

# Notes to the Consolidated Financial Statements

May 6, 2006 (in millions except share capital)

## 1. Summary of significant accounting policies

Empire Company Limited (the “Company”) is a diversified Canadian company whose key businesses include food retailing, real estate and corporate investment activities. These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”), and include the accounts of the Company, all subsidiary companies, including 70.3% owned Sobeys Inc., and certain enterprises considered variable interest entities (“VIEs”) where control is achieved on a basis other than through ownership of a majority of voting rights. 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

#### Adopted during fiscal 2006

##### (a) Vendor allowances

During the first quarter of fiscal 2006, the Company adopted the amendment to the Canadian Institute of Chartered Accountants (“CICA”) Emerging Issues Committee (“EIC”) Abstract 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 26).

#### Adopted during fiscal 2005

##### (a) Generally accepted accounting principles

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

##### Depreciation

The sinking fund method was used to record depreciation of the real estate buildings, calculated as an amount which, compounded annually at the rate of 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 resulted in additional depreciation of \$1.2 during the 2005 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 2005 fiscal year as a result of this policy change in the food reporting segment. Real estate revenue was recognized in accordance with the lease agreements with tenants. The Company has changed its policy to record income on a straight-line basis. Adoption of this policy resulted in recognition of additional straight-line real estate revenue of \$2.2 during the 2005 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 25).

##### (b) Hedging

Accounting guideline (“AcG”) 13, “Hedging Relationships”, came into effect during fiscal 2005. This guideline addresses the identification, designation, documentation and effectiveness of hedging relationships for the purpose of applying hedge accounting and provides guidance with respect to the discontinuance of hedge accounting. The Company adopted this guideline prospectively, and there was no effect on the Company from the adoption of this guideline.

##### (c) Asset retirement obligations

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

**(d) Vendor allowances**

In January 2004, the CICA issued EIC 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 (see Note 26).

**(e) Variable interest entities**

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 by the Company on a basis other than through ownership of a voting interest in the entity (see Note 27).

**(f) Stock-based compensation**

The Company has a Share Purchase Loan plan for employees. In accordance with EIC Abstract 132, these loans, which are granted to employees to purchase Non-Voting Class A shares are considered to be stock options and are treated as stock-based compensation and recorded at their fair market value. This application was on a prospective basis beginning in 2005 as it was determined that application on a retroactive basis would not result in a material change (see Note 24).

**Cash and cash equivalents**

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

**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 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.

**Property and equipment**

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	Lesser of lease term and 7 – 10 years

Property and equipment is reviewed for impairment when events or circumstances indicate that the carrying value exceeds the sum of the undiscounted future cash flows expected from use and eventual disposal. Property and equipment is reviewed for impairment annually. The carrying value of the property and equipment is also reviewed whenever events or changes in circumstances indicate that the carrying value of property and equipment may not be recoverable. If property and equipment is determined to be impaired, the impairment loss is measured at the excess of the carrying value over fair value.

Assets to be disposed are classified as held for sale and are no longer depreciated. Assets held for sale are recognized at the lower of carrying value and fair value.

The Company follows the full cost method of accounting for its exploration and development of petroleum and natural gas reserves. Costs initially capitalized are depleted and depreciated using the unit-of-production method based on production volumes, before royalties, in relation to the Company’s share of estimated proved petroleum and natural gas reserves.

**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 \$0.5 (2005 – \$0.1).

(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 2005 or 2006.

(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 \$0.2 (2005 – \$0.1).

**Leases**

Leases meeting certain criteria are accounted for as capital leases. The imputed interest is charged against income. If the lease contains a term that allows ownership to pass to the Company or there is a bargain purchase option the capitalized value is depreciated over the estimated useful life of the related asset. Otherwise 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. Should the carrying value exceed the fair value of goodwill or intangible assets, the carrying value will be written down to the fair value.

**Intangibles**

Intangibles arise on the purchase of a new business, 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 purchase agreement

**Assets held for sale**

Certain land and buildings have been listed for sale and reclassified as “Assets held for sale” 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 held for sale 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.

**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 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 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 exchange rate for the period.

