

Notes to the Consolidated Financial Statements

May 7, 2005 (in millions except share capital and per share data)

1. Summary of Significant Accounting Policies

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (GAAP).

Principles of Consolidation

These consolidated financial statements include the accounts of the Company and all subsidiary companies and entities considered variable interest entities. Investments in which the Company has significant influence are accounted for by the equity method. Investments in significant joint ventures are consolidated on a proportionate basis.

Changes in Accounting Policies

(a) Generally accepted accounting principles

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

Depreciation

The sinking fund method was used to record depreciation of the real estate buildings, calculated as an amount which, compounded annually at the rate of 5%, would have fully amortized the cost of the buildings over their estimated useful lives ranging from 20 to 40 years. Effective May 1, 2004 the straight-line method is now used to record depreciation of the real estate buildings. Depreciation is determined with reference to each rental property's book value, its estimated useful life (not greater than 40 years) and its residual value. Adoption of the straight-line method has resulted in additional depreciation of \$1.2 during the current fiscal year.

Real Estate Leases

Rental expense was recognized in accordance with the lease agreements with landlords. Effective May 1, 2004 the Company has changed its policy to record real

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

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 20).

(b) Asset Retirement Obligations

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

(c) Hedging

Accounting Guideline (AcG) 13, "Hedging relationships", came into effect during the current fiscal year. This guideline addresses the identification, designation, documentation and effectiveness of hedging relationships for the purpose of applying hedge

accounting and provides guidance with respect to the discontinuance of hedge accounting. There was no effect on the Company of adopting this guideline. Pursuant to the requirements of AcG-13, the Company has formally identified and documented loans denominated in U.S. dollars as hedges for a portion of its U.S. investments.

(d) Vendor Allowances

In January 2004, the CICA's Emerging Issues Committee (EIC) issued a new accounting standard, EIC-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 the second quarter, adjusting for it retroactively, with restatement of the comparative periods for the current and prior fiscal year (see Note 21).

(e) Variable Interest Entities (VIEs)

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 22).

Cash and Cash Equivalents

Cash and cash equivalents are defined as cash, treasury bills and guaranteed investments with a maturity less than 90 days.

Inventories

Warehouse inventories are valued at the lower 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.

Portfolio Investments

Portfolio investments are accounted for under the cost method. Investment income is recognized on an accrual basis. Portfolio investments are written down when the inherent loss is determined to be other than temporary. Gains and losses on sale of investments are recorded in earnings as realized.

Depreciation and Amortization

Depreciation on real estate buildings is calculated using the straight-line method with reference to each property's book value, its estimated useful life (not exceeding 40 years) and its residual value. Deferred leasing costs are amortized over the terms of the related leases.

Depreciation of other property and equipment is recorded on a straight-line basis over the estimated useful lives of the assets as follows:

| | |
|------------------------|---------------|
| Equipment | 3 – 20 years |
| Buildings | 10 – 40 years |
| Leasehold improvements | 7 – 10 years |

Capitalization of Costs

(a) Construction Projects

Certain subsidiary companies and joint ventures capitalize interest during the construction period until the project opening date. The amount of interest capitalized to construction in progress in the current year was \$0.1 (2004 – \$0.6).

(b) Commercial Properties

Certain subsidiaries and joint ventures capitalize the direct carrying and operating costs applicable to the unleased areas of each new project for a reasonable period from the project opening date until a certain level of occupancy is reached. No amounts were capitalized in fiscal 2004 or 2005.

(c) Development Properties and Land Held for Future Development

A subsidiary company capitalizes interest and real estate taxes to the extent that they relate to properties for immediate development. The carrying costs on the balance of development properties are expensed as incurred. The amount of real estate taxes capitalized in the current year was \$0.1 (2004 – \$0.1).

Notes to the Consolidated Financial Statements

Long-lived Assets

Effective May 1, 2003, the Company adopted two new CICA Handbook sections prospectively. Section 3063, "Impairment of long-lived assets", provides guidance with regard to the measurement, recognition and disclosure of the impairment of long-lived assets. There was no impact of the application of Section 3063 on the financial statements. Section 3475, "Disposal of long-lived assets and discontinued operations", provides guidance with regard to the identification, measurement and disclosure of any long-lived assets not held for use and discontinued operations.

Leases

Leases meeting certain criteria are accounted for as capital leases. The imputed interest is charged against income and the capitalized value is depreciated on a straight-line basis over the lesser of the lease term and its estimated useful life. Obligations under capital leases are reduced by rental payments net of imputed interest. All other leases are accounted for as operating leases.

Goodwill

Goodwill represents the excess of the purchase price of the business acquired over the fair value of the underlying net tangible and intangible assets acquired at the date of acquisition.

Goodwill and intangible assets with indefinite useful lives are subject to an annual impairment review. Any permanent impairment in the book value of goodwill or intangible assets (i.e. trademarks) will be written off against earnings. The Company has completed its review and has determined the book value of existing goodwill is not impaired.

Intangibles

Intangibles arise on the purchase of new businesses, existing franchises and the acquisition of pharmacy prescription files. Amortization is on a straight-line basis over 10-15 years.

Deferred Costs

Deferred costs consist of deferred store marketing, deferred financing, transitional pension assets and deferred purchase agreements.

Deferred costs are amortized as follows:

- Deferred store marketing – 7 years
- Deferred financing – over the term of the debt
- Deferred purchase agreements – over the term of the franchise agreement

Assets for Realization

Certain land and buildings have been listed for sale and reclassified as "Assets for realization" in accordance with CICA Handbook Section 3475. These assets are expected to be sold within a twelve month period, are no longer productive assets and there is no longer an intent to develop for future use. Assets for realization are valued at the lower of cost and fair value less cost of disposal.

Store Opening Expenses

Opening expenses of new stores and store conversions are written off during the first year of operation.

Stock-based Compensation Plans

At the beginning of fiscal 2003, the Company adopted, on a prospective basis, the CICA Handbook Section 3870, "Stock-based compensation and other stock-based payments". In fiscal 2004, the Company adopted EIC Abstract 132, "Share purchase financing". This abstract requires share purchase loans that are not treated as assets on the balance sheet to be accounted for as stock-based compensation. There was no effect on the Company upon implementation of this section and abstract.

The Company's stock option plan and share purchase plan are described in Note 8.

