twelve-month period.

Investments and other operations' operating income equalled \$2.4 million in the second quarter compared to \$3.8 million in the second quarter last year. The decrease is attributed to a decline in operating income for theatre operations partially offset by increased equity earnings from Empire's investment in the Wajax Income Fund. The decline in Empire Theatres operating income in the second quarter was the result of integration costs associated with the acquisition of 27 movie theatres on September 30, 2005 along with very poor film quality. Since the end of the second quarter, film quality and attendance levels have improved significantly. The integration of the newly acquired theatres is proceeding on schedule.

Interest expense increased \$1.0 million, to \$22.1 million from \$21.1 million in the second quarter last year. Fund indebtedness increased largely as a result of funding the acquisition of 27 movie theatres (202 screens) from Cineplex Galaxy LP on September 30, 2005 and also as a result of funding additional short-term investments.

The Company recorded a net capital gain of \$0.8 million in the second quarter largely as a result of investments sales. A net capital loss of \$3.0 million was realized from the sale of investments in the second quarter last year.

Consolidated net earnings, including net capital gains (losses) and other items, totalled \$48.6 million or \$0.74 per share versus \$40.0 million or \$0.61 per share in the second quarter last year, a 21.5 percent increase. Excluding net capital gains (losses), Empire recorded operating earnings of \$47.8 million or \$0.73 per share in the second quarter versus \$43.0 million or \$0.66 per share in the second quarter last year, an 11.2 percent increase.

## Consolidated Financial Condition

The ratio of funded debt to capital at the end of the second quarter equalled 42.3 percent versus 41.1 percent at the beginning of the fiscal year. Operating income provided 5.5 times coverage of interest expense in the second quarter versus 5.3 times coverage in the second quarter last year.

At November 5, 2005, Empire's investment portfolio, including the value of a currency hedge, carried a market value of \$525.3 million on a cost base of \$399.1 million, resulting in an unrealized gain of \$126.2 million. At the end of the second quarter last year, the unrealized capital gain on the investment portfolio, including the value of a currency hedge, was \$81.5 million.

Since the beginning of the fiscal year to the end of the second quarter, the Company has realized capital gains from the sale of investments of \$27.8 million.

The total return on the investment portfolio for the twelve-month period ended September 30, 2005 was 30.4 percent as compared to a 29.3 percent return for the S&P/TSX Composite Index and a 3.1 percent return for the S&P 500 Index (in Canadian dollars) over the same time period.

The purchase of property, equipment and other assets in the second quarter equalled \$121.4 million (\$214.8 million fiscal year-to-date) as compared to \$70.6 million in the same quarter last year (\$146.3 million last fiscal year-to-date). Investment in food division property, equipment and other assets, accounted for \$91.1 million of the total capital investment in the second quarter and \$175.1 million fiscal year-to-date. Capital expenditures for the real estate division amounted to \$22.5 million in the second quarter and \$27.8 million fiscal year-to-date. Capital expenditures for Empire's other operations equalled \$7.8 million in the second quarter and \$11.9 million fiscal year-to-date. On September 30, 2005, Empire Theatres Limited acquired 27 movie theatres, as mentioned, for a total consideration of \$86.2 million.

## Dividend Declaration

The Board of Directors declared a quarterly dividend of \$0.14 per share on both the Non-Voting Class A shares and the Class B common shares that will be payable on January 31, 2006, to shareholders of record on January 13, 2006. In addition, the Board declared regular dividends on the Company's outstanding preferred shares.

In conclusion, our strong second quarter operating earnings performance is reflective of an outstanding contribution from our Genstar residential operation along with solid performances from our food, commercial real estate portfolio and investment divisions. We continue to be pleased with the progress being made by each of our businesses and are confident that the fundamentals of our operating businesses will continue to strengthen as they stay focused on the execution of their respective business plans.



Paul D. Sobey  
President & Chief Executive Officer

December 14, 2005

**EMPIRE COMPANY LIMITED**  
**CONSOLIDATED BALANCE SHEETS**

(Unaudited, in millions)

	<b>November 5 2005 Unaudited</b>	<b>May 7 2005 Audited</b>	<b>October 30 2004 Unaudited <i>Restated (Note 1)</i></b>
<b>ASSETS</b>			
Current			
Cash and cash equivalents	\$ 198.4	\$ 281.7	\$ 119.0
Receivables	307.0	257.8	294.0
Income taxes receivable	14.5	15.0	12.1
Inventories	728.7	639.6	563.2
Prepaid expenses	62.0	52.3	51.5
	<b>1,310.6</b>	1,246.4	1,039.8
Investments, at cost (quoted market value \$391.6; May 7, 2005 \$320.9; October 30, 2004 \$291.8)	350.0	270.8	251.5
Investments, at equity (realizable value \$125.2; May 7, 2005 \$162.4; October 30, 2004 \$103.5)	49.1	72.9	70.3
Current assets and marketable investments	<b>1,709.7</b>	1,590.1	1,361.6
Property and equipment	<b>2,545.4</b>	2,429.8	2,324.2
Assets for realization	<b>23.5</b>	11.5	11.5
Other assets (Note 4)	<b>221.6</b>	212.9	297.6
Goodwill	<b>718.7</b>	684.9	668.9
	<b>\$ 5,218.9</b>	\$ 4,929.2	\$ 4,663.8
<b>LIABILITIES</b>			
Current			
Bank indebtedness	\$ 356.1	\$ 219.4	\$ 168.2
Accounts payable and accrued liabilities	1,162.8	1,149.1	1,064.1
Future income taxes	52.8	52.4	46.8
Long-term debt due within one year (Note 5)	74.7	247.0	234.5
	<b>1,646.4</b>	1,667.9	1,513.6
Long-term debt (Note 5)	<b>896.2</b>	727.4	724.2
Long-term lease obligation	<b>13.3</b>	12.3	12.4
Deferred revenue	<b>0.9</b>	3.0	4.7
Employee future benefit obligation	<b>99.0</b>	94.5	93.6
Future income taxes	<b>157.8</b>	158.8	134.9
Minority interest	<b>596.5</b>	556.3	545.8
	<b>3,410.1</b>	3,220.2	3,029.2
<b>SHAREHOLDERS' EQUITY</b>			
Capital stock (Note 6)	195.0	194.6	196.7
Retained earnings	1,615.1	1,515.5	1,438.5
Cumulative translation adjustment	(1.3)	(1.1)	(0.6)
	<b>1,808.8</b>	1,709.0	1,634.6
	<b>\$ 5,218.9</b>	\$ 4,929.2	\$ 4,663.8

See accompanying notes to the unaudited interim period consolidated financial statements.

**EMPIRE COMPANY LIMITED**  
**CONSOLIDATED STATEMENTS OF RETAINED EARNINGS**  
**26 WEEKS ENDED**  
(Unaudited, in millions)

	<b>November 5, 2005</b>	October 30, 2004 <i>Restated (Note 1)</i>
Balance, beginning of period as previously reported	<b>\$ 1,515.5</b>	\$ 1,380.7
Adjustment due to adoption of accounting standards prior period (Note 1)	<b>(3.7)</b>	(9.2)
Balance, beginning of period as restated	<b>1,511.8</b>	1,371.5
Net earnings	<b>122.4</b>	84.2
	<b>1,634.2</b>	1,455.7
Dividends declared		
Preferred shares	<b>(0.1)</b>	(0.2)
Common shares	<b>(18.3)</b>	(15.8)
	<b>(18.4)</b>	(16.0)
Premium on common shares purchased for cancellation	<b>(0.7)</b>	(1.2)
Balance, end of period	<b>\$ 1,615.1</b>	\$ 1,438.5

*See accompanying notes to the unaudited interim period consolidated financial statements.*

**EMPIRE COMPANY LIMITED**  
**CONSOLIDATED STATEMENTS OF EARNINGS**  
**PERIODS ENDED**

(Unaudited, in millions, except per share amounts)

	<b>November 5 2005 (13 weeks)</b>	October 30 2004 (13 weeks) <i>Restated (Note 1)</i>	<b>November 5 2005 (26 weeks)</b>	October 30 2004 (26 weeks) <i>Restated (Note 1)</i>
Revenue	\$ 3,285.6	\$ 3,022.8	\$ 6,647.3	\$ 6,096.5
Cost of sales, selling and administrative expenses	<u>3,115.4</u>	<u>2,867.8</u>	<u>6,312.9</u>	<u>5,783.2</u>
	170.2	155.0	334.4	313.3
Depreciation and amortization	<u>56.0</u>	<u>48.6</u>	<u>108.9</u>	<u>96.7</u>
	114.2	106.4	225.5	216.6
Investment income (Note 7)	<u>7.9</u>	<u>5.2</u>	<u>16.7</u>	<u>9.8</u>
Operating income	<u>122.1</u>	<u>111.6</u>	<u>242.2</u>	<u>226.4</u>
Interest expense				
Long-term debt	19.4	20.1	39.3	40.5
Short-term debt	<u>2.7</u>	<u>1.0</u>	<u>3.8</u>	<u>2.5</u>
	22.1	21.1	43.1	43.0
Capital gain (loss) and other items (Note 8)	<u>100.0</u>	<u>90.5</u>	<u>199.1</u>	<u>183.4</u>
Earnings before income taxes and minority interest	<u>1.1</u>	<u>(3.7)</u>	<u>27.4</u>	<u>(4.0)</u>
Income taxes				
Current	101.1	86.8	226.5	179.4
Future	<u>38.1</u>	<u>31.8</u>	<u>70.0</u>	<u>60.3</u>
	(4.5)	(1.2)	(0.6)	2.5
Earnings before minority interest	<u>33.6</u>	<u>30.6</u>	<u>69.4</u>	<u>62.8</u>
Minority interest	<u>67.5</u>	<u>56.2</u>	<u>157.1</u>	<u>116.6</u>
Net earnings	<u>18.9</u>	<u>16.2</u>	<u>34.7</u>	<u>32.4</u>
	\$ 48.6	\$ 40.0	\$ 122.4	\$ 84.2
Earnings per share, basic and diluted (Note 3)	<u>\$ 0.74</u>	<u>\$ 0.61</u>	<u>\$ 1.86</u>	<u>\$ 1.28</u>

See accompanying notes to the unaudited interim period consolidated financial statements.

**EMPIRE COMPANY LIMITED**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**PERIODS ENDED**

(Unaudited, in millions)

	<b>November 5 2005 (13 weeks)</b>	October 30 2004 (13 weeks) <i>Restated (Note 1)</i>	<b>November 5 2005 (26 weeks)</b>	October 30 2004 (26 weeks) <i>Restated (Note 1)</i>
<b>Operating Activities</b>				
Net earnings	\$ 48.6	\$ 40.0	\$ 122.4	\$ 84.2
Items not affecting cash (Note 9)	73.5	66.2	123.1	138.3
Preferred dividends	-	(0.1)	(0.1)	(0.2)
	<u>122.1</u>	106.1	<u>245.4</u>	222.3
Net change in non-cash working capital	<u>(69.6)</u>	<u>(41.1)</u>	<u>(131.3)</u>	<u>(135.6)</u>
Cash flows from operating activities	<u>52.5</u>	<u>65.0</u>	<u>114.1</u>	<u>86.7</u>
<b>Investing Activities</b>				
Net (increase) decrease in investments	(50.3)	12.6	(76.0)	21.6
Net proceeds from sale of Wajax Income Fund	-	-	50.5	-
Purchase of shares in subsidiary, Sobeys Inc.	-	(21.8)	-	(29.2)
Purchase of property, equipment and other assets	(121.4)	(70.6)	(214.8)	(146.3)
Proceeds from sale of property	6.6	10.9	11.3	21.6
Business acquisitions, net of cash acquired	(87.3)	(1.2)	(87.3)	(13.4)
Cash flows used in investing activities	<u>(252.4)</u>	<u>(70.1)</u>	<u>(316.3)</u>	<u>(145.7)</u>
<b>Financing Activities</b>				
Increase in bank indebtedness	153.3	14.8	136.7	27.4
Increase (decrease) in construction loans	1.3	(0.1)	2.0	(1.2)
Issue of long-term debt	183.2	3.5	198.4	11.2
Repayment of long-term debt	(189.6)	(23.5)	(213.5)	(47.0)
Increase in long-term lease obligation	0.8	-	1.0	-
Increase in minority interest	9.0	0.2	12.6	1.9
Issue of Non-Voting Class A shares	-	-	0.8	0.9
Repurchase of Non-Voting Class A shares for cancellation	-	-	(0.8)	(1.6)
Common dividends	(9.3)	(7.9)	(18.3)	(15.8)
Cash flows from financing activities	<u>148.7</u>	<u>(13.0)</u>	<u>118.9</u>	<u>(24.2)</u>
Decrease in cash and cash equivalents	(51.2)	(18.1)	(83.3)	(83.2)
Cash and cash equivalents, beginning of period	<u>249.6</u>	<u>137.1</u>	<u>281.7</u>	<u>202.2</u>
Cash and cash equivalents, end of period	<u>\$ 198.4</u>	<u>\$ 119.0</u>	<u>\$ 198.4</u>	<u>\$ 119.0</u>

See accompanying notes to the unaudited interim period consolidated financial statements.

**EMPIRE COMPANY LIMITED**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**November 5, 2005**

(Unaudited, in millions, except per share amounts)

**1. Summary of Significant Accounting Policies**

**Interim financial statements**

The unaudited interim period consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP). These interim consolidated financial statements do not include all of the disclosures included in the Company's annual consolidated financial statements. Accordingly, these interim consolidated financial statements should be read in conjunction with the consolidated financial statements for the year ended May 7, 2005, as set out in the 2005 Annual Report.