### Revenue recognition

Food sales are recognized at the point-of-sale. Sales include revenues from customers through corporate stores operated by the Company and consolidated VIEs, and revenue from sales to non-VIE franchised stores, affiliated stores and independent accounts. Revenue received from non-VIE franchised 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.

### Financial instruments

The Company uses various derivative financial instruments to hedge its exposure to foreign exchange and interest rate risks. If documentation and effectiveness requirements are met, gains and losses on these instruments are deferred and recognized in earnings in the same period the related hedged risk is realized.

### Pension benefit plans and other benefit plans

The cost of the Company's pension benefits for defined contribution plans are expensed when the employees 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 Supplemental Executive Retirement Plan, the impact of changes in the plan provisions are amortized over five 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 are 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. Sale of Wajax Income Fund

On June 6, 2005, the shareholders of Wajax Limited, an equity accounted investment, approved a Plan of Arrangement to convert into Wajax Income Fund ("Wajax"). The Company owned approximately 45% of the outstanding shares of Wajax Limited (on a fully diluted basis). The Plan of Arrangement was completed on June 15, 2005 with the Company receiving one unit of Wajax for each Wajax Limited share held. Through a secondary offering on June 21, 2005, the Company sold a total of 2.5 million Wajax units for net proceeds of approximately \$44.0. On June 29, 2005, the underwriter exercised their over-allotment option to purchase 375,000 Wajax 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	\$	50.8
Book value		21.1
		<hr/>
		29.7
Equity share of income fund		
conversion-related items		4.1
		<hr/>
Capital gain before income taxes		25.6
Income taxes		2.1
		<hr/>
Net capital gain	\$	23.5

**3. Sale of property to Crombie REIT**

On March 23, 2006, the Company's real estate segment sold 44 commercial properties to Crombie Real Estate Investment Trust ("Crombie REIT"). Included in the proceeds is an interest in Crombie REIT giving the Company effective ownership of 48.3%. The Company's investment in Crombie REIT is accounted using the equity method. Details of the sale are as follows:

Proceeds	
Cash	\$ 267.7
Investment in Crombie REIT	200.8
	<u>468.5</u>
Book value of assets sold and liabilities assumed	
Property and equipment	593.2
Net working capital	(1.0)
Employee future benefits obligation	(2.2)
Future income taxes	(44.7)
Long-term debt	(312.9)
	<u>232.4</u>
Early extinguishment of long-term debt	25.4
Share of issue costs	9.4
Other costs	17.1
	<u>284.3</u>
Capital gain before deferral and income taxes	184.2
Deferral of capital gain related to retained interest	(88.2)
Capital gain before income taxes	96.0
Income taxes	19.8
Net capital gain	<u>\$ 76.2</u>

**4. Earnings per share**

Earnings per share amounts are calculated on the weighted average number of shares outstanding after providing for preferred share dividends accrued to the balance sheet date. Diluted earnings per share is calculated on the assumption that all the outstanding stock options were exercised and share purchase loans were repaid at the beginning of the year.

Earnings applicable to common shares is comprised of the following:

	2006 (52 Weeks)	2005 (53 Weeks)
Operating earnings	\$ 202.0	\$ 182.9
Capital gain and other items, net of tax of \$14.4 (2005 - \$0.7)	94.8	3.7
Net earnings	296.8	186.6
Preferred share dividends	(0.3)	(0.3)
Earnings applicable to common shares	<u>\$ 296.5</u>	<u>\$ 186.3</u>

Earnings per share is comprised of the following:

Operating earnings	\$ 3.08	\$ 2.79
Capital gain and other items	1.45	0.05
Basic earnings per share	<u>\$ 4.53</u>	<u>\$ 2.84</u>
Operating earnings	\$ 3.07	\$ 2.78
Capital gain and other items	1.44	0.05
Diluted earnings per share	<u>\$ 4.51</u>	<u>\$ 2.83</u>

**5. Cash and cash equivalents**

Included in cash and cash equivalents is restricted cash of \$6.8 (2005 - \$7.5) relating to deposits on future sale of real estate inventories.