Future Income Taxes

The Company accounts for income taxes under the liability method. The difference between the tax basis of assets and liabilities and their carrying value on the balance sheet is used to calculate future tax assets and liabilities. The future tax assets and liabilities have been measured using the substantively enacted tax rates that will be in effect when the differences are expected to reverse.

Deferred Revenue

Deferred revenue consists of long-term supplier purchase agreements and rental revenue arising from the sale of subsidiaries. Deferred revenue is being taken into income over the term of the related agreements.

Foreign Currency Translation

Assets and liabilities of self-sustaining foreign investments are translated at exchange rates in effect at the balance sheet date. The revenues and expenses are translated at average exchange rates for the year. Cumulative gains and losses on translation are shown as a separate component of shareholders' equity.

Other assets and liabilities are translated at the currency exchange rate in effect at the balance sheet date. These exchange gains or losses are recognized in operating income. Revenues and expenses denominated in foreign currencies are translated into Canadian dollars at the average currency exchange rate for the period.

Revenue Recognition

Food distribution sales are recognized at the point-of-sale. Sales include revenue from customers through corporate stores operated by the Company, consolidated VIE's and revenue from sales to franchised stores, affiliated stores and independent accounts. Revenue received from franchise stores, associated 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 as described above.

Financial Instruments

The Company uses interest rate instruments to manage exposure to fluctuations in interest rates. The realized gain or loss arising from these instruments is included in interest expense.

The Company also uses derivative financial instruments to partially hedge its exposure to foreign exchange in its U.S. dollar denominated investment portfolio. These instruments are accounted for as hedges of anticipated transactions and accordingly, gains and losses on these instruments are included in measurement of the related hedged risk when realized.

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 supplementary executive retirement plan, the impact of changes in the plan provisions are amortized over 5 years.

Use of Estimates

The preparation of 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.

Earnings Per Share

Earnings per share is calculated by dividing the earnings available to common shareholders by the weighted average number of common shares outstanding during the year. Diluted earnings per share is calculated using the treasury stock method.

2. Cash and Cash Equivalents

Included in cash and cash equivalents is restricted cash of \$7.5 (2004 – \$30.4) relating to the sale of assets.

Notes to the Consolidated Financial Statements

3. Earnings Per Share

Earnings per share amounts are calculated on the weighted average number of shares outstanding (2005 – 65,750,928 shares; 2004 – 65,772,518 shares) after providing for preferred share dividends accrued to the balance sheet date. Diluted earnings per share have been calculated on the assumption that all the outstanding stock options were exercised and share purchase loans were repaid at the beginning of the year. There is no effect as a result of this calculation.

Earnings applicable to common shares is comprised of the following:

| | 2005 (53 Weeks) | 2004 (52 Weeks) <i>Restated (Note 1)</i> |
|--|--------------------|--|
| Operating earnings | \$ 182.9 | \$ 163.3 |
| Capital gain and other items, net of tax of \$0.7 (2004 – \$2.4) | 3.7 | 9.2 |
| Net earnings | 186.6 | 172.5 |
| Preferred share dividends | (0.3) | (0.4) |
| Earnings applicable to common shares | \$ 186.3 | \$ 172.1 |
| Earnings per share is comprised of the following: | | |
| Operating earnings | \$ 2.78 | \$ 2.48 |
| Capital gain and other items | 0.05 | 0.14 |
| Basic earnings per share | \$ 2.83 | \$ 2.62 |
| Diluted earnings per share | \$ 2.83 | \$ 2.62 |

4. Property and Equipment

| | May 7, 2005 | | |
|----------------------------------|-------------|-----------------------------|-------------------|
| | Cost | Accumulated Depreciation | Net Book Value |
| Real estate segment | | | |
| Land | \$ 147.1 | \$ – | \$ 147.1 |
| Land held for future development | 9.1 | – | 9.1 |
| Buildings | 915.0 | 174.3 | 740.7 |
| | 1,071.2 | 174.3 | 896.9 |
| Food division and other segments | | | |
| Land | 95.2 | – | 95.2 |
| Land held for future development | 85.4 | – | 85.4 |
| Buildings | 615.7 | 125.5 | 490.2 |
| Equipment | 1,714.2 | 1,016.2 | 698.0 |
| Leasehold improvements | 328.3 | 198.2 | 130.1 |
| Oil and gas exploration costs | 10.7 | 0.8 | 9.9 |
| Assets under capital leases | 35.8 | 11.7 | 24.1 |
| | 2,885.3 | 1,352.4 | 1,532.9 |
| Total | \$ 3,956.5 | \$ 1,526.7 | \$ 2,429.8 |

| | | April 30, 2004 <i>Restated (Note 1)</i> | |
|---|-------------------|--|-------------------|
| | Cost | Accumulated Depreciation | Net Book Value |
| Real estate segment | | | |
| Land | \$ 144.4 | \$ – | \$ 144.4 |
| Land held for future development | 11.7 | – | 11.7 |
| Buildings | 887.7 | 161.7 | 726.0 |
| | 1,043.8 | 161.7 | 882.1 |
| Food division and other segments | | | |
| Land | 72.8 | – | 72.8 |
| Land held for future development | 81.4 | – | 81.4 |
| Buildings | 573.0 | 107.4 | 465.6 |
| Equipment | 1,619.4 | 960.4 | 659.0 |
| Leasehold improvements | 293.4 | 174.0 | 119.4 |
| Oil and gas exploration costs | 0.6 | – | 0.6 |
| Assets under capital leases | 23.9 | 6.6 | 17.3 |
| | 2,664.5 | 1,248.4 | 1,416.1 |
| Total | \$ 3,708.3 | \$ 1,410.1 | \$ 2,298.2 |

5. Other Assets

| | May 7, 2005 | April 30, 2004 <i>Restated (Note 1)</i> |
|--|-----------------|--|
| Loans and mortgages | | |
| receivable | \$ 41.7 | \$ 147.8 |
| Deferred costs | 149.6 | 144.0 |
| Intangibles (less accumulated amortization of \$2.4 2004 – \$0.5) | | |
| | 21.6 | 13.1 |
| | \$ 212.9 | \$ 304.9 |

Loans Receivable

Loans receivable represent long-term financing to certain retail associates. These loans are primarily secured by inventory, fixtures and equipment, bear various interest rates and have repayment terms up to ten years. The carrying amount of the loans receivable approximates fair value based on the variable interest rates charged on the loans and the operating relationship of the associates with the Company. Loans receivable decreased by \$108.8 as a result of the consolidation of VIE's (see Note 22).