**Generally accepted accounting principles**

The accounting policies used in the preparation of these interim consolidated financial statements conform with those used in the Company's 2005 annual consolidated financial statements. Selected changes in accounting policies adopted in fiscal 2005 and those changes adopted in 2006 are noted below:

**a) Real estate leases**

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 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. The total lease expense is amortized straight-line over the entire term of the lease including rent free periods related to store fixturing. A store fixturing period varies by store but is generally considered to be one month prior to the store opening. The Company has adopted this guideline retroactively with restatement (see Note 13).

**b) Vendor allowances**

In January 2004, the Canadian Institute of Chartered Accountants (CICA) Emerging Issues Committee (EIC) issued Abstract 144, "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 reimbursement of costs incurred to sell the vendor's products, provided certain conditions are met. The Company adopted EIC-144 in November 2004, adjusting for it retroactively, with restatement of the comparative periods.

During the first quarter of fiscal 2006, the Company adopted the amendment to EIC-144 issued in January 2005. The amendment requires disclosure of the amount of any vendor allowances that have been recognized in income but for which the full requirements for entitlement have not yet been met (see Note 14).

**EMPIRE COMPANY LIMITED**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**November 5, 2005**

(Unaudited, in millions, except per share amounts)

**1. Summary of Significant Accounting Policies (continued)**

**c) Variable interest entities (VIE's)**

Effective for the fourth quarter ended May 7, 2005, the Company was required to implement AcG-15, "Consolidation of variable interest entities" issued by the CICA. AcG-15 requires the Company to consolidate certain entities that are deemed to be subject to control of the Company on a basis other than through ownership of a voting interest in the entity (see Note 15).

**Inventories**

Warehouse inventories are valued at the lower of cost and net realizable value with cost being determined substantially on a first-in, first-out (FIFO) basis. Retail inventories are valued at the lower of cost and net realizable value. Cost is determined by using FIFO or the retail method. The retail method uses the anticipated selling price less normal profit margins, substantially on an average cost basis. Real estate inventory of residential properties is carried at the lower of cost and net realizable value.

**Revenue recognition**

Food division sales are recognized at the point-of-sale. Sales include revenues from customers through corporate stores operated by the Company and consolidated VIE's, and revenue from sales to non-VIE franchised stores, associated stores and independent accounts. Revenue received from non-VIE franchise stores, affiliated stores and independent accounts is mainly derived from the sale of product. The Company also collects franchise fees under two types of arrangements. Franchise fees contractually due based on the dollar value of product shipped are recorded as revenue when the product is shipped. Franchise fees contractually due based on the franchisee's retail sales are recorded as revenue weekly upon invoicing based on the franchisee's retail sales. Real estate revenue is recognized in accordance with the lease agreements with tenants on a straight-line basis.

**Pension benefit plans and other benefit plans**

The cost of the Company's pension benefits for defined contribution plans are expensed as contributions are paid. The cost of defined benefit pension plans and other benefit plans is accrued based on actuarial valuations, which are determined using the projected benefit method pro-rated on service and management's best estimate of the expected long term rate of return on plan assets, salary escalation, retirement ages and expected growth rate of health care costs.

Current market values are used to value benefit plan assets. The obligation related to employee future benefits is measured using 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 impact of changes in plan amendments is amortized on a straight-line basis over the expected average remaining service life (EARSL) of active members. For pension benefit plans, the actuarial gains and losses and the impact of changes in the actuarial basis in excess of 10% of the greater of the projected benefit obligation and the market value of assets are amortized on a straight-line basis over the EARSL of the active members. For other benefit plans, actuarial gains and losses are recognized immediately. For the Company's Senior Executive Retirement Plan, the impact of changes in the plan provisions are amortized over 5 years.

**EMPIRE COMPANY LIMITED**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**November 5, 2005**

(Unaudited, in millions, except per share amounts)

**1. Summary of Significant Accounting Policies (continued)**

**Use of estimates**

The preparation of these consolidated financial statements, in conformity with Canadian GAAP, requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. These estimates are based on management's best knowledge of current events and actions that the Company may undertake in the future.

**2. Sale of Wajax Income Fund**

On June 6, 2005, the shareholders of Wajax Limited (Wajax), an equity accounted investment, approved a Plan of Arrangement to convert Wajax into an income fund. The Company owned approximately 45% of the outstanding shares of Wajax (on a fully diluted basis). The Plan of Arrangement was completed on June 15, 2005 with the Company receiving one unit of Wajax Income Fund (Fund) for each Wajax share held. Through a secondary offering, on June 21, 2005, the Company sold a total of 2.5 million Fund units for net proceeds of approximately \$43.7. On June 29, 2005, the underwriter exercised their over-allotment option to purchase 375,000 Fund units at \$19.25 per unit, resulting in additional net proceeds of \$6.8. This reduced the Company's ownership percentage to approximately 27.6%. Details of the sale are as follows:

Net proceeds	\$ 50.5
Book value	<u>21.1</u>
	29.4
Equity share of income fund conversion-related items	<u>3.1</u>
Capital gain before income taxes	26.3
Income taxes	<u>2.1</u>
Capital gain, net of tax expense	<u>\$ 24.2</u>

**EMPIRE COMPANY LIMITED**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**November 5, 2005**

(Unaudited, in millions, except per share amounts)

**3. Earnings Per Share**

Earnings per share amounts are calculated on the weighted average number of shares outstanding (2005 - 65,735,810 shares; 2004 - 65,766,542 shares) after providing for preferred share dividends accrued to the balance sheet date. Diluted earnings per share are calculated on the assumption that all the outstanding stock options were exercised and share purchase loans were repaid at the beginning of the period. There is no effect as a result of this calculation. Earnings applicable to common shares is comprised of the following:

	<b>2005</b> <i>(13 weeks)</i>	2004 <i>(13 weeks)</i> <i>Restated (Note 1)</i>	<b>2005</b> <i>(26 weeks)</i>	2004 <i>(26 weeks)</i> <i>Restated (Note 1)</i>
Operating earnings	\$ 47.8	\$ 43.0	\$ 97.4	\$ 87.4
Capital gain (loss) and other items, net of tax of \$0.3; \$(0.7); \$2.4; \$(0.8)	<u>0.8</u>	<u>(3.0)</u>	<u>25.0</u>	<u>(3.2)</u>
Net earnings	48.6	40.0	122.4	84.2
Preferred share dividends	-	(0.1)	(0.1)	(0.2)
Earnings applicable to common shares	<u>\$ 48.6</u>	<u>\$ 39.9</u>	<u>\$ 122.3</u>	<u>\$ 84.0</u>
Earnings per share is comprised of the following:				
Operating earnings	\$ 0.73	\$ 0.66	\$ 1.48	\$ 1.33
Capital gain and other items	<u>0.01</u>	<u>(0.05)</u>	<u>0.38</u>	<u>(0.05)</u>
Basic earnings per share	<u>\$ 0.74</u>	<u>\$ 0.61</u>	<u>\$ 1.86</u>	<u>\$ 1.28</u>
Diluted earnings per share	<u>\$ 0.74</u>	<u>\$ 0.61</u>	<u>\$ 1.86</u>	<u>\$ 1.28</u>

**4. Other Assets**

	<b>November 5, 2005</b>	May 7, 2005	October 30, 2004
Loans and mortgages receivable	\$ 45.8	\$ 41.7	\$ 151.0
Deferred costs	147.2	149.6	133.0
Intangibles (less accumulated amortization of \$3.6; May 7, 2005 \$2.4; October 30, 2004 \$1.0)	<u>28.6</u>	<u>21.6</u>	<u>13.6</u>
	<u>\$ 221.6</u>	<u>\$ 212.9</u>	<u>\$ 297.6</u>

Loans receivable decreased by \$100.0 as a result of the consolidation of VIE's (see Note 15).

**5. Long-Term Debt**

On October 21, 2005, the Company filed a Short Form Base Shelf prospectus providing for the issuance of up to \$500.0 of unsecured Medium Term Notes. On October 28, 2005, the Company issued new Medium Term Notes of \$175.0, maturing October 29, 2035.

On November 1, 2005, Medium Term Notes of \$175.0 were repaid according to the terms of the agreement.

**EMPIRE COMPANY LIMITED**  
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(Unaudited, in millions, except per share amounts)

**6. Capital Stock**

During the period, under a normal course issuer bid which expires on July 27, 2006, the Company purchased for cancellation 20,254 (2004 - 61,129) Non-Voting Class A shares. The purchase price was \$0.8 of which \$0.7 of the purchase price (representing the premium on common shares purchased for cancellation) was charged to retained earnings. During the period 20,254 (2004 - 42,129) Non-Voting Class A shares were issued under the Company's stock option and share purchase plans to certain officers and employees for \$0.8 (2004 - \$0.9). Loans receivable from officers and employees of \$4.8 (May 7, 2005 - \$4.4; October 30, 2004 - \$4.8) under the Company's share purchase plan are classified as a reduction of Shareholders' Equity.

**7. Investment Income**

	<b>2005</b> <i>(13 weeks)</i>	2004 <i>(13 weeks)</i>	<b>2005</b> <i>(26 weeks)</i>	2004 <i>(26 weeks)</i>
Dividend and interest income	\$ 2.1	\$ 2.2	\$ 4.2	\$ 4.6
Share of income of investments accounted for by the equity method	<u>5.8</u>	<u>3.0</u>	<u>12.5</u>	<u>5.2</u>
	<u>\$ 7.9</u>	<u>\$ 5.2</u>	<u>\$ 16.7</u>	<u>\$ 9.8</u>

**8. Capital Gain (Loss) and Other Items**

	<b>2005</b> <i>(13 weeks)</i>	2004 <i>(13 weeks)</i>	<b>2005</b> <i>(26 weeks)</i>	2004 <i>(26 weeks)</i>
Gain on sale of Wajax Income Fund (Note 2)	\$ -	\$ -	\$ 26.3	\$ -
Gain (Loss) on sale of investments	1.5	(3.7)	1.5	(4.0)
Other items	<u>(0.4)</u>	<u>-</u>	<u>(0.4)</u>	<u>-</u>
	<u>\$ (1.1)</u>	<u>\$ (3.7)</u>	<u>\$ 27.4</u>	<u>\$ (4.0)</u>

**9. Supplementary Cash Flow Information**

**a) Items not affecting cash**

	<b>2005</b> <i>(13 weeks)</i>	2004 <i>(13 weeks)</i>	<b>2005</b> <i>(26 weeks)</i>	2004 <i>(26 weeks)</i>
		<i>Restated (Note 1)</i>		<i>Restated (Note 1)</i>
Depreciation and amortization	\$ 56.0	\$ 48.6	\$ 108.9	\$ 96.7
Future income taxes	(4.5)	(1.0)	(0.6)	2.5
Amortization of deferred items	6.8	6.6	15.8	13.9
Equity in earnings of other companies, net of dividends received	(0.3)	(2.7)	(3.8)	(4.6)
Minority interest	11.8	13.3	24.6	26.6
Employee future benefit obligation	3.7	1.4	4.5	3.2
Gain on sale of Wajax Income Fund	-	-	(26.3)	-
	<u>\$ 73.5</u>	<u>\$ 66.2</u>	<u>\$ 123.1</u>	<u>\$ 138.3</u>

**EMPIRE COMPANY LIMITED**  
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**9. Supplementary Cash Flow Information (continued)**

**b) Other cash flow information**

Net interest paid	<u>\$ 26.2</u>	<u>\$ 17.5</u>	<u>\$ 39.2</u>	<u>\$ 32.3</u>
Net income taxes paid	<u>\$ 27.3</u>	<u>\$ 31.8</u>	<u>\$ 74.5</u>	<u>\$ 88.5</u>

**10. Segmented Information**

	<b>2005</b> <i>(13 weeks)</i>	<b>2004</b> <i>(13 weeks)</i>	<b>2005</b> <i>(26 weeks)</i>	<b>2004</b> <i>(26 weeks)</i>
<b>Revenue</b>				
Food	<u>\$ 3,218.4</u>	<u>\$ 2,966.7</u>	<u>\$ 6,518.8</u>	<u>\$5,977.7</u>
Real estate				
Commercial	<u>34.0</u>	34.0	<u>68.0</u>	68.1
Inter-segment	<u>13.1</u>	14.0	<u>26.4</u>	27.8
Residential	<u>12.4</u>	5.5	<u>18.9</u>	12.7
	<u>59.5</u>	53.5	<u>113.3</u>	108.6
Other operations	<u>20.8</u>	16.6	<u>41.6</u>	38.0
	<u>3,298.7</u>	3,036.8	<u>6,673.7</u>	6,124.3
Elimination	<u>(13.1)</u>	(14.0)	<u>(26.4)</u>	(27.8)
	<u>\$ 3,285.6</u>	<u>\$ 3,022.8</u>	<u>\$ 6,647.3</u>	<u>\$ 6,096.5</u>

	<b>2005</b> <i>(13 weeks)</i>	<b>2004</b> <i>(13 weeks)</i>	<b>2005</b> <i>(26 weeks)</i>	<b>2004</b> <i>(26 weeks)</i>
<b>Operating income</b>				
Food	<u>\$ 84.1</u>	\$ 81.2	<u>\$ 167.8</u>	\$ 161.8
Real estate				
Commercial	<u>21.6</u>	21.8	<u>43.1</u>	43.9
Residential	<u>14.0</u>	4.8	<u>22.3</u>	11.0
Other operations	<u>(0.3)</u>	1.5	<u>2.6</u>	5.7
Investment income	<u>5.3</u>	4.8	<u>11.4</u>	9.3
Corporate expenses	<u>(2.6)</u>	(2.5)	<u>(5.0)</u>	(5.3)
	<u>\$ 122.1</u>	<u>\$ 111.6</u>	<u>\$ 242.2</u>	<u>\$ 226.4</u>