## 6. Investments, at equity

	May 6, 2006	May 7, 2005
Wajax Income Fund (27.6% interest, 2005 – 45.0% interest)	\$ 33.1	\$ 55.1
Crombie REIT (48.3% interest)	112.8	–
U.S. residential real estate partnerships	11.6	17.8
	<u>\$ 157.5</u>	<u>\$ 72.9</u>

The Company's carrying value of its investment in Wajax Income Fund (formerly Wajax Limited to June 6, 2005) as at May 6, 2006 is as follows:

	May 6, 2006	May 7, 2005
Balance, beginning of year	\$ 55.1	\$ 46.7
Equity earnings	16.3	9.8
Distributions received	(13.1)	(1.4)
Book value of equity interest sold	(25.2)	–
Balance, end of year	<u>\$ 33.1</u>	<u>\$ 55.1</u>

## 7. Property and equipment

	May 6, 2006		
	Cost	Accumulated Depreciation	Net Book Value
Food segment			
Land	\$ 89.5	\$ –	\$ 89.5
Land held for future development	138.6	–	138.6
Buildings	681.1	135.7	545.4
Equipment	1,707.4	1,062.7	644.7
Leasehold improvements	361.0	218.2	142.8
Assets under capital leases	78.9	27.7	51.2
	<u>3,056.5</u>	<u>1,444.3</u>	<u>1,612.2</u>
Real estate and other segments			
Land	79.6	–	79.6
Land held for future development	23.6	–	23.6
Buildings*	385.9	94.1	291.8
Equipment	69.4	26.9	42.5
Leasehold improvements	51.6	8.3	43.3
Petroleum and natural gas costs	54.0	3.4	50.6
	<u>664.1</u>	<u>132.7</u>	<u>531.4</u>
Total	<u>\$ 3,720.6</u>	<u>\$ 1,577.0</u>	<u>\$ 2,143.6</u>

\*During the year, based on revised estimates of holding periods, it was determined that the carrying value of five commercial properties was impaired. Accordingly, the Company recorded an impairment charge of \$27.4 to reduce their carrying value to estimated fair value using external appraisals.

The Company's carrying value of its investment in Crombie REIT as at May 6, 2006 is as follows:

	May 6, 2006
Interest received in Crombie REIT	\$ 200.8
Less deferral of gain related to retained interest	(88.2)
Equity earnings since acquisition	0.2
	<u>\$ 112.8</u>

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	May 7, 2005		
	Cost	Accumulated Depreciation	Net Book Value
<b>Food segment</b>			
Land	\$ 94.5	\$ —	\$ 94.5
Land held for future development	85.4	—	85.4
Buildings	589.4	117.6	471.8
Equipment	1,662.7	993.6	669.1
Leasehold improvements	309.7	192.7	117.0
Assets under capital leases	47.7	23.6	24.1
	2,789.4	1,327.5	1,461.9
<b>Real estate and other segments</b>			
Land	147.8	—	147.8
Land held for future development	9.1	—	9.1
Buildings	941.3	182.2	759.1
Equipment	51.5	22.6	28.9
Leasehold improvements	18.6	5.5	13.1
Petroleum and natural gas costs	10.7	0.8	9.9
	1,179.0	211.1	967.9
<b>Total</b>	<b>\$ 3,968.4</b>	<b>\$ 1,538.6</b>	<b>\$ 2,429.8</b>

### 8. Other assets

	May 6, 2006	May 7, 2005
<b>Loans and mortgages</b>		
receivable	\$ 68.4	\$ 41.7
Deferred costs	101.4	89.0
Transitional pension asset	36.2	28.3
Restricted cash	14.7	—
Other	25.4	32.3
<b>Intangibles (less accumulated amortization of \$7.6; 2005 - \$4.7)</b>		
	27.2	24.3
	<b>\$ 273.3</b>	<b>\$ 215.6</b>

#### 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.

The loans and mortgages receivable are net of current portions of \$15.9 (2005 - \$15.5).

### 9. 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. During the year, the expiry date of the revolving unsecured credit facility was extended from June 22, 2006 to December 20, 2010. All indebtedness and obligations under the agreement shall be payable in full on December 20, 2010. Interest payable on this facility fluctuates with changes in the prime interest rate.