The loans and mortgages receivable are net of current portions of \$15.5 (2004 – \$15.4).

6. Bank Indebtedness

As security for certain bank loans the Company has provided an assignment of certain marketable securities and, in certain divisions and subsidiaries, general assignments of receivables and leases, first floating charge debentures on assets and the assignment of proceeds of fire insurance policies.

Under the terms of a credit agreement entered into between the Company and a banking syndicate, a revolving term credit facility of \$300.0 was established. This 364-day revolving unsecured facility will expire on June 22, 2006. Various provisions of the agreement provide the Company with the ability to extend the facility for a minimum period of two years. Interest is payable on this facility at rates which fluctuate with changes in the prime rate.

In the ordinary course of managing its debt the Company uses various financial instruments, which are not reflected on the balance sheet, to reduce or eliminate exposure to interest rate and foreign currency risks. Interest rate swaps, caps, collars and forward contracts are used to hedge or reduce the exposure to floating interest rates and foreign currency fluctuations associated with short-term obligations. At May 7, 2005 the Company had no such instruments in place for short-term obligations.

Notes to the Consolidated Financial Statements

7. Long-term Debt

| | May 7, 2005 | | | April 30, 2004 <i>Restated (Note 1)</i> |
|---|---------------------------|---------------------------------|-----------------|--|
| | Real Estate Segment | Food Distribution Segment | Total | Total |
| First mortgage loans, average interest rate 9.1%, due 2005 – 2026 | \$ 401.1 | \$ 23.9 | \$ 425.0 | \$ 443.6 |
| Bank loans, average interest rate 6.4%, due September 30, 2004 | – | – | – | 20.0 |
| Medium term note, interest rate 7.6%, due November 1, 2005 | – | 175.0 | 175.0 | 175.0 |
| Medium term note, interest rate 7.2%, due February 26, 2018 | – | 100.0 | 100.0 | 100.0 |
| Debentures, average interest rate 10.6%, due 2005 – 2016 | 69.9 | 68.2 | 138.1 | 147.6 |
| Notes payable and other debt at interest rates fluctuating with the prime rate | 45.2 | 67.5 | 112.7 | 85.1 |
| | 516.2 | 434.6 | 950.8 | 971.3 |
| Construction loans at interest rates fluctuating with the prime rate | 0.4 | – | 0.4 | 1.5 |
| Capital lease obligations, due 2005 – 2011, net of imputed interest | – | 23.2 | 23.2 | 22.9 |
| | 516.6 | 457.8 | 974.4 | 995.7 |
| Less amount due within one year | 52.1 | 194.9 | 247.0 | 82.7 |
| | \$ 464.5 | \$ 262.9 | \$ 727.4 | \$ 913.0 |

The Company has fixed the interest rate on \$16.0 of its long-term debt at 4.2 percent by utilizing an interest exchange agreement. Through a bond forward the Company has locked in the rate on the underlying Government of Canada 15 year yield for refinancing \$100.0 of the Medium term note due November 1, 2005.

Long-term debt is secured by land and buildings, specific charges on certain assets and additional security as described in Note 6.

During fiscal 2001 the Company negotiated a new unsecured \$550.0 credit facility consisting of \$250.0 of non-revolving debt to be repaid over five years, plus a \$300.0 revolving line of credit. The balance of \$250.0 of the non-revolving debt was retired on September 30, 2004.

Debt retirement payments and capital lease obligations in each of the next five fiscal years are:

| | Long-term Debt | Capital Leases |
|------|----------------|----------------|
| 2006 | \$ 242.0 | \$ 5.0 |
| 2007 | \$ 38.9 | \$ 3.7 |
| 2008 | \$ 73.8 | \$ 3.3 |
| 2009 | \$ 75.4 | \$ 2.9 |
| 2010 | \$ 41.0 | \$ 2.1 |

Operating Leases

The net aggregate, annual, minimum rent payable under operating leases for fiscal 2006 is approximately \$129.3 (\$205.3 gross less expected sub-lease income of \$76.0).

The commitments over the next five fiscal years are:

| | Net Lease Obligation | Gross Lease Obligation |
|------|-------------------------|---------------------------|
| 2006 | \$ 129.3 | \$ 205.3 |
| 2007 | \$ 115.1 | \$ 186.7 |
| 2008 | \$ 99.1 | \$ 163.3 |
| 2009 | \$ 88.0 | \$ 146.5 |
| 2010 | \$ 80.6 | \$ 132.6 |

8. Capital Stock

| | Number of Shares | | | |
|--|-------------------------|--------------------|-------------------------|-----------------------|
| Authorized: | | | | |
| Preferred shares, par value of \$25 each, issuable in series as a class. | | | | |
| Series 2 cumulative, redeemable, rate of 75% of prime | | | | 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 |
| | | May 7, 2005 | | April 30, 2004 |
| | Number of Shares | | Number of Shares | |
| Issued and outstanding: | | | | |
| Preferred shares, Series 2 cumulative, redeemable, rate of 75% of prime | 331,900 | \$ 8.3 | 431,900 | \$ 10.8 |
| Non-Voting Class A | 31,150,585 | 183.0 | 30,869,585 | 182.5 |
| Class B common | 34,585,225 | 7.7 | 34,885,225 | 7.7 |
| | | | 199.0 | 201.0 |
| Loans receivable from officers and employees under share purchase plan | | (4.4) | | (4.3) |
| | | \$ 194.6 | | \$ 196.7 |

During the year the Company purchased for cancellation 100,000 Series 2 preferred shares for \$2.5.

During the year, under a normal course issuer bid which expires on July 11, 2005, the Company purchased for cancellation 61,129 (2004 – 68,477) Non-Voting Class A shares. The purchase price was \$1.6 of which \$1.2 of the purchase price (representing the premium on common shares purchased for cancellation) was charged to retained earnings.

During the year 9,400 (2004 – 30,000) options were exercised resulting in 9,400 (2004 – 30,000) Non-Voting Class A shares being issued for \$0.1 (2004 – \$0.2). Options allow holders to purchase Non-Voting Class A shares at \$6.555 per share. Options expire in October 2006. There were 27,674 options outstanding at May 7, 2005.

During the year 32,729 (2004 – 34,429) Non-Voting Class A shares were issued under the Company's share purchase plan to certain officers and employees for \$0.8 (2004 – \$0.9), which was based on the average

trading price of the Non-Voting Class A shares on the Toronto Stock Exchange for the five previous trading days.