**EMPIRE COMPANY LIMITED**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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**10. Segmented Information (continued)**

	<b>November 5, 2005</b>	May 7, 2005	October 30, 2004 <i>Restated (Note 1)</i>
<b>Identifiable assets</b>			
Food	<b>\$ 2,929.5</b>	\$ 2,829.0	\$ 2,580.7
Goodwill	<b>681.4</b>	681.1	665.1
	<b>3,610.9</b>	3,510.1	3,245.8
Real estate	<b>1,051.7</b>	1,017.9	1,018.7
Investments	<b>384.0</b>	325.9	302.2
Other (including goodwill of \$37.3; May 7, 2005 \$3.8; October 30, 2004 \$3.8)	<b>172.3</b>	75.3	97.1
	<b><u>\$ 5,218.9</u></b>	<u>\$ 4,929.2</u>	<u>\$ 4,663.8</u>

	<b>2005 (13 weeks)</b>	2004 (13 weeks) <i>Restated (Note 1)</i>	<b>2005 (26 weeks)</b>	2004 (26 weeks) <i>Restated (Note 1)</i>
<b>Capital expenditure</b>				
Food	<b>\$ 91.1</b>	\$ 59.6	<b>\$ 175.1</b>	\$ 118.5
Real estate	<b>22.5</b>	7.4	<b>27.8</b>	22.3
Corporate and other	<b>7.8</b>	3.6	<b>11.9</b>	5.5
	<b><u>\$ 121.4</u></b>	<u>\$ 70.6</u>	<b><u>\$ 214.8</u></b>	<u>\$ 146.3</u>

**11. Employee Future Benefits**

During the Company's second quarter and first half of fiscal 2006, the net employee future benefit expense was \$6.0 and \$12.0 respectively (2004 - \$5.9 and \$11.5). The expense included costs for the Company's defined contribution pension plans, defined benefit pension plans, post-retirement benefit plans and post-employment benefit plans.

**12. Business Acquisitions**

On September 30, 2005, Empire Theatres Limited (a subsidiary of the Company) acquired 27 theatres with 202 screens located in Ontario and Western Canada from Cineplex Galaxy LP. On October 21, 2005 Empire Theatres Limited further acquired one theatre with 4 screens in Western Canada from Motion Picture Distribution LP. The total cash consideration of the acquisitions was \$87.6. The acquisitions were accounted using the purchase method with net identifiable assets recorded at \$54.1 (including intangible assets of \$8.3) and goodwill recorded at \$33.5. The allocation of purchase price is preliminary and the actual calculation and allocation of the purchase price will be based on the estimated fair value of the assets acquired and liabilities assumed at the effective date of the acquisition. Accordingly, the purchase price will be adjusted subsequent to completion of the acquisition and the final purchase price allocation process.

**EMPIRE COMPANY LIMITED**  
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**13. Real Estate Leases**

During fiscal 2005 the Company reviewed its practices related to lease accounting and determined that adjustments were required to align to the recent clarification of lease accounting guidelines. The first adjustment related 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 related 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 period 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 related 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 with the following net impact on the comparative statements for the period ended November 5, 2005:

- As at October 30, 2004 a reduction to retained earnings of \$5.4.
- A reduction in net income for the 26 week period ended October 30, 2004 of \$0.1 from \$84.3 to \$84.2, and a nil reduction in earnings per share.
- As at October 30, 2004 an increase to Property and equipment, Future income taxes, Long-term debt and Long-term lease obligation of \$9.6, \$4.7, \$10.3 and \$12.4 respectively, and a decrease in minority interest of \$3.0.

These lease accounting adjustments did not have any material impact on the Company's first half fiscal 2006 net earnings, historical or future revenues, cash flows or lease payments.

**14. Vendor Allowances**

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 volume allowances has changed, resulting in the Company recording a decrease in opening retained earnings for fiscal 2005 of \$3.8 (net of income tax effect of \$3.4 and minority interest of \$2.1) and a decrease to inventory of \$9.3. The implementation of EIC-144 did not result in a material change in the first half net earnings for the current or prior year.

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 allowance is estimable. During the first half of fiscal 2006, the Company recognized \$3.0 of allowances in income whereby the minimum purchase level had not yet been met.

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**15. 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 has implemented AcG-15 on 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 for the fiscal quarter.

The Company has identified the following entities as VIE's:

Franchisees

The Company has identified 289 franchisees whose franchise agreements result in the Company being deemed the primary beneficiary of the entity according to AcG-15. The results for these entities require consolidation with the results of the Company.

Warehouse and Distribution Agreement

The Company has an agreement with an independent entity to provide warehouse and distribution services. 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 independent franchisees and the entity providing warehouse and distribution services effective at the fourth quarter of fiscal 2005.

**EMPIRE COMPANY LIMITED**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
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(Unaudited, in millions, except per share amounts)

**15. Variable Interest Entities (continued)**

Balance Sheet as at November 5, 2005

	Consolidated Balance Sheet as at November 5, 2005 before AcG-15 Impact	Impact of the Implementation of AcG-15	Consolidated Balance Sheet as at November 5, 2005 after AcG-15 Impact
<b>Assets</b>			
Current			
Cash and cash equivalents	\$ 159.7	\$ 38.7	\$ 198.4
Receivables	331.0	(24.0)	307.0
Income taxes receivable	13.9	0.6	14.5
Inventories	605.4	123.3	728.7
Prepaid expenses	54.6	7.4	62.0
	<u>1,164.6</u>	<u>146.0</u>	<u>1,310.6</u>
Investments, at cost (quoted market value \$391.6)	350.0	-	350.0
Investments, at equity (realizable value \$125.2)	49.1	-	49.1
	<u>1,563.7</u>	<u>146.0</u>	<u>1,709.7</u>
Current assets and marketable investments	1,563.7	146.0	1,709.7
Property and equipment	2,510.6	34.8	2,545.4
Assets for realization	23.5	-	23.5
Other assets	321.6	(100.0)	221.6
Goodwill	718.7	-	718.7
	<u>\$5,138.1</u>	<u>\$ 80.8</u>	<u>\$5,218.9</u>
<b>LIABILITIES</b>			
Current			
Bank indebtedness	\$ 356.1	\$ -	\$ 356.1
Accounts payable and accrued liabilities	1,122.2	40.6	1,162.8
Future income taxes	52.8	-	52.8
Long-term debt due within one year	72.9	1.8	74.7
	<u>1,604.0</u>	<u>42.4</u>	<u>1,646.4</u>
Long-term debt	880.7	15.5	896.2
Long-term lease obligation	13.3	-	13.3
Deferred revenue	0.9	-	0.9
Employee future benefit obligation	99.0	-	99.0
Future income taxes	157.8	-	157.8
Minority interest	559.1	37.4	596.5
	<u>3,314.8</u>	<u>95.3</u>	<u>3,410.1</u>
<b>SHAREHOLDERS' EQUITY</b>			
Capital stock	195.0	-	195.0
Retained earnings	1,629.6	(14.5)	1,615.1
Cumulative translation adjustment	(1.3)	-	(1.3)
	<u>1,823.3</u>	<u>(14.5)</u>	<u>1,808.8</u>
	<u>\$5,138.1</u>	<u>\$ 80.8</u>	<u>\$5,218.9</u>

**EMPIRE COMPANY LIMITED**  
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**15. Variable Interest Entities (continued)**

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 franchisees were eliminated upon consolidation. Cash, inventories, fixed assets, accounts payable and debt financing the fixed assets has been consolidated.

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

- 1) The reduction of inventory values of the franchisees that include charges from the Company for distribution costs and vendor allowances that are not recognized by the Company until final sale to customers,
- 2) Goodwill that is carried on the accounts of stores determined to be VIE's 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 (net of minority interest of \$2.0) to retained earnings was required in the second quarter of fiscal 2006 to reflect additional minority interest in the VIE's.

Minority interest represents the equity in the VIE's held by the common shareholder.

**EMPIRE COMPANY LIMITED**  
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**15. Variable Interest Entities (continued)**

Income Statement for the 26 weeks ended November 5, 2005

	Consolidated Income Statement as at November 5, 2005 before AcG-15 Impact	Impact of the Implementation of AcG-15	Consolidated Income Statement as at November 5, 2005 after AcG-15 Impact
Revenue	\$ 6,336.0	\$ 311.3	\$ 6,647.3
Operating expenses			
Cost of sales, selling and administrative expenses	6,009.5	303.4	6,312.9
Depreciation and amortization	106.2	2.7	108.9
	<u>220.3</u>	<u>5.2</u>	<u>225.5</u>
Investment income	16.7	-	16.7
Operating income	<u>237.0</u>	<u>5.2</u>	<u>242.2</u>
Interest expense			
Long-term debt	38.6	0.7	39.3
Short-term debt	3.8	-	3.8
	<u>42.4</u>	<u>0.7</u>	<u>43.1</u>
	194.6	4.5	199.1
Capital gain and other items	27.4	-	27.4
Earnings before income taxes and minority interest	222.0	4.5	226.5
Income taxes	68.8	0.6	69.4
Earnings before minority interest	153.2	3.9	157.1
Minority interest	30.1	4.6	34.7
Net earnings	<u>\$ 123.1</u>	<u>\$ (0.7)</u>	<u>\$ 122.4</u>
Earnings per share, basic and diluted	<u>\$ 1.87</u>	<u>\$ (0.01)</u>	<u>\$ 1.86</u>
Basic and diluted weighted average number of common shares outstanding, in millions	65.7		65.7

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

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

**EMPIRE COMPANY LIMITED**  
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**16. Contingent Liabilities**

On June 21, 2005, Sobeys Inc. (a subsidiary of the Company) received a notice of reassessment from Canada Revenue Agency (CRA) for fiscal years 1999 and 2000 related to the Goods and Service Tax (GST). CRA asserts that Sobeys Inc. was obligated to collect GST on the sales of tobacco products to status Indians. The total tax, interest and penalties in the reassessment was \$13.6. Sobeys Inc. has reviewed this matter, has received legal advice, and believes it was not required to collect GST. Sobeys Inc. is challenging this reassessment. Accordingly, the Company has deposited with CRA, funds to cover the total tax, interest and penalties in the reassessment and has recorded this amount as a receivable from CRA pending resolution of this matter.

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.

**17. Comparative Figures**

Comparative figures have been reclassified, where necessary, to reflect the current period's presentation and to record the effects of retroactive application of certain new accounting standards.

# **MANAGEMENT'S DISCUSSION AND ANALYSIS INTERIM REPORT FOR THE 26 WEEKS ENDED NOVEMBER 5, 2005**

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## Management's Discussion and Analysis

The following is Management's Discussion and Analysis ("MD&A") of the consolidated financial results of Empire Company Limited ("Empire" or the "Company") for the 13 weeks and 26 weeks ended November 5, 2005, as compared to the 13 weeks and 26 weeks ended October 30, 2004. This MD&A also provides analysis of the operating performance of the Company's divisions as well as a discussion of cash flows and the financial condition of the Company.

This discussion and analysis should be read in conjunction with the Company's unaudited interim consolidated financial statements and accompanying notes for the 13 and 26 weeks ended November 5, 2005, the audited annual consolidated financial statements and accompanying notes for the 53 weeks ended May 7, 2005 and the related annual MD&A as contained on pages 19 through 57 of Empire's 2005 Annual Report. Additionally, information about the Company, including the Annual Report and Annual Information Form, can be found on SEDAR at [www.sedar.com](http://www.sedar.com).

In the fourth quarter of fiscal 2005, the Company adopted Accounting Guideline 15 ("AcG-15") "Consolidation of Variable Interest Entities". These consolidated financial statements include the accounts of Variable Interest Entities ("VIEs") which the Company is required to consolidate. Please review the section entitled "AcG-15, Consolidation of Variable Interest Entities" included in this MD&A for more information.

### Forward-looking Information

The discussion contains certain forward-looking information about the future performance of the Company and its divisions. 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, including but not limited to: general industry and economic conditions, pricing pressures and competitive factors, rates of return on capital spending, the results of business improvement and development initiatives and the availability and terms of financing, amongst other factors. 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.

### Non-GAAP Financial Measures

There are measures included in this MD&A that do not have a standardized meaning under Canadian generally accepted accounting principles ("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 document.

### Overview of the Business

Empire is a diversified Canadian company headquartered in Stellarton, Nova Scotia. Empire's key businesses are food retailing - through 68.3% ownership of Sobeys Inc. ("Sobeys"), real estate through two wholly-owned operating subsidiaries: Sobey Leased Properties Limited ("SLP"), and Crombie Properties Limited ("Crombie"), including 35.7% ownership of Genstar Development Partnership ("Genstar"); and corporate investment activities and other operations which includes an approximately 27.6% ownership position in the Wajax Income Fund ("Wajax") and wholly-owned Empire Theatres Limited ("Empire Theatres"). With \$5.2 billion in assets, Empire employs approximately 37,000 people directly and through its subsidiaries.

## Consolidated Operating Results

The consolidated financial overview provided below reports on the financial performance for the 13 and 26 weeks ended November 5, 2005 relative to the same periods last year.