## 10. Long-term debt

	May 6, 2006			May 7, 2005	
	Food Segment	Real Estate and other Segments	Total	Total	Total
First mortgage loans, average interest rate 9.3%, due 2008-2026	\$ 25.8	\$ 141.4	\$ 167.2	\$ 425.0	
Medium Term Notes, interest rate 7.6%, due November 1, 2005	–	–	–	175.0	
Medium Term Notes, interest rate 6.1%, due October 29, 2035	175.0	–	175.0	–	
Medium Term Notes, interest rate 7.2%, due February 26, 2018	100.0	–	100.0	100.0	
Debentures, average interest rate 10.4%, due 2008-2016	63.1	32.6	95.7	138.1	
Notes payable and other debt at interest rates fluctuating with the prime rate	76.9	138.7	215.6	113.1	
Capital lease obligations, net of imputed interest	49.2	–	49.2	23.2	
	490.0	312.7	802.7	974.4	
Less amount due within one year	25.0	70.4	95.4	247.0	
	\$ 465.0	\$ 242.3	\$ 707.3	\$ 727.4	

Long-term debt is secured by land and buildings, specific charges on certain assets and additional security as described in Note 9. Capital lease obligations are secured by the related capital lease asset.

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 on October 29, 2035.

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

During the year the Company increased its capital lease obligation by \$29.0 with a similar increase in assets under capital lease.

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

	Long Term Debt	Capital Leases
2007	\$ 86.7	\$ 8.7
2008	\$ 44.4	\$ 7.2
2009	\$ 84.4	\$ 6.6
2010	\$ 39.0	\$ 6.0
2011	\$ 38.7	\$ 2.7

## Operating leases

The net aggregate, annual, minimum rent payable under operating leases for fiscal 2007 is approximately \$160.1 (\$231.9 gross less expected sub-lease income of \$71.8).

The commitments over the next five fiscal years are:

	Net Lease Obligation	Gross lease Obligation
2007	\$ 160.1	\$ 231.9
2008	\$ 141.6	\$ 205.9
2009	\$ 126.6	\$ 183.7
2010	\$ 117.3	\$ 168.3
2011	\$ 104.6	\$ 149.7

## 11. Other liabilities

	May 6, 2006	May 7, 2005
Deferred revenue	\$ 3.3	\$ 3.0
Deferred hedge gain	10.2	–
Above market leases		
from acquisitions	5.0	–
Asset retirement obligations	0.4	–
	\$ 18.9	\$ 3.0



**12. Capital stock**

Authorized	No. of Shares
Preferred shares, par value of \$25 each, issuable in series. Series 2 cumulative, redeemable, rate of 75% of prime.	2,846,000
2002 Preferred Shares, par value of \$25 each, issuable in series.	992,000,000
Non-Voting Class A shares, without par value.	259,154,492
Class B common shares, without par value, voting.	40,800,000

	No. of Shares	May 6, 2006	No. of Shares	May 7, 2005
Issued and outstanding:				
Preferred shares, Series 2	331,900	\$ 8.3	331,900	\$ 8.3
Non-Voting Class A	31,175,047	183.7	31,150,585	183.0
Class B common	34,560,763	7.7	34,585,225	7.7
		199.7		199.0
Loans receivable from officers and employees under share purchase plan		(4.6)		(4.4)
		\$ 195.1		\$ 194.6

During the year, under a normal course issuer bid which expires on July 27, 2006, the Company purchased for cancellation 20,254 (2005 – 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 2005, the Company purchased for cancellation 100,000 Series 2 preferred shares for \$2.5.

During the year, no options were exercised. 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 6, 2006.

During the year, 20,254 (2005 – 32,729) Non-Voting Class A shares were issued under the Company's share purchase plan to certain officers and employees for \$0.8 (2005 – \$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 \$4.6 (2005 – \$4.4) 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 229,484 (2005 – 245,030) Non-Voting Class A shares. Market value of the shares at May 6, 2006 was \$9.9 (2005 – \$9.0).

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, 24,462 (2005 – 300,000) Class B common shares were exchanged for 24,462 (2005 – 300,000) Non-Voting Class A shares.