Loans receivable from officers and employees of \$4.4 (2004 – \$4.3) under the Company's share purchase plan are classified as a reduction of Shareholders' Equity. Loan repayments will result in a corresponding increase in Share Capital. The loans are non-interest bearing and non-recourse, secured by 245,030 (2004 – 255,597) Non-Voting Class A shares. Market value of the shares at May 7, 2005 was \$9.0 (2004 – \$6.8).

Under certain circumstances, where an offer (as defined in the share conditions) is made to purchase Class B common shares, the holders of the Non-Voting Class A shares shall be entitled to receive a follow-up offer at the highest price per share paid, pursuant to such offer to purchase Class B common shares.

During the year 300,000 Class B common shares were exchanged for 300,000 Non-Voting Class A shares.

Notes to the Consolidated Financial Statements

9. Investment Income

| | 2005 (53 Weeks) | 2004 (52 Weeks) |
|---|--------------------|--------------------|
| Dividend and interest income | \$ 9.0 | \$ 10.7 |
| Share of income of companies accounted for by the equity method | 12.0 | 5.1 |
| | <u>\$ 21.0</u> | <u>\$ 15.8</u> |

10. Capital Gain and Other Items

| | 2005 (53 Weeks) | 2004 (52 Weeks) |
|-----------------------------|--------------------|--------------------|
| Gain on sale of investments | \$ 2.9 | \$ 11.7 |
| Other items | 1.5 | (0.1) |
| | <u>\$ 4.4</u> | <u>\$ 11.6</u> |

11. Income Taxes

Income tax expense varies from the amount that would be computed by applying the combined federal and provincial statutory tax rate as a result of the following:

| | 2005 (53 Weeks) | 2004 (52 Weeks) <i>Restated (Note 1)</i> |
|---|--------------------|--|
| Income tax expense according to combined statutory rate of 35.3% (2004 – 34.7%) | \$ 133.1 | \$ 114.6 |
| Increase (decrease) in income taxes resulting from | | |
| Adjustment to future tax assets and liabilities for substantially enacted changes in tax laws | – | (3.8) |
| Non-taxable gains | – | (1.4) |
| Non-taxable dividends and equity earnings | (5.5) | (4.1) |
| Large corporation tax | 2.9 | 3.3 |
| | <u>130.5</u> | <u>108.6</u> |
| Capital gain and other items | 0.7 | 2.4 |
| | <u>\$ 131.2</u> | <u>\$ 111.0</u> |

May 7, 2005 income tax expense attributable to net income consists of:

| | Current | Future | Total |
|------------------------------|----------------|----------------|-----------------|
| Operations | \$ 97.8 | \$ 32.7 | \$ 130.5 |
| Capital gain and other items | 1.7 | (1.0) | 0.7 |
| | <u>\$ 99.5</u> | <u>\$ 31.7</u> | <u>\$ 131.2</u> |

April 30, 2004 income tax expense attributable to net income consists of:

| | Current | Future <i>Restated (Note 1)</i> | Total <i>Restated (Note 1)</i> |
|------------------------------|----------------|------------------------------------|-----------------------------------|
| Operations | \$ 85.0 | \$ 23.6 | \$ 108.6 |
| Capital gain and other items | 8.4 | (6.0) | 2.4 |
| | <u>\$ 93.4</u> | <u>\$ 17.6</u> | <u>\$ 111.0</u> |

The tax effect of temporary differences that give rise to significant portions of future income taxes are presented below:

| | May 7, 2005 | April 30, 2004 <i>Restated (Note 1)</i> |
|------------------------------------|-----------------|--|
| Property and equipment | \$ 112.7 | \$ 90.5 |
| Investments | 36.0 | 35.4 |
| Future employee benefit obligation | (32.2) | (31.0) |
| Restructuring provisions | (5.3) | (1.5) |
| Pension contributions | 16.0 | 16.2 |
| Deferred cost | 23.7 | 18.8 |
| Deferred credits | 57.7 | 47.8 |
| Goodwill | 6.0 | 6.3 |
| Other | (3.4) | (3.0) |
| | <u>\$ 211.2</u> | <u>\$ 179.5</u> |
| Future income taxes – current | \$ 52.4 | \$ 46.3 |
| Future income taxes – non-current | 158.8 | 133.2 |
| | <u>\$ 211.2</u> | <u>\$ 179.5</u> |

12. Supplementary Cash Flow Information

| | 2005 <i>(53 Weeks)</i> | 2004 <i>(52 Weeks)</i> <i>Restated (Note 1)</i> |
|--|---------------------------|---|
| a) Items not affecting cash | | |
| Depreciation and amortization | \$ 201.5 | \$ 173.7 |
| Future income taxes | 31.7 | 17.6 |
| Amortization of deferred costs | 34.0 | 25.5 |
| Equity in earnings of other companies, net of dividends received | (8.4) | (4.8) |
| Minority interest | 53.1 | 48.3 |
| Employee future benefit obligation | 4.1 | 12.0 |
| | <u>\$ 316.0</u> | <u>\$ 272.3</u> |
| b) Other information | | |
| Net interest paid | \$ 85.1 | \$ 93.2 |
| Net income taxes paid | \$ 124.7 | \$ 145.6 |

13. Joint Ventures

The financial statements include the Company's proportionate share of the accounts of incorporated and unincorporated joint ventures. A summary of these amounts is as follows:

| | May 7, 2005 | April 30, 2004 |
|----------------------------|---------------------------|---------------------------|
| Assets | \$ 101.6 | \$ 81.4 |
| Liabilities | \$ 41.9 | \$ 55.1 |
| Equity and advances | 59.7 | 26.3 |
| | <u>\$ 101.6</u> | <u>\$ 81.4</u> |
| | 2005 <i>(53 Weeks)</i> | 2004 <i>(52 Weeks)</i> |
| Revenues | \$ 43.2 | \$ 34.4 |
| Expenses | 7.9 | 7.0 |
| Income before income taxes | \$ 35.3 | \$ 27.4 |
| Cash provided (used) | | |
| Operating activities | \$ 36.8 | \$ 23.6 |
| Investing activities | (8.4) | (18.0) |
| Financing activities | (0.1) | (3.6) |
| | <u>\$ 28.3</u> | <u>\$ 2.0</u> |