### Summary Table of Consolidated Financial Results

(\$ in millions, except per share information)	13 Weeks Ended November 5, 2005		13 Weeks Ended October 30, 2004		26 Weeks Ended November 5, 2005		26 Weeks Ended October 30, 2004	
	\$	% of Revenue	\$	% of Revenue	\$	% of Revenue	\$	% of Revenue
<b>Revenue</b>								
Food	\$ 3,218.4	97.96%	\$ 2,966.7	98.14%	\$ 6,518.8	98.06%	\$ 5,977.7	98.05%
Real Estate, net of inter-segment	46.4	1.41	39.5	1.31	86.9	1.31	80.8	1.33
Other Operations	20.8	0.63	16.6	0.55	41.6	0.63	38.0	0.62
<b>Consolidated revenue</b>	<b>\$ 3,285.6</b>	<b>100.00%</b>	<b>\$ 3,022.8</b>	<b>100.00%</b>	<b>\$ 6,647.3</b>	<b>100.00%</b>	<b>\$ 6,096.5</b>	<b>100.00%</b>
<b>Operating income</b>								
Food	\$ 84.1		\$ 81.2		\$ 167.8		\$ 161.8	
Real Estate, net of inter-segment	35.6		26.6		65.4		54.9	
Other Operations	2.4		3.8		9.0		9.7	
<b>Consolidated operating income</b>	<b>\$ 122.1</b>	<b>3.72%</b>	<b>\$ 111.6</b>	<b>3.69%</b>	<b>242.2</b>	<b>3.64%</b>	<b>226.4</b>	<b>3.71%</b>
Interest expense	22.1	0.67	21.1	0.70	43.1	0.65	43.0	0.71
Income taxes (from operating activities)	33.3	1.01	31.3	1.03	67.0	1.01	63.6	1.04
Minority interest	18.9	0.58	16.2	0.54	34.7	0.52	32.4	0.53
<b>Operating earnings</b>	<b>\$ 47.8</b>	<b>1.46%</b>	<b>\$ 43.0</b>	<b>1.42%</b>	<b>\$ 97.4</b>	<b>1.46%</b>	<b>\$ 87.4</b>	<b>1.43%</b>
<b>Capital gain (loss) and other items,</b>								
net of tax	0.8	0.02	(3.0)	(0.10)	25.0	0.38	(3.2)	(0.05)
<b>Net earnings</b>	<b>\$ 48.6</b>	<b>1.48%</b>	<b>\$ 40.0</b>	<b>1.32%</b>	<b>\$ 122.4</b>	<b>1.84%</b>	<b>\$ 84.2</b>	<b>1.38%</b>
<b>Cash flows from operating activities</b>	<b>\$ 52.5</b>	<b>1.60%</b>	<b>\$ 65.0</b>	<b>2.15%</b>	<b>\$ 114.1</b>	<b>1.72%</b>	<b>\$ 86.7</b>	<b>1.42%</b>
<b>Total assets</b>	<b>\$ 5,218.9</b>		<b>\$ 4,663.8</b>					
<b>Total long-term liabilities</b>	<b>\$ 1,763.7</b>		<b>\$ 1,515.6</b>					

### Per Share, basic and fully diluted

Operating earnings	\$ 0.73		\$ 0.66		\$ 1.48		\$ 1.33	
Capital gain (loss) and other items,								
net of tax	0.01		(0.05)		0.38		(0.05)	
<b>Net earnings</b>	<b>\$ 0.74</b>		<b>\$ 0.61</b>		<b>\$ 1.86</b>		<b>\$ 1.28</b>	
Basic and diluted weighted average								
number of shares outstanding	65.7		65.7					
(in millions)								
<b>Annualized dividends per share</b>	<b>\$ 0.56</b>		<b>\$ 0.48</b>					

The 13 weeks and 26 weeks ended October 30, 2004 have been restated to reflect the retroactive adjustment related to lease accounting. Please see the section entitled Accounting Standards – “Lease Accounting” in the fiscal 2005 annual MD&A.

## Management's Explanation of Consolidated Results

The following is a review of Empire's consolidated financial performance for the 13-week and 26-week periods ended November 5, 2005 compared to the same periods last year.

Revenue and financial performance of each of the Company's businesses (food, real estate, and investments and other operations) are discussed in detail in the section entitled "Operating Performance by Division" in this MD&A.

### Revenue

The following shows second quarter and fiscal year-to-date revenues adjusted to eliminate the impact of VIE consolidation:

(\$ in millions)	Reported Revenue Fiscal 2006	Reported Growth over Fiscal 2005	VIE Impact	Adjusted Revenue Fiscal 2006	Reported Revenue Fiscal 2005	Adjusted Growth over Fiscal 2005
Second Quarter	\$3,285	8.7%	\$150	\$3,135	\$3,023	3.7%
Year-to-date	\$6,647	9.0%	\$311	\$6,336	\$6,096	3.9%

Each of Empire's operating businesses contributed to the growth in consolidated second quarter revenue of \$262.8 million or 8.7 percent. The food division generated sales of \$3.22 billion, an increase of \$251.7 million or 8.5 percent over the second quarter last year. Real estate operations recorded revenue (net of inter-segment elimination) of \$46.4 million, an increase of \$6.9 million or 17.5 percent over the second quarter last year. Other operations generated revenue of \$20.8 million in the second quarter, an increase of \$4.2 million or 26.2 percent over the second quarter last year.

Fiscal year-to-date revenue growth of \$550.8 million or 9.0 percent was largely driven by a \$541.1 million or 9.1 percent growth in food division sales over the comparable period last year. Real estate revenues grew by \$6.1 million or 7.6 percent while revenue from other operations increased by \$3.6 million or 9.5 percent over the prior year.

Impacting revenue growth for both the second quarter and fiscal year-to-date was the consolidation of VIEs, which accounted for approximately \$150 million or 5.0 percentage points of the increase in revenues compared to the second quarter and \$311 million or 5.1 percentage points of the increase in revenues compared to the first half of fiscal 2005. Excluding the impact of VIEs, consolidated revenue increased 3.7 percent in the second quarter and by 3.9 percent fiscal year-to-date.

Please refer to the section entitled "Operating Performance by Division" for an explanation of the change in revenue by division.

### Operating Income

Consolidated operating income in the second quarter totalled \$122.1 million, an increase of \$10.5 million or 9.4 percent compared to the second quarter last year. The increase is the result of a \$2.9 million or 3.6 percent increase in operating income from the food division, a \$9.0 million or 33.8 percent increase in operating income from the real estate division and a \$1.4 million or 36.8 percent decrease in operating income contribution from investments and other operations.

Fiscal year-to-date operating income growth of \$15.8 million or 7.0 percent was attributed to a \$10.5 million or 19.1 percent growth in real estate division operating income and a \$6.0 million or 3.7 percent growth in food division operating income; partially offset by a reduction in operating income from investments and other operations of \$0.7 million over the comparable period last year.

Operating income for the 13-week and 26-week periods ended November 5, 2005 were impacted by higher depreciation and amortization expense for the food division along with Ontario business and system initiative costs incurred for Sobeys Ontario region.

Please refer to the section entitled "Operating Performance by Division" for an explanation of the change in operating income by division.

### **Interest Expense**

Interest expense increased \$1.0 million, to \$22.1 million from \$21.1 million in the second quarter last year. The increase in interest expense is primarily attributed to higher average bank indebtedness relative to the prior year. Major cash outlays which required new bank indebtedness over the prior year included the purchase in the third and fourth quarters of fiscal 2005 by Empire of an aggregate 1,626,000 common shares of Sobeys for \$63.0 million and the funding of the acquisition of 28 movie theatres in the second quarter for a total consideration of \$87.6 million.

Consolidated interest coverage, which is operating income divided by interest expense, improved to 5.5 times compared to 5.3 times coverage last year.

Long-term debt levels (including the current portion of long-term debt) were relatively unchanged from the beginning of the fiscal year and were up modestly compared to the end of the second quarter last year. Interest expense on long-term debt declined marginally from the second quarter last year as a result of a decline in the weighted average interest rate on the Company's long-term debt.

For the 26 weeks ended November 5, 2005, interest expense was relatively unchanged at \$43.1 million, a \$0.1 million increase over last year. Interest coverage improved to 5.6 times compared to 5.3 times last year.

The majority of the Company's debt is long-term in nature carrying fixed interest rates, accordingly, there is limited exposure to interest rate volatility. The Company is exposed to interest rate risk when arranging new debt.

In the second quarter of fiscal 2006, Sobeys issued \$175 million of Series D medium term notes ("MTN") that mature in 2035. They carry an interest rate of 6.06 percent and replace the Series A MTN that matured in the second quarter which carried a 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 will amortize to interest expense over the 30 year term of the related MTN.

### **Income Tax Expense**

Income tax expense increased by \$2.0 million over the second quarter last year and by \$3.4 million fiscal year-to-date over the comparable period last year. The respective increases in income tax expense are the result of higher taxable income versus higher income tax rates. The effective income tax rate for the second quarter was 33.3 percent versus 34.6 percent in the second quarter last year. The reduction in the effective tax rate was primarily the result of a shift in the current year to a greater portion of taxable

earnings in jurisdictions with lower statutory rates along with the impact of VIEs. The effective income tax rate for the 26 weeks ended November 5, 2005 was 33.7 percent compared to 34.7 percent last year.

### **Minority Interest**

In the second quarter of fiscal 2006, Empire recorded minority interest expense of \$18.9 million compared to \$16.2 million in the second quarter last year. The increase in second quarter and fiscal year-to-date minority interest was primarily related to Sobeys recording higher minority interest as a result of inclusion of VIEs, offset in part by Empire's increased ownership position in Sobeys.

For the trailing twelve months ended November 5, 2005, Empire purchased 1,626,000 common shares of Sobeys, resulting in the increase in ownership as mentioned. No common shares of Sobeys were purchased by Empire in the first or second quarters of fiscal 2006.

### **Operating Earnings**

The \$4.8 million or 11.2 percent improvement in operating earnings in the second quarter (earnings before net capital gains (losses) and other items) over the same quarter last year was the result of the \$10.5 million increase in operating income, the \$1.0 million increase in interest expense, the \$2.0 million increase in income tax expense and the \$2.7 million increase in minority interest, as previously discussed.

The \$10.0 million or 11.4 percent increase in operating earnings in the first 26 weeks of the fiscal year is attributed to the \$15.8 million increase in operating income, a \$0.1 million increase in interest expense, a \$3.4 million increase in income tax expense and a \$2.3 million increase in minority interest as discussed.

### **Net Capital Gain (Loss)**

The Company generated a net capital gain of \$0.8 million in the second quarter largely as a result of investment sales. A net capital loss of \$3.0 million was realized from the sale of investments in the second quarter last year.

On a fiscal year-to-date basis, the Company recorded net capital gains of \$25.0 million compared to a \$3.2 million net capital loss over the same period last fiscal year. The capital gains to date in fiscal 2006 are largely the result of a \$24.2 million gain on the sale of Wajax Income Fund units in the first quarter.

### **Net Earnings**

Consolidated net earnings, including net capital gains (losses) and other items, totalled \$48.6 million (\$0.74 per share) in the second quarter, an increase of \$8.6 million or 21.5 percent over the second quarter last year. Net earnings for the 26 weeks ended November 5, 2005 totalled \$122.4 million (\$1.86 per share), an increase of \$38.2 million or 45.4 percent over the \$84.2 million (\$1.28 per share) reported in the same period last year.

The consolidation of VIEs had no material impact on net earnings for the second quarter or for the 26-weeks ended November 5, 2005.

## Quarterly Results of Operations

The following table summarizes selected consolidated financial information from the Company's unaudited interim financial statements for each of the most recently completed eight quarters. The consolidation of VIEs results in higher revenue and lower margins as a percent of revenue, due to the addition of VIE retail sales. The Company began consolidating VIEs in the fourth quarter of fiscal 2005 and prior quarters have not been restated. The first and second quarters of fiscal 2006 and the fourth quarter of fiscal 2005 include the impact of consolidating the VIEs.

(\$ in millions, except per share information)

	Fiscal 2006		Fiscal 2005				Fiscal 2004	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
	(13 weeks) Nov 5/05	(13 weeks) Aug 6/05	(14 weeks) May 7/05	(13 weeks) Jan 29/05	(13 weeks) Oct 30/04	(13 weeks) July 31/04	(13 weeks) Apr 30/04	(13 weeks) Jan 31/04
Revenue	\$3,285.6	\$3,361.7	\$3,360.2	\$2,978.5	\$3,022.8	\$3,073.7	\$2,876.4	\$2,798.5
Operating income	122.1	120.1	124.0	113.3	111.6	114.8	100.9	109.9
Operating earnings <sup>(1)</sup>	47.8	49.6	49.3	46.2	43.0	44.5	41.0	44.0
Net capital gain (loss) and other items	0.8	24.2	5.5	1.4	(3.0)	(0.2)	(0.1)	8.8
Net earnings	\$ 48.6	\$ 73.8	\$ 54.8	\$ 47.6	\$ 40.0	\$ 44.3	\$ 40.9	\$ 52.8
<u>Per Share, basic and diluted</u>								
Operating earnings <sup>(1)</sup>	\$ 0.73	\$ 0.75	\$ 0.75	\$ 0.70	\$ 0.66	\$ 0.67	\$ 0.62	\$ 0.67
Net capital gain (loss) and other items	0.01	0.37	0.08	0.02	(0.05)	-	-	0.13
Net earnings	\$ 0.74	\$ 1.12	\$ 0.83	\$ 0.72	\$ 0.61	\$ 0.67	\$ 0.62	\$ 0.80
Weighted average number of shares outstanding (in millions)	65.7	65.7	65.7	65.8	65.8	65.8	65.8	65.8

*All quarters prior to the fourth quarter of fiscal 2005 have been restated to reflect the retroactive adjustment related to lease accounting. Please see the section entitled "Accounting Standards - Lease Accounting" in the fiscal 2005 annual MD&A.*

<sup>(1)</sup> Operating earnings is net earnings before net capital gain (loss) and other items.