**13. Investment income**

	2006 (52 Weeks)	2005 (53 Weeks)
Dividend and interest income	\$ 8.3	\$ 9.0
Share of earnings of companies accounted using the equity method	23.5	12.0
	<b>\$ 31.8</b>	<b>\$ 21.0</b>

**14. Capital gain and other items**

	2006 (52 Weeks)	2005 (53 Weeks)
Gain on sale of Wajax Income Fund (Note 2)	\$ 25.6	\$ –
Gain on sale of property to Crombie REIT (Note 3)	96.2	–
Reduction of book value of real estate assets (Note 7)	(27.4)	–
Gain on sale of investments	11.6	2.9
Other items	3.4	1.5
	<b>\$ 109.4</b>	<b>\$ 4.4</b>

**15. 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:

	2006 (52 Weeks)	2005 (53 Weeks)
Income tax expense according to combined statutory rate of 34.8% (2005 – 35.3%)	\$ 141.8	\$ 133.1
Increase (decrease) in income taxes resulting from		
Rate changes effect on timing differences	(1.6)	–
Non-taxable dividends and equity earnings	(3.5)	(5.5)
Large corporation tax	2.0	2.9
	<b>138.7</b>	<b>130.5</b>
Capital gain and other items	14.4	0.7
	<b>\$ 153.1</b>	<b>\$ 131.2</b>

May 6, 2006 income tax expense attributable to net earnings consists of:

	Current	Future	Total
Operations	\$ 127.7	\$ 11.0	\$ 138.7
Capital gain and other items	14.1	0.3	14.4
	<b>\$ 141.8</b>	<b>\$ 11.3</b>	<b>\$ 153.1</b>

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

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

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

	May 6, 2006	May 7, 2005
Property and equipment	\$ 64.1	\$ 112.7
Investments	59.0	36.0
Future employee benefits obligation	(34.8)	(32.2)
Restructuring provisions	(5.0)	(5.3)
Pension contributions	17.4	16.0
Deferred costs	28.4	23.7
Deferred credits	54.6	57.7
Goodwill and intangibles	8.6	6.0
Other	(14.4)	(3.4)
	<u>\$ 177.9</u>	<u>\$ 211.2</u>
Future income taxes – current liabilities	\$ 46.1	\$ 52.4
Future income taxes – non-current liabilities	131.8	158.8
	<u>\$ 177.9</u>	<u>\$ 211.2</u>

## 16. Supplementary cash flow information

	May 6, 2006 (52 Weeks)	May 7, 2005 (53 Weeks)
a) Items not affecting cash		
Depreciation and amortization	\$ 225.8	\$ 201.5
Future income taxes	10.1	31.7
Amortization of deferred items	35.8	34.0
Equity in earnings of other companies, net of dividends received	(4.1)	(8.4)
Minority interest	55.8	52.5
Stock-based compensation	1.0	0.6
Long-term lease obligation	8.5	(0.2)
Employee future benefits obligation	4.2	4.1
Gain on sale of Wajax Income Fund, net of tax of \$2.1	(23.5)	–
Gain on sale of property to Crombie REIT, net of tax of \$19.8	(76.2)	–
Reduction of book value of real estate assets, net of tax of \$(10.4)	17.0	–
	<u>\$ 254.4</u>	<u>\$ 315.8</u>
b) Other information		
Net interest paid	\$ 83.1	\$ 85.1
Net income taxes paid	\$ 102.1	\$ 124.7

## 17. 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 6, 2006	May 7, 2005
Assets	\$ 101.0	\$ 101.6
Liabilities	\$ 60.0	\$ 41.9
Equity and advances	41.0	59.7
	\$ 101.0	\$ 101.6

## 18. Segmented information

	2006 (52 Weeks)	2005 (53 Weeks)
Revenue		
Food	\$ 12,853.3	\$ 12,189.4
Real estate		
Commercial	136.9	136.4
Inter-segment	54.0	57.8
Residential	48.1	35.0
	239.0	229.2
Investment and other operations	122.8	74.4
	13,215.1	12,493.0
Elimination	(54.0)	(57.8)
	\$ 13,161.1	\$ 12,435.2

	2006 (52 Weeks)	2005 (53 Weeks)
Operating income		
Food	\$ 331.6	\$ 322.6
Real estate		
Commercial	87.0	89.1
Residential	51.3	33.1
Investment and other operations	31.3	28.3
Corporate expenses	(9.8)	(9.4)
	\$ 491.4	\$ 463.7