14. Segmented Information

| | 2005 <i>(53 Weeks)</i> | 2004 <i>(52 Weeks)</i> |
|------------------------|---------------------------|---------------------------|
| Revenue | | |
| Food division | | |
| Sales | \$ 12,189.4 | \$ 11,046.8 |
| Gain on sale of assets | – | 14.6 |
| | <u>12,189.4</u> | <u>11,061.4</u> |
| Real estate | | |
| Commercial | 136.4 | 128.0 |
| Inter-segment | 57.8 | 52.3 |
| Residential | 35.0 | 30.2 |
| | <u>229.2</u> | <u>210.5</u> |
| Other operations | 74.4 | 64.4 |
| | <u>12,493.0</u> | <u>11,336.3</u> |
| Elimination | (57.8) | (52.3) |
| | <u>\$ 12,435.2</u> | <u>\$ 11,284.0</u> |

In fiscal 2004, Sobeys Inc. sold several redundant real estate assets. These assets were not considered strategic for the long-term plans of the Company. The gain realized on the sale of these assets was \$14.6.

Notes to the Consolidated Financial Statements

| | 2005 (53 Weeks) | 2004 (52 Weeks) <i>Restated (Note 1)</i> |
|--------------------|--------------------|--|
| Operating income | | |
| Food | \$ 322.6 | \$ 293.7 |
| Real estate | | |
| Commercial | 89.1 | 85.8 |
| Residential | 33.1 | 25.2 |
| Other operations | 9.5 | 9.8 |
| Investment income | 18.8 | 15.9 |
| Corporate expenses | (9.4) | (7.6) |
| | \$ 463.7 | \$ 422.8 |

| | May 7, 2005 | April 30, 2004 <i>Restated (Note 1)</i> |
|---|-------------------|--|
| Identifiable assets | | |
| Food | | |
| Food distribution | \$ 2,829.0 | \$ 2,620.2 |
| Goodwill | 681.1 | 656.9 |
| | 3,510.1 | 3,277.1 |
| Real estate | 1,017.9 | 990.8 |
| Investments | 325.9 | 324.7 |
| Other (including goodwill of \$3.8; 2004 - \$Nil) | 75.3 | 87.1 |
| | \$ 4,929.2 | \$ 4,679.7 |

| | 2005 (53 Weeks) | 2004 (52 Weeks) <i>Restated (Note 1)</i> |
|-------------------------------|--------------------|--|
| Depreciation and amortization | | |
| Food | \$ 176.4 | \$ 152.7 |
| Real estate | 18.7 | 16.3 |
| Corporate and other | 6.4 | 4.7 |
| | \$ 201.5 | \$ 173.7 |

| | 2005 (53 Weeks) | 2004 (52 Weeks) |
|---------------------|--------------------|--------------------|
| Capital expenditure | | |
| Food | \$ 321.1 | \$ 384.9 |
| Real estate | 33.2 | 34.2 |
| Corporate and other | 17.7 | 11.9 |
| | \$ 372.0 | \$ 431.0 |

The Company operates principally in two business segments: food distribution and real estate. The food distribution segment consists of distribution of food products in Canada. The real estate segment

consists of development and ownership of both commercial and residential properties. Commercial real estate is mainly shopping centres and office buildings in Central and Eastern Canada. Residential real estate is the development of housing lots for resale. Inter-segment transactions are at market values.

15. Financial Instruments

Credit Risk

There is no significant concentration of credit risk. The credit risk exposure is considered normal for the business.

Other Financial Instruments

The book value of cash and cash equivalents, receivables, loans and mortgages, bank indebtedness, accounts payables and accrued liabilities and income taxes payable approximate fair values at May 7, 2005. The fair value of investments is \$483.3.

The total fair value of long-term debt is estimated to be \$1,126.0. The fair value of variable rate debt is assumed to approximate its carrying amount. The fair value of other long-term debt has been estimated by discounting future cash flows at a rate offered for debt of similar maturities and credit quality. The fair value of the bond forward and of the delayed start interest rate swaps is \$(3.6).

Interest Rate Risk

The majority of the Company debt is at fixed rates. Accordingly, there is limited exposure for interest rate risk.

Foreign Currency Risk

Investments include \$152.1 Canadian that is denominated in U.S. funds. Bank indebtedness includes \$87.9 Canadian that is denominated in U.S. funds and it acts as a partial hedge to the foreign exchange fluctuations inherent in the market value of the U.S. investments.

16. Contingent Liabilities

At May 7, 2005 the Company was contingently liable for letters of credit issued in the aggregate amount of \$44.0 (2004 - \$42.0).

The Company has guaranteed certain bank loans contracted by franchisees. As at May 7, 2005 these loans amounted to approximately \$2.4 (2004 - \$5.0).

Upon entering into the lease of its Mississauga distribution centre in March 2000 Sobeys Inc., a subsidiary of the Company, guaranteed to the landlord a performance, by SERCA Foodservice, of all its obligation under the lease. The remaining term of the lease is 15 years with an aggregate obligation of \$46.2. At the time of the sale of assets of SERCA Foodservice to Sysco Corp., the lease of the Mississauga distribution centre was assigned to and assumed by the purchaser, and Sysco Corp. agreed to indemnify and hold Sobeys Inc. harmless from any liability it may incur pursuant to its guarantee.

Sobeys Inc. has received notice from Canada Revenue Agency (CRA) that it is proposing a reassessment related to Goods and Services Tax (GST) for fiscal years 1999 and 2000. The proposed reassessment relates to GST on sales of tobacco products to status Indians. CRA asserts that Sobeys Inc. was obliged to collect GST on the sales of these tobacco products to status Indians. The total tax, interest and penalties in the proposed reassessment are approximately \$13.0. Sobeys Inc. has reviewed this matter, has received legal advice and believes it was not required to collect GST. Sobeys Inc. is challenging this proposed reassessment and if necessary will defend against any reassessments to the appropriate judicial bodies. Accordingly, the Company has not recorded any of the proposed tax, interest or penalties in its financial statements.

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.

The Company has entered into the following delayed start interest rate swaps:

- Notional amount of \$5.5, commencing on September 7, 2007 and terminating September 7, 2017. The Company pays interest at a fixed rate of 6.16% and receives interest based on the 90-day bankers' acceptance rate.
- Notional amount of \$22.3, commencing on November 30, 2007 and terminating November 30, 2017. The Company pays interest at a fixed rate of 6.18% and receives interest based on the 90-day bankers' acceptance rate.