Both revenue and operating earnings growth have been influenced by the Company's investing activities, the competitive environment, general industry trends and by other risk factors as outlined in the fiscal 2005 annual MD&A.

## Operating Performance by Division

### Food Division

Empire's food division is carried out through its controlling ownership position in Sobeys. Sobeys conducts business through more than 1,300 retail grocery stores (corporately owned and franchised) which operate in four retail regions: Sobeys West, Sobeys Ontario, Sobeys Quebec, and Sobeys Atlantic. Empire's ownership interest in Sobeys at the end of the second quarter equalled 68.3 percent as compared to 65.9 percent at the end of the second quarter last year.

## Sales

Second quarter and fiscal year-to-date 2006 sales adjusted to eliminate the impact of VIE consolidation were as follows:

	Reported Sales	Reported Growth over	VIE	Adjusted Sales	Reported Sales	Adjusted Growth over
(\$ in millions)	Fiscal 2006	Fiscal 2005	Impact	Fiscal 2006	Fiscal 2005	Fiscal 2005
Second Quarter	\$3,218	8.5%	\$150	\$3,068	\$2,967	3.4%
Year-to-date	\$6,519	9.1%	\$311	\$6,208	\$5,978	3.8%

Food division sales for the second quarter of fiscal 2006 were \$3.22 billion compared to \$2.97 billion for the same quarter last year, an increase of \$251.7 million or 8.5 percent. During the second quarter of fiscal 2006, Sobeys' same-store sales, that is sales from stores in the same locations in both reporting periods, increased by 3.6 percent.

On a fiscal year-to-date basis, sales increased 9.1 percent from the prior year, with same-store growth of 3.9 percent.

Impacting sales growth for both the second quarter and fiscal year-to-date was the consolidation of VIEs, which accounted for approximately \$150 million or 5.1 percentage points of the increase in sales compared to the second quarter last year and \$311 million or 5.3 percentage points of the increase in sales compared to the first half of fiscal 2005. Excluding the impact of VIEs, sales grew by 3.4 percent in the second quarter and by 3.8 percent for the fiscal year-to-date.

Sales growth, for both the quarter and fiscal year-to-date, was 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.

## Earnings Before Interest, Income Taxes, Depreciation and Amortization

Sobeys' EBITDA ("earnings before interest, income taxes, depreciation and amortization") in the second quarter of fiscal 2006 increased \$8.9 million or 7.2 percent to \$132.8 million from \$123.9 million reported in the second quarter of fiscal 2005. EBITDA as a percent of sales decreased from 4.18 percent in the second quarter of fiscal 2005 to 4.13 percent in the second quarter of fiscal 2006. Excluding VIEs, EBITDA as a percent of sales was 4.15 percent, a three basis point reduction from the same quarter last year.

Sobeys' EBITDA for the first half of fiscal 2006 increased by 6.5 percent to \$262.9 million compared to the \$246.8 million reported for the same period last year. Excluding VIEs, EBITDA as a percent of sales was 4.11 percent, a two basis point decline from the comparable period last year.

Included in Sobeys' EBITDA for the 13 weeks and 26 weeks ended November 5, 2005 are \$4.6 million and \$8.4 million, respectively, of costs related to the Ontario business process and system initiative outlined in the annual MD&A included in Sobeys' 2005 Annual Report. Excluding these costs and the impact of VIEs, Sobeys' EBITDA increased by 6.5 percent over the same 13-week period in the prior fiscal year and EBITDA as a percentage of sales would have been 4.30 percent, a 12 basis point improvement over the prior fiscal prior year. On a fiscal year-to-date basis, excluding these costs and the impact of VIEs, Sobeys' EBITDA increased by 6.7 percent over the same 26-week period in prior fiscal year and EBITDA

as a percentage of sales would have been 4.24 percent, an 11 basis point improvement over the prior fiscal year.

Contributing to the increase in food division EBITDA was the growth in sales and increased gross margin as a result of improved productivity initiatives and changes in product mix, compared to the same period last fiscal year.

### **Earnings Before Interest, Income Taxes, Depreciation, Amortization and Rent**

Sobeys' earnings before interest, income taxes, depreciation, amortization and rent ("EBITDAR") for the second quarter of fiscal 2006 increased \$26.6 million or 13.8 percent to \$218.9 million compared to \$192.3 million in the same quarter last year. Sobeys leases a substantial portion of its store locations. Sobeys' gross rent expense of \$86.1 million in the second quarter of fiscal 2006 and \$68.4 million in the second quarter of fiscal 2005 is added to EBITDA to arrive at EBITDAR, a measure of operating performance excluding the impact of capital and how it is financed. EBITDAR as a percent of sales in the second quarter of fiscal 2006 was 6.80 percent compared to 6.48 percent in the second quarter of fiscal 2005.

On a fiscal year-to-date basis, Sobeys' EBITDAR increased \$47.7 million to \$430.1 million, an increase of 12.5 percent over the \$382.4 reported for the same time last fiscal year. EBITDAR as a percent of sales for the 26 weeks ended November 5, 2005 equalled 6.60 percent compared to 6.40 percent reported last year.

### **Earnings Before Interest and Income Taxes**

Sobeys' EBIT ("earnings before interest and income taxes") increased to \$84.1 million during the second quarter of fiscal 2006, a 3.6 percent increase from the second quarter last year. EBIT margin equalled 2.61 percent compared to 2.74 percent in the second quarter of fiscal 2005. Included in the second quarter of fiscal 2006 EBIT was a \$6.0 million increase in Sobeys' depreciation and amortization expense (\$48.7 million current quarter compared to \$42.7 million for the same quarter last year), reflecting Sobeys continued capital investments. Also, included in the EBIT are the Ontario business process and system initiative costs outlined above. Adjusting for these costs and the impact of VIEs, Sobeys' EBIT would have totalled \$84.7 million representing an EBIT margin of 2.76 percent, a two basis point improvement over the prior fiscal year.

For the 26 weeks ended November 5, 2005, Sobeys' EBIT increased by \$6.0 million to \$167.8 million, an increase of 3.7 percent over the \$161.8 million reported last year. EBIT as a percent of sales was 2.57 percent for the first 26 weeks of fiscal 2006 versus 2.71 percent for the comparable period last fiscal year. Adjusting for Ontario business program and system initiative costs and the impact of VIEs, Sobeys' EBIT would have totalled \$171.0 million representing an EBIT margin of 2.75 percent, a five basis point improvement over the comparable period last fiscal 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 and to improve margins over time.

### **Net Earnings**

Sobeys' second quarter fiscal 2006 net earnings totalled \$45.8 million, a decrease of \$1.4 million or 2.8 percent compared to the \$47.2 million recorded in the second quarter of fiscal 2005. Net earnings for the 26 weeks ended November 5, 20056 totalled \$94.0 million, relatively unchanged from the \$93.8 million reported in the same period last fiscal year.

Net earnings for the second quarter and fiscal year-to-date included the increased depreciation and amortization expense and Ontario business process and system initiative costs as referred to above and discussed in Sobeys 2005 Annual Report.

The consolidation of VIEs resulted in a \$0.8 million and \$1.0 million reduction in Sobeys' net earnings for the 13-weeks ended and the 26-weeks periods ended November 5, 2005, respectively.

The Ontario business process and system initiative costs reduced Sobeys' earnings per share by \$0.05 for the second quarter of fiscal 2006 and by \$0.09 for the first half of fiscal 2006.

## Real Estate Division

Empire's real estate operations are focused on the development and management of its existing commercial property portfolio, the acquisition and development of commercial properties, primarily in Ontario, and residential lot sales through its interest in Genstar.

Commercial real estate operations are conducted through Crombie and SLP, while residential land development is primarily conducted through Genstar, which operates principally in high growth communities in Western Canada and Ontario.

The table below presents revenue, operating income, operating earnings and funds from operations for the real estate division's commercial and residential operations.

(\$ in millions)	13 Weeks Ended		26 Weeks Ended	
	November 5, 2005	October 30, 2004	November 5, 2005	October 30, 2004
<b>Revenue</b>				
Commercial	\$ 34.0	\$ 34.0	\$ 68.0	\$ 68.1
Residential	12.4	5.5	18.9	12.7
	<u>\$ 46.4</u>	<u>\$ 39.5</u>	<u>\$ 86.9</u>	<u>\$ 80.8</u>
<b>Operating income</b>				
Commercial	\$ 21.6	\$ 21.8	\$ 43.1	\$ 43.9
Residential	14.0	4.8	22.3	11.0
	<u>\$ 35.6</u>	<u>\$ 26.6</u>	<u>\$ 65.4</u>	<u>\$ 54.9</u>
<b>Operating Earnings</b>				
Commercial	\$ 6.4	\$ 6.0	\$ 12.4	\$ 11.8
Residential	8.7	3.0	14.4	7.0
	<u>\$ 15.1</u>	<u>\$ 9.0</u>	<u>\$ 26.8</u>	<u>\$ 18.8</u>
<b>Funds from operations</b>				
Commercial	\$ 11.2	\$ 10.4	\$ 21.8	\$ 20.6
Residential	8.8	3.1	14.7	7.2
	<u>\$ 20.0</u>	<u>\$ 13.5</u>	<u>\$ 36.5</u>	<u>\$ 27.8</u>

### Revenue

Real estate division revenue (net of inter-segment amounts) increased \$6.9 million or 17.5 percent from the second quarter last fiscal year. Commercial property revenues were unchanged from the prior year at \$34.0 million while revenue from residential operations increased by \$6.9 million. The increase

in residential revenue from the Company's interest in Genstar reflects very strong residential lot sales in Western Canada.

On a fiscal year-to-date basis, revenue increased \$6.1 million or 7.6 percent over the comparable period last year. This increase was the result of higher revenues from residential operations due to exceptional lot sales in the second quarter as mentioned. Commercial operations revenue declined \$0.1 million for the 26-weeks ended November 5, 2005 relative to the prior fiscal year.

Overall (retail plus office) occupancy rate equalled 93.3 percent at the end of the second quarter compared to 93.0 percent a year ago. Office occupancy rate at the end of the second quarter was 89.4 percent, unchanged from a year ago. The retail occupancy rate was 94.3 percent at the end of the second quarter compared to 93.8 percent a year earlier.

### **Operating Income**

The \$9.0 million or 33.8 percent increase in second quarter operating income over the prior fiscal year was the result of a \$9.2 million increase in residential operating income offset by a \$0.2 million decline in commercial operations operating income. The growth in residential operating income is attributed to exceptional demand from housing lots in the primary markets in which it operates. As well, equity earnings contribution from Genstar's U.S. residential operations amounted to \$1.5 million in the second quarter as compared to no earnings contribution in the second quarter last fiscal year. This equity earnings contribution did not affect revenue but did positively impact operating income.

For the 26 weeks ended November 5, 2005, the real estate division contributed operating income of \$65.4 million compared to \$54.9 million last fiscal year. The increase of \$10.5 million or 19.1 percent was the result of higher operating income from residential activities as operating income from commercial activities declined by \$0.8 million over the prior fiscal year.

The real estate division contributed 27.0 percent of Empire's consolidated operating income in the first two quarters of fiscal 2006 compared to a 24.2 percent contribution in the comparable period last year.

### **Net Earnings**

Real estate division net earnings in the second quarter amounted to \$15.1 million compared to \$9.1 million last year, a \$6.0 million or 65.9 percent increase. The earnings increase largely reflects the \$9.0 million growth in operating income as discussed. There were no material capital gains or losses recorded by the real estate division this fiscal year-to-date or for last fiscal year-to-date.

For the 26 weeks ended November 5, 2005, real estate division net earnings amounted to \$26.9 million versus \$18.8 million in the comparable period last fiscal year. The increase of \$8.1 million or 43.1 percent is primarily attributed to a \$7.4 million increase in earnings from residential operations over the prior fiscal year. Earnings have benefited from exceptional residential lot sales in the first half of fiscal 2006, along with positive earnings contribution from U.S. investment activities.

### **Funds from Operations**

Trailing (last four quarters) funds from operations for the real estate division equalled \$73.0 million, up 20.7 percent from the prior four quarter trailing funds from operations of \$60.5 million.

Funds from operations in the second quarter equalled \$20.0 million, an increase of \$6.5 million over the second quarter last year largely as a result of earnings contribution from residential operations as discussed. Funds from operations for residential operations increased \$5.7 million over the second quarter last year while funds from operations for commercial real estate operations increased by \$0.8 million.

## Investments and Other Operations

The third component of Empire's business is its investments, consisting of an investment portfolio of equity investments and other operations which is primarily wholly-owned Empire Theatres.

At the end of the second quarter, Empire's total investments, including the value of a currency hedge, carried a market value of \$525.8 million on a cost base of \$399.1 million, resulting in an unrealized gain of \$126.7 million. Realized capital gains from the sale of investments equalled \$1.5 million in the second quarter. Total realized capital gains from investment sales in the first half of fiscal 2006 equalled \$27.8 million.

Realized capital gains fiscal year-to-date, plus unrealized capital gains, combined to equal \$154.0 million at the end of the second quarter. This compares to a total realized gain on investment sales plus unrealized investment gain position at the end of fiscal 2005 equal to \$143.1 million. The increase in the realized plus unrealized gain position of \$10.9 million since the end of fiscal 2005 is largely the result of an increase in the valuation of Wajax and financial services stocks.