	2006 (52 Weeks)	2005 (53 Weeks)
Revenues	\$ 61.4	\$ 43.2
Expenses	6.6	7.9
Income before income taxes	\$ 54.8	\$ 35.3
Cash provided (used)		
Operating activities	\$ 62.3	\$ 36.8
Investing activities	4.7	(8.4)
Financing activities	3.9	(0.1)
	\$ 70.9	\$ 28.3

	May 6, 2006	May 7, 2005
Identifiable assets		
Food	\$ 3,119.5	\$ 2,831.7
Goodwill	691.7	678.4
	3,811.2	3,510.1
Real estate	634.7	1,017.9
Investment and other operations (including goodwill of \$40.1; 2005 - \$3.8)	605.6	401.2
	\$ 5,051.5	\$ 4,929.2

	2006 (52 Weeks)	2005 (53 Weeks)
Depreciation and amortization		
Food	\$ 196.6	\$ 176.4
Real estate	16.9	18.7
Investment and other operations	12.3	6.4
	\$ 225.8	\$ 201.5

	2006 (52 Weeks)	2005 (53 Weeks)
Capital expenditure		
Food	\$ 421.3	\$ 321.1
Real estate	67.9	33.2
Investment and other operations	57.2	17.7
	\$ 546.4	\$ 372.0

The Company operates principally in two business segments: food and real estate. The food 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.

## 19. Financial instruments

### Credit risk

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

### Fair value of 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 6, 2006. The fair value of investments is \$824.2 (2005 – \$483.3).

The total fair value of long-term debt is estimated to be \$866.4 (2005 – \$1,126.0). The fair value of variable rate long-term 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.

### 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 \$187.9 Canadian that is denominated in U.S. funds. Bank indebtedness includes \$4.6 Canadian that is denominated in U.S. funds and it acts as a partial hedge to the foreign exchange fluctuations inherent in the residual value of certain equipment.

At May 6, 2006, there are outstanding forward exchange contracts to sell a notional amount of \$163.0 million, maturing over the next twelve months at a weighted average rate of U.S. \$87.60. The fair value of the outstanding forward exchange contracts, based on settlement requirements at May 6, 2006, is a positive value of U.S. \$5.5 million due to the strengthening of the Canadian dollar since the dates on which the contracts were entered.

## 20. Contingent liabilities

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

Sobeys Inc. has guaranteed certain bank loans contracted by franchise affiliates. As at May 6, 2006 these loans amounted to approximately \$1.3 (2005 – \$2.4).

Sobeys Inc. has guaranteed certain equipment leases of its franchise affiliates. Under the terms of the guarantee should a franchise affiliate be unable to fulfil their lease obligation Sobeys Inc. would be required to fund the difference of the lease commitments up to a maximum of \$100.0 on a cumulative basis. Sobeys Inc. approves each of the contracts. The aggregate, annual, minimum rent payable under the guaranteed operating equipment leases for fiscal 2007 is approximately \$21.1. The guaranteed lease commitments over the next five fiscal years are:

Guaranteed lease commitments	
2007	\$ 21.1
2008	\$ 23.2
2009	\$ 18.9
2010	\$ 15.9
2011	\$ 11.1

Upon entering into the lease of its Mississauga distribution centre in March 2000, Sobeys Inc. guaranteed to the landlord the performance, by SERCA Foodservice, of all its obligation under the lease. The remaining term of the lease is 14 years with an aggregate obligation of \$43.3 (2005 – \$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.

On June 21, 2005, Sobeys Inc. received a notice of reassessment from Canada Revenue Agency (“CRA”) for fiscal years 1999 and 2000 related to the Goods and Services Tax (“GST”). CRA asserts that Sobeys Inc. was obliged to collect GST on 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. During the second quarter of fiscal 2006, Sobeys Inc. filed a Notice of Objection with CRA. Accordingly the Company has not recorded in its statement of earnings any of the tax, interest or penalties in the notice of reassessment. Sobeys Inc. has deposited with CRA funds to cover the total tax, interest and penalties in the reassessment and has recorded this amount as a long-term receivable from CRA pending resolution of the matter.