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

17. Employee Future Benefits

The Company has a number of defined benefit and defined contribution plans providing pension and other retirement benefits to most of its food distribution and real estate employees.

Defined Contribution Pension Plans

The contributions required by the employee and the employer are specified. The employee's pension depends on what level of retirement income (for example, annuity purchase) that can be achieved with the combined total of employee and employer contributions and investment income over the period of plan membership, and the annuity purchase rates at the time of the employee's retirement.

Defined Benefit Pension Plans

The ultimate retirement benefit is defined by a formula that provides a unit of benefit for each year of service. Employee contributions, if required, pay for part of the cost of the benefit, but the employer contributions fund the balance. The employer contributions are not specified or defined within the plan text, they are based on the result of actuarial valuations which determine the level of funding required to meet the total obligation as estimated at the time of the valuation.

| | Most recent valuation date | Next required valuation date |
|--------------------------------|----------------------------|------------------------------|
| Retirement Pension Plan | December 31, 2003 | December 31, 2006 |
| Senior Management Pension Plan | December 31, 2004 | December 31, 2007 |

Defined Contribution Plans

The total expense and cash contributions for the Company's defined contribution plans are as follows:

| | | |
|------|----|------|
| 2005 | \$ | 12.1 |
| 2004 | \$ | 11.5 |

Notes to the Consolidated Financial Statements

Defined Benefit Plans

Information about the Company's defined benefits plans, in aggregate, is as follows:

| | Pension Benefit Plans | Pension Benefit Plans | Other Benefit Plans | Other Benefit Plans |
|---|--------------------------|--------------------------|------------------------|------------------------|
| | 2005 | 2004 | 2005 | 2004 |
| Accrued benefit obligation | | | | |
| Balance, beginning of year | \$ 252.0 | \$ 235.0 | \$ 112.0 | \$ 90.4 |
| New incidence (post-employment benefits) | – | – | 0.4 | 7.7 |
| Current service cost | 2.2 | 2.5 | 2.4 | 2.4 |
| Interest cost | 14.8 | 14.9 | 5.9 | 6.2 |
| Employee contributions | 0.4 | 0.5 | – | – |
| Past service costs | 0.7 | – | – | 1.3 |
| Special termination benefits | – | 1.3 | – | – |
| Benefits paid | (18.4) | (16.6) | (4.4) | (4.4) |
| Actuarial losses (gains) | 15.3 | 14.4 | (7.6) | 8.4 |
| Balance, end of year | \$ 267.0 | \$ 252.0 | \$ 108.7 | \$ 112.0 |
| Plan assets | | | | |
| Market value, beginning of year | \$ 223.5 | \$ 199.8 | \$ – | \$ – |
| Actual return on plan assets | 31.3 | 36.8 | – | – |
| Employer contributions | 7.6 | 3.0 | 4.4 | 4.5 |
| Employee contributions | 0.4 | 0.5 | – | – |
| Benefits paid | (18.4) | (16.6) | (4.4) | (4.5) |
| Market value, end of year | \$ 244.4 | \$ 223.5 | \$ – | \$ – |
| Funded status | | | | |
| Deficit | \$ (22.6) | \$ (28.5) | \$ (108.7) | \$ (112.0) |
| Unamortized past service cost | 1.0 | 0.4 | 1.2 | 1.3 |
| Unamortized actuarial losses | 49.9 | 53.1 | 13.0 | 20.3 |
| Accrued benefit asset (liability) | \$ 28.3 | \$ 25.0 | \$ (94.5) | \$ (90.4) |
| Expense | | | | |
| Current service cost | \$ 2.2 | \$ 2.5 | \$ 2.4 | \$ 2.3 |
| Interest cost | 14.8 | 14.9 | 5.9 | 6.2 |
| Special termination benefits | – | 1.3 | – | – |
| Actual return on plan assets | (31.3) | (36.8) | – | – |
| Actuarial losses (gains) | 15.3 | 14.4 | (7.6) | 8.4 |
| Past service costs | 0.7 | – | – | 1.3 |
| New incidence (post-employment benefits) | – | – | 0.4 | 7.7 |
| Expense before adjustments | 1.7 | (3.7) | 1.1 | 25.9 |
| Expected vs actual return on plan assets | 16.0 | 23.3 | – | – |
| Recognized vs actual past service costs | (0.5) | – | 0.1 | (1.3) |
| Recognized vs actual actuarial losses (gains) | (12.9) | (10.9) | 7.2 | (6.9) |
| Net expenses | \$ 4.3 | \$ 8.7 | \$ 8.4 | \$ 17.7 |

| | Pension Benefit Plans | Pension Benefit Plans | Other Benefit Plans | Other Benefit Plans |
|--|--------------------------|--------------------------|------------------------|------------------------|
| | 2005 | 2004 | 2005 | 2004 |
| Classification of accrued benefit asset (liability) | | | | |
| Other assets | \$ 55.2 | \$ 49.2 | \$ - | \$ - |
| Accrued liabilities/expected fiscal 2006 contributions | (9.2) | (7.3) | (4.9) | (4.4) |
| Other long-term liabilities | (17.7) | (16.9) | (89.6) | (86.0) |
| Accrued benefit asset (liability) | \$ 28.3 | \$ 25.0 | \$ (94.5) | \$ (90.4) |

Included in the above accrued benefit obligation at year-end are the following amounts in respect of plans that are not funded:

| | Pension Benefit Plans | Pension Benefit Plans | Other Benefit Plans | Other Benefit Plans |
|----------------------------|--------------------------|--------------------------|------------------------|------------------------|
| | 2005 | 2004 | 2005 | 2004 |
| Accrued benefit obligation | \$ 19.5 | \$ 18.5 | \$ 94.5 | \$ 90.4 |

The significant actuarial assumptions adopted in measuring the Company's accrued benefit obligations are as follows (weighted-average assumptions as of May 7, 2005):

| | Pension Benefit Plans | Pension Benefit Plans | Other Benefit Plans | Other Benefit Plans |
|--|--------------------------|--------------------------|------------------------|------------------------|
| | 2005 | 2004 | 2005 | 2004 |
| Discount rate | 5.50% | 6.00% | 5.75% | 6.00% |
| Expected long-term rate of return on plan assets | 7.00% | 7.00% | | |
| Rate of compensation increase | 4.00% | 4.00% | | |