At November 5, 2005, Empire's investment portfolio (excluding cash) consisted of:

(\$ in millions)	Market Value	% of Portfolio	Cost	Hedge Value <sup>(1)</sup>	Unrealized Gain (Loss)
Canadian equities	\$ 234.8	45.5%	\$ 173.8	-	\$ 61.0
Foreign equities	155.3	30.1%	174.7	\$ 9.0	(10.4)
Wajax	110.1	21.3%	34.0	-	76.1
Preferred Shares & Other <sup>(2)</sup>	16.6	3.1%	16.6	-	-
	\$ 516.8	100.0%	\$ 399.1	\$ 9.0	\$ 126.7

<sup>(1)</sup> The \$9.0mm hedge value equals the difference between the weighted average foreign exchange rate from booking \$93.0 million in U.S. loans (banker's acceptances) and the foreign exchange rate on the balance sheet date of November 5, 2005, multiplied by the \$93.0 million underlying U.S. loans.

<sup>(2)</sup> Includes a joint venture equity interest by Genstar in various U.S. residential builder deals at cost.

Empire's direct debt matched to the investment portfolio at the end of the second quarter equalled \$216.9 million Canadian equivalent (includes \$93.0 million U.S. borrowings). Direct debt equalled 42.0 percent of investment market value at the end of the second quarter, surpassing our 35.0 percent internal guideline but under our self-imposed 50 percent maximum. Debt has increased \$79.4 million since the beginning of the fiscal year largely as a result of Empire drawing down its bank lines by approximately \$87 million to fund Empire Theatres acquisition of 28 movie theaters in the second quarter as well as funding increased for new investment purchases. Debt has increased by \$157.5 million since the end of the second quarter last year as a result of funding the theatres acquisition as mentioned along with additional portfolio investments.

## Revenue

Other operations revenue, primarily generated by Empire Theatres, equalled \$20.8 million in the second quarter versus \$16.6 million in the second quarter last year. The \$4.2 million increase is largely the result of approximately one month of revenues associated with 27 movie-theatres (202 screens) acquired on September 30, 2005. On a same theatre basis, revenues were down from last year, consistent with the movie theatre industry generally and as a result of relatively weak film product quality.

Fiscal year-to-date revenues for other operations increased \$3.6 million or 9.5 percent over the comparable period last year. The growth in revenue was the result of the movie-theatre acquisition as mentioned. Box office admissions were down on a same-theatre basis due to weaker film quality in the first 26 weeks of fiscal 2006. The overall movie-theatre industry experienced an 11.5 percentage point decline in box office admission for the first ten months of calendar 2005, ended October 31, 2005.

## Investment Return

The table below presents the return performance for Empire's investments relative to Canadian and U.S. equity benchmarks for the three months ended September 30th, as well as on an annualized one-year, two-year and three-year basis.

### Empire Investment Portfolio Total Return For Periods ending September 30, 2005

	One Quarter	Annualized Returns		
		One Year	Two Years	Three Years
Empire Investment Portfolio	3.7%	30.4%	29.4%	30.0%
Median Manager	7.7%	22.7%	19.3%	18.4%
S&P/TSX Composite Index	11.6%	29.3%	24.0%	23.5%
S&P500 Index (in Cdn\$)	(1.9%)	3.1%	4.8%	5.1%

Empire's investment return for the three months ended September 30th of 3.7 percent was well below the calculated median manager return of 7.7 percent and the S&P/TSX Composite Index return of 11.6 percent over the same time period. This resulted in a fourth quartile performance ranking. The under performance is largely attributed to negative returns for the three months period ended September 30, 2005 for several foreign equity investments that were in the health care sector. Despite the negative returns for these holdings, we believe that each of these companies are solid fundamentally with excellent balance sheets, are leaders in their respective core businesses, and will perform over the long term.

Despite the weak quarter, on a one through three year trailing basis the portfolio return has exceeded the median manager return. The total return on the Empire investment portfolio, as independently benchmarked against the performance of over 100 equity fund managers, has been ranked as first quartile (first quartile means the top 25 percent of surveyed equity fund managers) investment return performance over one, two and three-year trailing periods ended September 30, 2005.

Despite the volatility inherent in equity markets, management continues to believe that over the long-term equity market returns will be superior to either fixed income or money market investment returns. Management remains committed to prudently managing a high quality, liquid portfolio of common equities.

### **Hedging Investment Currency Risk**

At November 5, 2005, Empire had hedged approximately 75 percent of the cost of its U.S. based common equity investments by way of \$93.0 million in U.S. dollar denominated short-term borrowings. The weighted average foreign exchange rate associated with these U.S. dollar bank loans is \$1.2749. The fair value of the hedge was approximately \$9.0 million at the end of the second quarter. Since the start of the fiscal year the value of the hedge has increased by approximately \$1.8 million.

### **Investment Income**

Investment income (excludes equity earnings from Genstar's U.S. joint-venture investments) equalled \$5.3 million in the second quarter, an increase of \$0.5 million over the second quarter last year, largely as a result of higher equity earnings from Wajax. Dividend income was relatively unchanged from the second quarter last fiscal year.

On a fiscal year-to-date basis, investment income amounted to \$11.4 million compared to \$9.3 million over the same period last fiscal year. The \$2.1 million increase was the result of higher equity earnings from Wajax of \$2.5 million offset by a reduction in dividend income of \$0.4 million.

### **Operating Earnings**

Investment (net of corporate expenses) and other operations' operating earnings equalled \$1.4 million in the second quarter compared to \$3.0 million in the second quarter last year, a decrease of \$1.6 million. The decrease is primarily attributed to lower earnings contribution from Empire Theatres as a result of weak film product quality which negatively impacted attendance levels, along with planned integration costs from the acquisition of 27 movie-theatres on September 30, 2005.

For the 26-weeks ended November 5, 2005, investment (net of corporate expenses) and other operations' operating earnings amounted to \$6.4 million versus \$7.2 million last year. The decrease of \$0.8 million was primarily the result of: (i) reduced earnings contribution from Empire Theatres due largely to poor film product quality as mentioned, (ii) higher interest expense as a result of increased average bank indebtedness incurred to fund the theatres acquisition as mentioned and to fund the purchase of additional investments and (iii) higher equity earnings contribution from Wajax.

The funding incurred for additional investments consisted of new portfolio investments as well as an increase in the number of shares owned in Sobeys relative to the second quarter last year. Over the trailing four quarters ended November 5, 2005, Empire has purchased 1,620,000 common shares of Sobeys, resulting in an increase in ownership percentage from 65.9 percent a year ago to 68.3 percent at the end of the second quarter.

### **Capital Gain (Loss)**

Net capital gains realized in second quarter amounted to \$0.8 million compared to a \$3.0 million net capital loss in the second quarter last year. On a fiscal year-to-date basis, net capital gains on the sale of investments equalled \$25.0 million as compared to a \$3.2 million net capital loss last fiscal year-to-

date. The net capital gain (losses) recorded in the quarter and for the year-to-date are largely due to the sale of common equity investments. The bulk of the net capital gain this fiscal year is attributed to the sale of 2.875 million units of the Wajax Income Fund in the first quarter.

## Net Earnings

Investments (net of corporate expenses) and other operations contributed \$2.1 million to Empire's consolidated second quarter net earnings (4.3 percent of consolidated net earnings). This compares to no net earnings contribution in the second quarter last fiscal year. The increase in net earnings contribution over the second quarter last fiscal year is due to higher net capital gains of \$3.7 million as mentioned, partially offset by the \$1.6 million decrease in operating income as discussed.

For the 26-weeks ended November 5, 2005, investments (net of corporate expenses) and other operations contributed \$31.3 million to Empire's consolidated net earnings (25.6 percent of consolidated net earnings) compared to a \$4.0 million contribution last fiscal year-to-date (4.8 percent of consolidated net earnings). The increase in net earnings of \$27.3 million over the prior fiscal year-to-date was the result of the \$28.1 million increase in net capital gains (loss) partially offset by the \$0.8 million decrease in operating earnings as mentioned.

## Financial Condition

At the end of the second quarter, management calculates Empire's consolidated net asset value at \$2,817 million or \$42.84 per share, an increase of \$589 million from the calculated net asset value of \$2,228 million or \$33.89 per share at October 30, 2004.

(\$ in millions except per share information)

	November 5, 2005		October 30, 2004	
	Net Asset Value	% of Total	Net Asset Value	% of Total
Food <sup>(1)</sup>	\$ 1,805	59%	\$ 1,367	59%
Real Estate <sup>(2)</sup>	570	19%	478	21%
Investments and Other Operations <sup>(3)</sup>	667	22%	461	20%
	<b>\$ 3,042</b>	<b>100%</b>	<b>\$ 2,306</b>	<b>100%</b>
Corporate debt & preferred share capital	(225)		(78)	
Net asset value	<u>\$ 2,817</u>		<u>\$ 2,228</u>	
Per share	<u>\$ 42.84</u>		<u>\$ 33.89</u>	

- (1) Food division net asset value at November 5, 2005 equals the 44.672 million common shares of Sobeys owned at second end quarter-end multiplied by the market price of a Sobeys' common share on that date. Food division net asset value at October 30, 2004 equalled 44.672 million common shares of Sobeys owned at the end of second quarter last year, October 30, 2004, times the market price of a Sobeys' common share on that date.
- (2) Real estate net asset value has been calculated at nine times trailing funds from commercial operations plus five times trailing funds from residential operations.
- (3) Investment net asset value is largely derived from stated public market values of securities held in the portfolio.

At November 5, 2005, approximately three-quarters of Empire's net asset value was derived from assets that are valued by publicly available market prices from recognized public stock exchanges. This includes Sobeys' common shares and securities held in Empire's investment portfolio. For each dollar increase in Sobeys' share price, Empire's net asset value increases by approximately \$0.68 per share.

### Capital Structure and Key Financial Condition Measures

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

(\$ in millions, except ratio calculations)	Nov. 5, 2005	May 7, 2005	Oct. 30, 2004
Shareholders' equity	<b>\$ 1,808.8</b>	\$ 1,709.0	\$ 1,634.6
Minority interest	<b>596.5</b>	556.3	545.8
Bank indebtedness	<b>356.1</b>	219.4	168.2
Long-term debt, including current portion	<b>970.9</b>	974.4	958.7
Funded debt to total capital ratio	<b>42.6%</b>	41.4%	41.1%
Net debt to capital ratio	<b>38.7%</b>	35.1%	38.4%
Interest coverage	<b>5.5x</b>	5.4x	5.3x
Total assets	<b>5,218.9</b>	4,929.2	4,663.8

*The first quarter of fiscal 2005 has been restated to reflect retroactive adjustments related to lease accounting and EIC-144. Please see the sections entitled Accounting Standards - "Lease Accounting" and "EIC-144" in the fiscal 2005 annual MD&A.*

### Shareholders Equity

Book value per common share was \$27.39 as at November 5, 2005 as compared to \$25.87 at May 7, 2005 and \$24.78 per share at October 30, 2004.

Total common shares outstanding at November 5, 2005 equalled 65,735,810 unchanged from the previous fiscal year-end (May 7, 2005) and the second quarter last year, October 30, 2004. There were 31,175,047 Non-Voting Class A shares outstanding and 34,560,763 Class B common shares outstanding at the end of the second quarter, November 5, 2005.

At November 5, 2005, Empire had 27,674 options outstanding with an expiry date of October 2006. There were no options exercised in either the first or second quarter of fiscal 2006 or during fiscal 2005.

During the 26-week period ended November 5, 2005, Empire purchased 20,254 Non-voting Class A shares for cancellation under a Normal Course Issuer Bid which expires on July 27, 2006. No shares were purchased for cancellation in the second quarter of fiscal 2006. For the 26-weeks ended October, 2004, Empire purchased 61,129 Non-Voting Class A shares for cancellation.

At December 14, 2005, Empire had 31,175,047 Non-Voting Class A shares and 34,560,763 Class B common shares outstanding. There were 27,674 options outstanding on December 14, 2005, each exercisable for one Non-voting Class A share.

Dividends paid to common shareholders amounted to \$9.3 million in the second quarter (\$0.14 per share) versus \$7.9 million (\$0.12 per share) in the second quarter last year. On a fiscal year-to-date basis, the Company has paid common dividends totalling \$18.3 million (\$0.28 per share) versus \$15.8 million (\$0.24 per share) in the comparable period last fiscal year.

## Liabilities

Empire finances a significant portion of its assets through the use of bank indebtedness and long-term debt. Total fixed rate, long-term debt (including the current portion of long-term debt) at November 5, 2005 was \$970.9 million, representing 73.2 percent of Empire's total funded debt. The amount of long-term debt (including the current portion) was relatively unchanged from the end of the fiscal year, May 7, 2005 (\$974.4 million) and from the second quarter last year (\$958.7 million).

Long-term debt by operating segment is detailed below:

(\$ in millions)	Nov. 5, 2005	May 7, 2005	Oct. 30, 2004
Food Distribution	\$ 461.2	\$ 457.8	\$ 428.8
Real Estate	505.6	512.2	525.4
Other Operations	4.1	4.4	4.5
<b>Total</b>	<b>\$ 970.9</b>	<b>\$ 974.4</b>	<b>\$ 958.7</b>

There is no long-term debt carried by the investment segment. Empire predominately finances its long-term assets with fixed rate, long-term debt, thereby reducing both interest rate and refinancing risk.

Interest coverage in the second quarter was 5.5 times, improved from the 5.4 times reported for the fiscal year ended May 7, 2005 and the 5.3 times recorded for the second quarter last fiscal year.