For measurement purposes, a 10% fiscal 2005 annual rate of increase in the per capita cost of covered health care benefits was assumed. The cumulative rate expectation to 2012 is 6%. The expected average remaining service period of the active employees covered by the pension benefit plans ranges from 11 to 19 years with a weighted average of 11 years at year end. The expected average remaining service period of the active employees covered by the other benefit plans range from 13 to 17 years with a weighted average of 16 years at year end.

| | Pension Plans | | Other Benefit Plans | |
|--|------------------------|--------------------------------|------------------------|--------------------------------|
| | Benefit Obligations | Benefit Cost ⁽¹⁾ | Benefit Obligations | Benefit Cost ⁽¹⁾ |
| Expected long-term rate of return on plan assets | | 7.0% | | |
| Impact of: 1% increase | | \$ (2.4) | | |
| 1% decrease | | \$ 2.4 | | |
| Discount rate | 5.5% | 5.5% | 5.75% | 5.75% |
| Impact of: 1% increase | \$ (29.3) | \$ 0.3 | \$ (15.7) | \$ (0.8) |
| 1% decrease | \$ 32.9 | \$ (0.6) | \$ 18.9 | \$ 0.9 |
| Growth rate of health costs ⁽¹⁾ | | | 10.0% | 10.0% |
| Impact of: 1% increase | | | \$ 15.9 | 1.9 |
| 1% decrease | | | \$ (13.0) | \$ (1.5) |

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

Notes to the Consolidated Financial Statements

The asset mix of the defined benefit pension plans as at year end is as follows:

| | 2005 | 2004 |
|---|----------------|----------------|
| Cash and short-term investments | 7.06% | 3.21% |
| Bonds, debenture, fixed income pooled funds and real estate funds | 17.71% | 21.27% |
| Equities and pooled equities fund | 74.96% | 75.24% |
| Accrued interest and dividends | 0.27% | 0.28% |
| Total investments | 100.00% | 100.00% |

Within these securities are investments in Empire Company Limited. The market value of these shares at year end are as follows:

| | 2005 | % of plan assets | 2004 | % of plan assets |
|----|------|---------------------|---------|---------------------|
| \$ | 80.2 | 10.0% | \$ 57.7 | 8.1% |

18. Business Acquisitions

Sobeys Inc.

During fiscal 2005 the Company increased its ownership interest in Sobeys Inc. from 65.0% to 68.4% by way of purchase of shares on the open market. The acquisition was accounted for using the purchase method with operating results being included in the consolidated financial statements from the date of each share acquisition. The cash consideration paid was \$93.5, goodwill increased by \$27.1 and minority interest decreased by \$66.4.

During fiscal 2004 the Company increased its ownership interest in Sobeys Inc. from 62% to 65% by way of purchase of shares on the open market. The acquisition was accounted for using the purchase method with operating results being included in the consolidated financial statements from the date of each share acquisition. The cash consideration paid was \$74.2, goodwill increased by \$26.2 and minority interest decreased by \$48.0.

Other Acquisitions

During the year the Company acquired franchisee stores and prescription files in its food distribution segment as part of its normal course of operations and acquired four cinemas in Nova Scotia and New Brunswick in its other operations segment for total cash consideration of \$19.1. The acquisitions were accounted using the purchase method with net identifiable assets recorded at \$15.3 (including intangible assets of \$7.2) and goodwill recorded at \$3.8.

Commisso's Acquisitions

During the 2004 fiscal year the Company acquired substantially all of the assets and trade liabilities of Commisso's Food Markets Limited, Commisso's Grocery Distributors Limited and Commisso's Properties Inc. which are located in Southern Ontario. Acquired were six grocery stores (and the shopping centres where they are located), nine additional grocery stores, six cash-and-carry outlets and a wholesale business and distribution centre. The acquisition was completed February 1, 2004 and was accounted for using the purchase method, with operating results being included in the consolidated financial statements at this date.

| | |
|------------------------|---------------|
| Inventories | \$ 16.2 |
| Property and equipment | 56.1 |
| Goodwill | 62.5 |
| Intangibles | 5.4 |
| Other assets | 3.1 |
| Accounts payable | (32.1) |
| Long-term liabilities | (38.5) |
| Other liabilities | (21.2) |
| | <hr/> 51.5 |
| Expenses | (0.8) |
| Cash consideration | <hr/> \$ 50.7 |

19. Stock-based Compensation

Members of the Board of Directors may elect to receive all or any portion of their fees in Deferred Share Units (DSU's) in lieu of cash. The number of DSU's received is determined by the market value of the Company's common shares on each directors' fee payment date. Additional DSU's are received as dividend equivalents. DSU's cannot be redeemed for cash until the holder is no longer a director of the Company. The redemption value of a DSU equals the market value of a Empire Company Limited common share at the time of the redemption. On an ongoing basis, the Company values the DSU obligation at the current market value of a common share and records any increase in the DSU obligation as an operating expense. At May 7, 2005 there were 50,420 (April 30, 2004 – 36,643) DSU's outstanding. During the year, the stock-based compensation expense was \$0.9 (2004 – \$0.2).

20. Real Estate Leases

The Company has reviewed its practices related to lease accounting and has determined that adjustments were required to align to the recent clarification of lease accounting guidelines. The first adjustment relates to lease allowances and incentives. Historically the Company classified lease allowances as a reduction of the related capital assets, which effectively reduced the depreciation expense over the expected life of the asset. The guideline clarification suggests these lease allowances should be recorded as a deferred credit and amortized as a reduction of lease expense over the term of the lease. The second adjustment relates to rent expense to be recorded during a store's fixturing period. The Company is often granted a fixturing period during which rent is not charged. The fixturing 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 rent free period that should be included in the term of the lease. Since lease expense must be recognized on a straight-line basis over the lease term an appropriate portion of the straight-line expense must be recorded for the fixturing period. The third adjustment relates to the capitalization of long-term

leases. An evaluation was completed in the fourth quarter of the current year and certain long-term leases have been 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:

As at April 30, 2004 a reduction to retained earnings of \$5.4.

A reduction in net income for the 52 week period ended April 30, 2004 of \$0.6 from \$173.1 to \$172.5, and a reduction in earnings per share from \$2.63 to \$2.62.

As at April 30, 2004 an increase to Property and equipment, Future income taxes, Long-term debt and Long-term liabilities of \$10.1, \$4.4, \$10.3 and \$12.5, respectively and a decrease in Minority interest of \$2.9. These lease accounting adjustments did not have any material impact on the Company's fiscal 2005 net earnings, historical or future revenues, cash flows or lease payments.

21. 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 vendor allowances has changed, resulting in the Company recording a decrease in opening retained earnings for fiscal 2004 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 annual net earnings for fiscal 2004 or in the current year.

22. 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.

Notes to the Consolidated Financial Statements

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 VIE have been consolidated in the Company's results for the fourth quarter.

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

Franchisees

The Company has identified 287 franchisees whose franchise agreements result in the Company being deemed the primary beneficiary of the entity according to AcG-15. The results of 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 warehousing 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.

Balance Sheet as at May 7, 2005

| | Consolidated Balance Sheet as at May 7, 2005 before AcG-15 Impact | Impact of the Implementation of AcG-15 | Consolidated Balance Sheet as at May 7, 2005 after AcG-15 Impact |
|--|---|--|--|
| Assets | | | |
| Current | | | |
| Cash and cash equivalents | \$ 247.6 | \$ 34.1 | \$ 281.7 |
| Receivables | 279.7 | (21.9) | 257.8 |
| Income taxes receivable | 14.8 | 0.2 | 15.0 |
| Inventories | 518.3 | 121.3 | 639.6 |
| Prepaid expenses | 48.1 | 4.2 | 52.3 |
| | 1,108.5 | 137.9 | 1,246.4 |
| Investments, at cost (quoted market value \$320.9) | 270.8 | – | 270.8 |
| Investments, at equity (realizable value \$162.4) | 72.9 | – | 72.9 |
| Current assets and marketable investments | 1,452.2 | 137.9 | 1,590.1 |
| Property and equipment | 2,395.3 | 34.5 | 2,429.8 |
| Assets for realization | 11.5 | – | 11.5 |
| Other assets | 321.7 | (108.8) | 212.9 |
| Goodwill | 684.9 | – | 684.9 |
| | \$ 4,865.6 | \$ 63.6 | \$ 4,929.2 |

Balance Sheet as at May 7, 2005

| | Consolidated Balance Sheet as at May 7, 2005 before AcG-15 Impact | Impact of the Implementation of AcG-15 | Consolidated Balance Sheet as at May 7, 2005 after AcG-15 Impact |
|--|---|--|--|
| Liabilities | | | |
| Current | | | |
| Bank indebtedness | \$ 219.4 | \$ – | \$ 219.4 |
| Accounts payable and accrued liabilities | 1,119.5 | 29.6 | 1,149.1 |
| Future income taxes | 52.4 | – | 52.4 |
| Long-term debt due within one year | 245.1 | 1.9 | 247.0 |
| | 1,636.4 | 31.5 | 1,667.9 |
| Long-term debt | 709.6 | 17.8 | 727.4 |
| Long-term lease obligation | 12.3 | – | 12.3 |
| Deferred revenue | 3.0 | – | 3.0 |
| Employee future benefit obligation | 94.5 | – | 94.5 |
| Future income taxes | 158.8 | – | 158.8 |
| Minority interest | 531.9 | 24.4 | 556.3 |
| | 3,146.5 | 73.7 | 3,220.2 |
| Shareholders' Equity | | | |
| Capital stock | 194.6 | – | 194.6 |
| Retained earnings | 1,525.6 | (10.1) | 1,515.5 |
| Cumulative translation adjustment | (1.1) | – | (1.1) |
| | 1,719.1 | (10.1) | 1,709.0 |
| | \$ 4,865.6 | \$ 63.6 | \$ 4,929.2 |

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.

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

Notes to the Consolidated Financial Statements

Income Statement for the 53 weeks ended May 7, 2005

| | Consolidated Income Statement as at May 7, 2005 before AcG-15 Impact | Impact of the Implementation of AcG-15 | Consolidated Income Statement as at May 7, 2005 after AcG-15 Impact |
|--|--|--|---|
| Sales | \$ 12,297.8 | \$ 137.4 | \$ 12,435.2 |
| Operating expenses | | | |
| Cost of sales, selling and administrative expenses | 11,655.2 | 135.8 | 11,791.0 |
| Depreciation and amortization | 199.7 | 1.8 | 201.5 |
| | 442.9 | (0.2) | 442.7 |
| Investment income | 21.0 | – | 21.0 |
| Operating income | 463.9 | (0.2) | 463.7 |
| Interest expense | | | |
| Long-term debt | 81.1 | 0.4 | 81.5 |
| Short-term debt | 5.1 | 0.1 | 5.2 |
| | 86.2 | 0.5 | 86.7 |
| | 377.7 | (0.7) | 377.0 |
| Capital gain and other items | 4.4 | – | 4.4 |
| Earnings before income taxes and minority interest | 382.1 | (0.7) | 381.4 |
| Income taxes | 131.3 | (0.1) | 131.2 |
| Earnings before minority interest | 250.8 | (0.6) | 250.2 |
| Minority interest | 63.8 | (0.2) | 63.6 |
| Net earnings | \$ 187.0 | \$ (0.4) | \$ 186.6 |
| Earnings per share basic and diluted | \$ 2.84 | \$ (0.01) | \$ 2.83 |
| 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 franchisees have been eliminated. The impact on all other financial statement line items including net earnings is immaterial.

23. Change in Fiscal Year-end

Effective for fiscal 2005, Empire's year-end changed from April 30th to the first Saturday in May. As such, the quarter-end dates and fiscal year-end will be consistent with Sobeys Inc.

24. Subsequent Events

- (a) On June 17, 2005, Sobeys Inc. received notice from Canada Revenue Agency (CRA) that a notice of reassessment was forthcoming related to the Goods and Services Tax (GST) matter outlined in Note 16. Sobeys Inc. has reviewed this matter, has received legal advice and believes it was not required to collect GST. Sobeys Inc. is challenging this proposed reassessment and if necessary will defend against any reassessments to the appropriate judicial bodies. Accordingly, the Company has not recorded any of the proposed tax, interest or penalties in its financial statements.
- (b) 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 \$44. This reduced the Company's ownership percentage to approximately 29.9%. The net proceeds from this sale are expected to be used to repay bank indebtedness. The Company has granted an over-allotment option to the underwriters exercisable to July 21, 2005, whereby the underwriters can purchase from the Company up to 375,000 units at \$19.25 per unit.

25. Comparative Figures

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