Since the beginning of the fiscal year, the consolidated funded debt to total capital ratio has increased 1.2 percentage points largely as a result of higher bank indebtedness incurred to fund the acquisition of 27 movie-theatres on September 30, 2005 and also incurred to fund additional portfolio investments.

Empire and its subsidiaries have provided covenants to its lenders in support of various financing facilities. All covenants were complied with for the 26-weeks ended November 5, 2005 and for fiscal 2005.

## Hedging Instruments

Empire utilizes hedging instruments from time to time to prudently manage its exposure to interest rate volatility and its exposure to volatility in the Canadian to U.S. dollar exchange rate.

Empire directly has no interest rate hedges in place. Any such hedges are held by its operating subsidiaries.

The food division had no interest hedges in place at the end of the second quarter.

At the end of the second quarter, the real estate division had one interest rate exchange agreement outstanding with a notional amount of \$16.0 million at a rate of 4.22 percent. This swap carried a fair value of negative \$0.2 million at the end of the second quarter. As well, Crombie has entered into delayed start swaps in order to fix the interest rate on certain maturing debt tranches in future periods. These delayed start swaps totalling \$27.8 million carried a fair value of negative \$3.0 million at the end of the second quarter.

To mitigate the currency risk associated with the Company's U.S. dollar denominated investments, Empire has designated U.S. dollar denominated bank loans as hedges. Empire and its subsidiaries use hedging instruments to mitigate risk exposure, not for speculative purposes. Empire Company directly

has in place U.S. dollar denominated based bankers acceptances totalling \$93.0 million, equal to approximately 75 percent of the market value of U.S. common equity investments held at the end of the second quarter. The fair market value of this hedge at the end of the second quarter was approximately \$9.0 million.

Sobeys uses foreign exchange contracts to fix the exchange rates associated with U.S. dollar purchases of products. These U.S. dollar purchases represent approximately two percent of Sobeys' total annual purchases. The maximum length of these contracts is 30 days.

Certain property investments made by Genstar are in the U.S. and, as such, Crombie is exposed to foreign currency fluctuations. At the end of the second quarter, the U.S. dollar denominated asset exposure of Crombie totalled \$11.0 million. Crombie had \$10.0 million in U.S. dollar denominated bankers' acceptances at the end of the second quarter. The fair value of this hedge at the end of the second quarter was \$1.4 million.

## **Liquidity and Capital Resources**

Empire's liquidity remained strong at November 5, 2005 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 its expected cash outflows.

At November 5, 2005, cash and cash equivalents equalled \$198.4 million versus \$281.7 million at May 7, 2005 and \$119.0 million at October 30, 2004.

On a non-consolidated basis, Empire maintains authorized bank lines for operating, general and corporate purposes of \$325.0 million, of which approximately two-thirds was utilized at November 5, 2005. Financial instruments are used from time to time to manage the risk of short-term interest rate fluctuations on underlying short-term bank indebtedness. On a consolidated basis, Empire's authorized bank credit facilities exceeded borrowings by \$430.1 million at November 5, 2005, versus \$548.2 million capacity at May 7, 2005.

The table below highlights major cash flow components for the 13 weeks and 26 weeks ended November 5, 2005 compared to last fiscal year.

Major Cash Flow Components:

(\$ in millions)	13 Weeks Ended		26 Weeks Ended	
	November 5, 2005	October 30, 2004	November 5, 2005	October 30, 2004
Net earnings	\$ 48.6	\$ 40.0	\$ 122.4	\$ 84.2
Items not affecting cash	73.5	66.2	123.1	138.3
Preferred dividends	-	(0.1)	(0.1)	(0.2)
Net change in non-cash working capital	(69.6)	(41.1)	(131.3)	(135.6)
Cash flows from operating activities	52.5	65.0	114.1	86.7
Cash flows used in investing activities	(252.4)	(70.1)	(316.3)	145.7
Cash flows (used in) from financing activities	148.7	(13.0)	118.9	(24.2)
Decrease in cash and cash equivalents	\$ (51.2)	\$ (18.1)	\$ (83.3)	\$ (83.2)

The 13 weeks and 26 weeks ended October 30, 2004 have been restated to reflect retroactive adjustments related to lease accounting. Please see the sections entitled "Lease Accounting" in the fiscal 2005 annual MD&A.

## Operating Activities

Second quarter cash flows from operating activities of \$52.5 million compares to \$65.0 million in the comparable period last year. The decrease of \$12.5 million is attributed to increased net earnings of \$8.6 million as discussed, an increase in items not affecting cash of \$7.3 million and a reduction in the change in non-cash working capital of \$28.5 million. An increase in depreciation and amortization expense of \$7.4 million was largely responsible for the increase in items not affecting cash.

The following table presents non-cash working capital changes for the second quarter of fiscal 2006 as compared to the first quarter of fiscal 2006 and also the fiscal year-ended May 7, 2005, with VIEs included.

### Non-Cash Working Capital (Including VIEs)

(\$ in millions)	Including VIEs as of November 5, 2005	Including VIEs as of August 6, 2005	Quarter Increase (Decrease) in Cash flows	Including VIEs of May 7, 2005	Year-to-Date Increase (Decrease) in Cash flows
Receivables	\$ 307.0	\$ 271.4	\$ (35.6)	\$ 257.8	\$ (49.2)
Inventories	728.7	676.2	(52.5)	639.6	(89.1)
Prepaid expenses	62.0	61.9	(0.1)	52.3	(9.7)
Income taxes receivable	14.5	28.8	14.3	15.0	0.5
Accounts payable and accrued liabilities	(1,162.8)	(1,161.0)	1.8	(1,149.1)	13.7
Total	\$ (50.6)	\$ (72.1)	\$ (72.1)	\$ (184.4)	\$ (133.8)

The table below presents non-cash working capital changes compared to the second quarter last year excluding VIEs.

### Non-Cash Working Capital (Excluding VIEs)

(\$ in millions)	<b>November 5, 2005</b>	October 30, 2004	Year-Over-Year Increase (Decrease) in Cash flows
Receivables	\$ 331.0	\$ 294.0	\$ (37.0)
Inventories	605.4	563.2	(42.2)
Prepaid expenses	54.6	51.5	(3.1)
Income taxes receivable	13.9	12.1	(1.8)
Accounts payable and accrued liabilities	(1,122.2)	(1,064.1)	58.1
<b>Total</b>	<b>\$ (117.3)</b>	<b>\$ (143.3)</b>	<b>\$ (26.0)</b>

*October 30, 2004 has been restated to reflect retroactive adjustments related to lease accounting and EIC-144. Please see the sections entitled "Lease Accounting" and "E1C-144" in the fiscal 2005 annual MD&A.*

In the second quarter, receivables increased \$35.6 million and inventory levels increased \$52.5 million from the end of the first quarter fiscal 2006. The increase in inventory reflects additional inventory required for the December selling season.

Compared to May 7, 2005 fiscal year-end levels, receivables increased \$49.2 million and inventory levels increased \$89.1 million. The bulk of the receivable and inventory increases relate to the food division where receivables increased \$44.7 million and inventories grew \$80.0 million since the beginning of the fiscal year.

A portion of the increase in receivables is related to Sobeys depositing funds with Canada Revenue Agency ("CRA") to cover total tax, interest and penalties of \$13.6 million in a reassessment which Sobeys is challenging.

The increase in inventory largely reflects seasonal buying patterns for the food division which is typical in the business, allowing Sobeys to meet its December selling requirements and to more effectively service its growing customer and store base.

Compared to October 30, 2004, excluding the impact of VIEs, receivables increased \$37.0 million, inventories increased \$42.2 million and accounts payable and accrued liabilities increased by \$58.1 million. The bulk of these increases are attributed to the food division where receivables increased \$33.2 million; inventories increased \$33.0 million and accounts payable and accrued liabilities grew by \$64.3 million compared to the second quarter last fiscal year. The growth in food division inventories reflects higher sales and greater retail store square footage from continued capital investment activities. The inventory increase was more than offset by an increase in related payables. Food division receivables were impacted by a deposit of \$13.6 million with CRA as previously discussed.

## Investing Activities

Cash used in investing activities of \$252.4 million in the second quarter was significantly higher than the \$70.1 million of cash used in the second quarter last year.

The increase was mainly the result of an increase in property, equipment and other asset purchases of \$50.8 million over the second quarter last year along with a business acquisition which involved the purchase by Empire Theatres of 27 theatres (202 screens) located in Ontario and Western Canada on September 30, 2005 from Cineplex Galaxy LP. On October 21, 2005, Empire Theatres further acquired one theatre with four screens in Western Canada from Alliance Atlantis Cinemas. The total cash consideration of these theatre acquisitions was \$87.6 million.

The actual calculation and allocation of the acquired theatres purchase price will be based on the estimated fair value of the assets acquired and the liabilities assumed at the effective date of acquisition. Accordingly, the purchase price will be adjusted subsequent to completion of the final purchase price allocation process.

With respect to expenditures on property, equipment and other assets, the food division accounted for \$31.5 million of the increase, reflecting higher planned capital spending levels in the second quarter of fiscal 2006. During the quarter, the food division opened or replaced 12 corporate and franchised stores compared to two corporate and franchised stores opened or replaced during the second quarter of last year. An additional three stores were expanded during the quarter. A total of 20 stores were closed during the second quarter of fiscal 2006 compared to 11 stores closed in the second quarter last year. There was one store rebannered in the second quarter of fiscal 2006 compared to seven for the same quarter last fiscal year.

Net retail store square footage increased during the second quarter of fiscal 2006 by 147,132 square feet (368,324 square feet opened, less 221,192 square feet closed). At November 5, 2005, Sobeys' square footage totalled 25.0 million square feet, a 3.3 percent increase over the second quarter last fiscal year.

Capital expenditures for the real estate division were \$15.1 million higher than the second quarter last year as a result of ongoing property developments plus three new property additions: a 48,000 square foot shopping plaza in Stratford, Ontario for \$4.8 million, a free-standing building in Orleans, Ontario for \$7.0 million and the purchase of 15 acres of land in Markham, Ontario for \$2.3 million (net of assumed mortgage of \$9.6 million).

Capital expenditures for other operations increased \$4.2 million, largely reflecting planned capital activity for the movie-theatre network in Atlantic Canada.

For the 26 weeks ended November 5, 2005, cash used in investing activities increased by \$170.6 million to \$316.3 million. Investment in property, equipment and other assets in the current fiscal year amounted to \$214.8 million, an increase of \$68.5 over the same period last fiscal year. The food division accounted for \$56.6 million of this increase, reflecting higher planned capital spending levels in the first half of fiscal 2006. Capital expenditures increased \$5.5 million and \$6.4 million for the real estate division and for other operations respectively, relative to last fiscal year-to-date. Cash used for business acquisitions were \$73.9 million higher than last fiscal year-to-date, largely due to the theatre acquisition on September 30, 2005 as discussed.

## **Financing Activities**

Financing activities during the second quarter generated \$148.7 million of cash compared to \$13.0 million of cash used in the comparable period of fiscal 2005. The increase in cash flows from financing activities was largely the result of increased bank indebtedness at the corporate centre in order to fund the theatre acquisition as discussed as well as a net increase in investments of \$50.3 million.

On October 21, 2005, Sobeys filed a short-form base shelf prospectus providing for the issuance of up to \$500 million in unsecured MTNs over the next two years. On October 28, 2005, Sobeys issued \$175 million Series D MTNs with a maturity date of October 29, 2035 (30 years), carrying a coupon rate of 6.06 percent. The proceeds from this issuance were used to repay a Sobeys' Series A MTN which matured on November 1, 2005. These transactions did not result in a material increase in net cash in the second quarter.

Financing activities for the first half of fiscal 2006 generated \$118.9 million of cash compared to cash used of \$24.2 million in the comparable period last fiscal year. The increase in cash flow generated from financing activities was largely the result of an increase in bank indebtedness of \$136.7 million. Long-term debt issued in the first half of the fiscal year of \$198.4 million was basically used to repay long-term debt that was scheduled for maturity amounting to \$213.5 million.

Subsequent to the end of the second quarter, Sobeys extended the term of its in place \$300 million revolving bank line to five years and also lowered the effective borrowing rate.

The Company's share capital was comprised of the following on November 5, 2005:

<b>Authorized</b>	<b>Number of Shares</b>
Preferred shares, Series 2, par value of \$25 each, issuable in series as a class.	994,846,000
Non-Voting Class A shares, without par value	259,174,746
Class B common shares, without par value, voting	40,800,000
<hr/>	
<b>Issued</b>	
Preferred shares, Series 2	331,900
Non-Voting Class A	31,175,047
Class B common	34,560,763

The Company anticipates that its capital resources and liquidity position will meet its capital and liquidity requirements over the next year, including capital expenditures, dividends and planned debt reduction.

On July 26, 2005, Empire filed a Notice of Intention to make a Normal Course Issuer Bid with the Toronto Stock Exchange to purchase for cancellation up to 623,011 shares representing approximately 2.0 percent of the issued and outstanding shares. The board of directors and management of Empire believe that the repurchase of its shares at recent prevailing market prices is a worthwhile investment and in the best interests of the Company. Subsequent to this filing, Empire has repurchased for cancellation 20,254 Class A Non-Voting shares. The Normal Course Issuer Bid expires on July 27, 2006.

As of December 7, 2005 the Company had total Class A Non-Voting plus Class B common shares outstanding of 65,735,810.

## Accounting Policy Changes

### AcG-15, Consolidation of Variable Interest Entities

Effective for the fourth quarter ended May 7, 2005, the Company was required to implement AcG-15 issued by the CICA. AcG-15 requires the Company to consolidate certain entities that are deemed to be subject to control of the Company on a basis other than through ownership of a voting interest in the entity.

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 VIEs expected losses and its expected residual returns.

The Company has implemented AcG-15 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 for the second quarter of fiscal 2006.

The Company has identified the following entities as VIEs:

### **Franchises**

The Company has identified 289 (May 7, 2005 – 287) franchises 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.

### **Warehouse and Distribution Agreement**

The Company has an agreement with an independent entity to provide warehouse and distribution services for one of the Company's distribution facilities. 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 independent franchisees and the entity providing warehouse and distribution services effective for the quarter ended May 7, 2005.

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 franchisees were eliminated upon consolidation. Cash, inventories, fixed assets, accounts payable and debt financing the fixed assets has been consolidated.

A charge of \$9.5 million has been recorded to opening retained earnings in the fourth quarter of fiscal 2005 (net of minority interest of \$5.0 million), to reflect:

1. The reduction of inventory values of the franchisees that include charges from the Company for distribution costs and vendor allowances that are not recognized by the Company until final sale to customers,
2. Goodwill that is carried on the accounts of stores determined to be VIE's 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 VIE's. Minority interest represents the equity in the VIEs held by the common shareholder.

Balance Sheet as at November 5, 2005

(\$ in millions)

	Consolidated Balance Sheet as at November 5, 2005 before AcG-15 Impact	Impact of the Implementation of AcG-15	Consolidated Balance Sheet as at November 5, 2005 after AcG-15 Impact
<b>ASSETS</b>			
Current			
Cash and cash equivalents	\$ 159.7	\$ 38.7	\$ 198.4
Receivables	331.0	(24.0)	307.0
Income taxes receivable	13.9	0.6	14.5
Inventories	605.4	123.3	728.7
Prepaid expenses	54.6	7.4	62.0
	1,164.6	146.0	1,310.6
Investments, at cost (quoted market value \$391.6)	350.0	-	350.0
Investments, at equity (realizable value \$125.2)	49.1	-	49.1
Current assets and marketable investments	1,563.7	146.0	1,709.7
Property and equipment	2,510.6	34.8	2,545.4
Assets for realization	23.5	-	23.5
Other Assets	321.6	(100.0)	221.6
Goodwill	718.7	-	718.7
	<u>\$ 5,138.1</u>	<u>\$ 80.8</u>	<u>\$ 5,218.9</u>
<b>LIABILITIES</b>			
Current			
Bank indebtedness	\$ 356.1	\$ -	\$ 356.1
Accounts payable and accrued liabilities	1,122.2	40.6	1,162.8
Future income taxes	52.8	-	52.8
Long-term debt due within one year	72.9	1.8	74.7
	1,604.0	42.4	1,646.4
Long-term debt	880.7	15.5	896.2
Long-term lease obligation	13.3	-	13.3
Deferred revenue	0.9	-	0.9
Employee future benefit obligation	99.0	-	99.0
Future income taxes	157.8	-	157.8
Minority interest	559.1	37.4	596.5
	<u>3,314.8</u>	<u>95.3</u>	<u>3,410.1</u>
<b>SHAREHOLDERS' EQUITY</b>			
Capital stock	195.0	-	195.0
Retained earnings	1,629.6	(14.5)	1,615.1
Cumulative translation adjustment	(1.3)	-	(1.3)
	<u>1,823.3</u>	<u>(14.5)</u>	<u>1,808.8</u>
	<u>\$ 5,138.1</u>	<u>\$ 80.8</u>	<u>\$ 5,218.9</u>

Income Statement for the 26 weeks ended November 5, 2005  
(\$ in millions)

	Consolidated Income Statement as at November 5, 2005 before AcG-15 Impact	Impact of the Implementation of AcG-15	Consolidated Income Statement as at November 5, 2005 after AcG-15 Impact
Revenue	\$ 6,336.0	\$ 311.3	\$ 6,647.3
Operating Expenses			
Cost of sales, selling and administrative expenses	6,009.5	303.4	6,312.9
Depreciation and amortization	106.2	2.7	108.9
	<u>220.3</u>	<u>5.2</u>	<u>225.5</u>
Investment income	16.7	-	16.7
Operating Income	<u>237.0</u>	<u>5.2</u>	<u>242.2</u>
Interest expense			
Long-term debt	38.6	0.7	39.3
Short-term debt	3.8	-	3.8
	<u>42.4</u>	<u>0.7</u>	<u>43.1</u>
	194.6	4.5	199.1
Capital gain and other items	27.4	-	27.4
Earning before income taxes and minority interests	222.0	4.5	226.5
Income taxes	68.8	0.6	69.4
Earnings before minority interest	153.2	3.9	157.1
Minority interest	30.1	4.6	34.7
Net earnings	<u>\$ 123.1</u>	<u>\$ (0.7)</u>	<u>\$ 122.4</u>
Earnings per share, basic and diluted	<u>\$ 1.87</u>	<u>\$ (0.01)</u>	<u>\$ 1.86</u>
Basic and diluted weighted average number of common shares outstanding, in millions	65.7		65.7

The impact of implementation of AcG-15 the on consolidated income statement of the Company can be explained as follows: Franchise retail sales are recorded and sales from the Company's warehouse and cost of the costs sold to the franchisee have been eliminated. The impact on all other financial statement line items including net earnings is immaterial.

## 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 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 has adopted this guideline retroactively with restatement.

During fiscal 2005, the Company reviewed its practices related to lease accounting and determined that adjustments were required to align to the recent clarification of lease accounting guidelines. The first adjustment related 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 related 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 period 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 related 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 with the following net impact on the comparative statements for the period ended November 5, 2005:

- As at October 30, 2004 a reduction to retained earnings of \$5.4 million.
- A reduction in net income for the 26 week period ended October 30, 2005 of \$0.1 million from \$84.3 million to \$84.2 million, and a nil reduction in earnings per share.
- As at October 30, 2004 an increase to Capital Assets, Future Taxes, Long-Term Debt and Other Long-term Liabilities of \$9.6 million, \$4.7 million, \$10.3 million and \$12.4 million, respectively, and a decrease in minority interest of \$3.0 million.

These lease accounting adjustments did not have any material impact on the Company’s first half fiscal 2006 net earnings, historical or future revenues, cash flows or lease payments.

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

In January 2004, the 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 provides 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, therefore, be characterized as a reduction in cost of sales and related inventory when recognized in the customer’s income statement and balance sheet. If the consideration is a payment for assets or services delivered to the vendor, the cash consideration should be characterized as revenue or other income. If it is a reimbursement of costs incurred to sell the vendor’s products, the cash consideration should be characterized as a reduction of that cost, 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 the prior fiscal year, adjusting for it retroactively, with restatement of the comparative periods for the current and prior fiscal year.

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 income tax effect of \$3.4 million and 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 first half net earnings for the current or prior fiscal year.

In January 2005 the CICA issued an amendment to EIC-144 that required disclosure in all financial statements of the amount of any vendor rebate that has been recognized in income but for which the full requirements for entitlement have not yet been met. These amounts are permitted by EIC-144 to be recognized in income when it is probable that the requirement will be met, and the amount of rebate is estimable. During the first quarter of 2006, the Company adopted the disclosure as required by the amendment to EIC-144. During the first half of fiscal 2006, the Company recognized \$3.0 million of allowances in income where minimum purchase levels had not yet been met.

## **Critical Accounting Estimates**

Critical accounting estimates used by the Company's management are discussed in detail in the "Management's Discussion and Analysis" section of the 2005 Annual Report on pages 50 and 51.

## **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 November 5, 2005 that these controls and procedures operated effectively.

## **Contingencies**

On June 21, 2005, Lumsden Brothers Limited ("Lumsden"), a wholesaling subsidiary of Sobeys, received a notice of reassessment from CRA related to Goods and Services Tax ("GST") for fiscal years 1999 and 2000. The reassessment relates to GST on sales of tobacco products to status Indians. CRA asserts that Lumsden was obliged to collect GST on the sales of these tobacco products to status Indians. The total tax, interest and penalties in the reassessment are approximately \$13.6 million.

Lumsden has reviewed this matter, has received legal advice, and believes it was not required to collect GST. Lumsden is challenging this reassessment. Accordingly, Sobeys has not recorded in its income statement any of the tax, interest or penalties set-out in the notice of reassessment, however Sobeys has deposited with CRA the funds to cover the total tax, interest and penalties in the reassessment and has recorded this amount as a receivable from CRA pending resolution of this matter. During the second quarter of fiscal 2006, Sobeys filed a notice of objection with CRA.

## Risk Management

Risk and uncertainties related to economic and industry factors and Empire's management of this risk, are discussed in detail in the "Management's Discussion and Analysis" section of the Company's fiscal 2005 annual report on pages 53 to 55.

## 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 plus 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 expense.
- Interest coverage is calculated as operating income divided by interest expense.
- Net asset value is management's estimate of the market value of the Company's assets less liabilities.
- 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.
- 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.

The following table reconciles the Food division's EBITDA and EBITDAR to GAAP measures as reported in Sobeys' unaudited interim consolidated statement of earnings for the periods ended November 5, 2005 and October 30, 2004, respectively:

(\$ in millions)	13 Weeks Ended		26 Weeks Ended	
	November 5, 2005	October 30, 2004	November 5, 2005	October 30, 2004
EBIT	\$ 84.1	\$ 81.2	\$ 167.8	\$ 161.8
Depreciation	48.1	42.4	93.9	84.5
Amortization of intangibles	0.6	0.3	1.2	0.5
EBITDA	\$ 132.8	\$ 123.9	\$ 262.9	\$ 246.8
Gross Rent	86.1	68.4	167.2	135.6
EBITDAR	\$ 218.9	\$ 192.3	\$ 430.1	\$ 382.4

The following table reconciles Empire's funded debt and total capital to GAAP measures reported in the unaudited interim period balance sheets as at November 5, 2005, May 7, 2005 and October 30, 2004, respectively:

(\$ in millions)	November 5, 2005	May 7, 2005	October 30, 2004
Bank indebtedness	\$ 356.1	\$ 219.4	\$ 168.2
Long-term debt due within one year	74.7	247.0	234.5
Long-term debt	896.2	727.4	724.2
Long-term lease obligation	13.3	12.3	12.4
Funded Debt	1,340.3	1,206.1	1,139.3
Total Shareholders Equity	1,808.8	1,709.0	1,634.6
<b>Total Capital</b>	<b>\$ 3,149.1</b>	<b>\$ 2,915.1</b>	<b>\$ 2,773.9</b>

Additional financial information relating to Empire, including the Company's Annual Information Form, can be found on the Company's web site or on the SEDAR web site for Canadian regulatory filings at [www.sedar.com](http://www.sedar.com).

Dated: December 14, 2005  
Stellarton, Nova Scotia, Canada

## INVESTOR INFORMATION

### EMPIRE COMPANY LIMITED

Head Office:  
115 King St.  
Stellarton, Nova Scotia  
B0K 1S0  
Telephone: (902) 755-4440  
Fax: (902) 755-6477  
Internet: [www.empireco.ca](http://www.empireco.ca)

### INVESTOR RELATIONS AND INQUIRIES

Shareholders, analysts, and investors should direct their financial inquiries or requests to:  
Stewart H. Mahoney, CFA  
Vice President, Treasury and Investor Relations  
E-mail: [investor.relations@empireco.ca](mailto:investor.relations@empireco.ca)

Communications regarding investor records, including changes of address or ownership, lost certificates or tax forms, should be directed to the Company's transfer agent and registrar, CIBC Mellon Trust Company.

### AFFILIATED COMPANY WEB ADDRESSES

[www.sobeys.com](http://www.sobeys.com)  
[www.empiretheatres.com](http://www.empiretheatres.com)  
[www.crombieproperties.com](http://www.crombieproperties.com)

### STOCK EXCHANGE LISTING

The Toronto Stock Exchange

### STOCK SYMBOLS

Non-Voting Class A shares – EMP.NV.A  
Preferred shares: Series 2 – EMP.PR.B

### AVERAGE DAILY TRADING VOLUME (TSX)

27,500

### COMMON DIVIDEND RECORD AND PAYMENT DATES FOR FISCAL 2006

Record Date	Payment Date
July 15, 2005	July 29, 2005
October 14, 2005	October 28, 2005
January 13, 2006	January 31, 2006
April 14, 2006	April 28, 2006

### OUTSTANDING SHARES

As of November 5, 2005

Non-Voting Class A Shares	31,175,047
Options exercisable with non-voting Class A shares	27,674
Class B common shares, voting	34,560,763

### TRANSFER AGENT

CIBC Mellon Trust Company  
Investor Correspondence  
P.O. Box 7010  
Adelaide Street Postal Station  
Toronto, Ontario  
M5C 2W9  
Telephone: (800) 387-0825  
Email: [enquires@cibcmellon.com](mailto:enquires@cibcmellon.com)

### BANKERS

Bank of Montreal  
Bank of Nova Scotia  
Canadian Imperial Bank of Commerce  
National Bank of Canada  
Royal Bank of Canada  
TD Canada Trust

### SOLICITORS

Stewart McKelvey Stirling Scales  
Halifax, Nova Scotia

### AUDITORS

Grant Thornton, LLP  
New Glasgow, NS

### MULTIPLE MAILINGS

If you have more than one account, you may receive a separate mailing for each. If this occurs, please contact CIBC Mellon Trust Company at (800) 387-0825 to eliminate the multiple mailings.