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

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

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

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

## 21. Related party transactions

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

## 22. 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 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.

The Company uses December 31 as an actuarial valuation date and April 30 as a measurement date for accounting purposes for its defined benefit pension plans.

	Most recent valuation date	Next required valuation date
Retirement Pension Plan	December 31, 2004	December 31, 2007
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:

2006	\$ 14.2
2005	\$ 12.1

**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
	2006	2005	2006	2005
<b>Accrued benefit obligation</b>				
Balance, beginning of year	\$ 267.0	\$ 252.0	\$ 108.7	\$ 112.0
New incidence (post-employment benefits)	–	–	–	0.4
Current service cost	2.4	2.2	2.9	2.4
Interest cost	14.5	14.8	6.1	5.9
Employee contributions	0.4	0.4	–	–
Past service costs	–	0.7	–	–
Divestitures	(0.8)	–	(2.2)	–
Benefits paid	(20.0)	(18.4)	(3.7)	(4.4)
Actuarial losses (gains)	5.8	15.3	2.3	(7.6)
Balance, end of year	\$ 269.3	\$ 267.0	\$ 114.1	\$ 108.7
<b>Plan assets</b>				
Market value, beginning of year	\$ 244.4	\$ 223.5	\$ –	\$ –
Actual return on plan assets	33.0	31.3	–	–
Employer contributions	9.3	7.6	3.7	4.4
Employee contributions	0.4	0.4	–	–
Benefits paid	(19.9)	(18.4)	(3.7)	(4.4)
Market value, end of year	\$ 267.2	\$ 244.4	\$ –	\$ –
<b>Funded status</b>				
Deficit	\$ (2.1)	\$ (22.6)	\$ (114.1)	\$ (108.7)
Unamortized past service cost	0.7	1.0	1.1	1.2
Unamortized actuarial losses	37.6	49.9	15.7	13.0
Accrued benefit asset (liability)	\$ 36.2	\$ 28.3	\$ (97.3)	\$ (94.5)
<b>Expense</b>				
Current service cost	\$ 2.5	\$ 2.2	\$ 2.9	\$ 2.4
Interest cost	14.5	14.8	6.1	5.9
Actual return on plan assets	(33.0)	(31.3)	–	–
Actuarial losses (gains)	5.8	15.3	2.3	(7.6)
Past service costs	–	0.7	–	–
New incidence (post-employment benefits)	–	–	–	0.4
(Income) expense before adjustments	(10.2)	1.7	11.3	1.1
Expected vs actual return on plan assets	16.0	16.0	–	–
Recognized vs actual past service costs	0.2	(0.5)	0.1	0.1
Recognized vs actual actuarial losses (gains)	(3.9)	(12.9)	(3.5)	7.2
Net expenses	\$ 2.1	\$ 4.3	\$ 7.9	\$ 8.4
<b>Classification of accrued benefit asset (liability)</b>				
Other assets	\$ 60.8	\$ 55.2	\$ –	\$ –
Other liabilities	(24.6)	(26.9)	(97.3)	(94.5)
Accrued benefit asset (liability)	\$ 36.2	\$ 28.3	\$ (97.3)	\$ (94.5)

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
	2006	2005	2006	2005
Accrued benefit obligation	\$ 19.9	\$ 19.5	\$ 97.3	\$ 94.5

The significant actuarial assumptions adopted in measuring the Company's accrued benefit obligations are as follows (weighted-average assumptions as of May 6, 2006):

	Pension Benefit Plans	Pension Benefit Plans	Other Benefit Plans	Other Benefit Plans
	2006	2005	2006	2005
Discount rate	5.50%	5.50%	5.50%	5.75%
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 2006 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 <sup>(1)</sup>	Benefit Obligations	Benefit Cost <sup>(1)</sup>
Expected long term rate of return on plan assets		7.00%		
Impact of: 1% increase		\$ (2.6)		
1% decrease		\$ 2.6		
Discount rate	5.50%	5.50%	5.50%	5.50%
Impact of: 1% increase	\$ (30.5)	\$ 0.3	\$ (17.5)	\$ (0.9)
1% decrease	\$ 34.4	\$ (0.6)	\$ 21.1	\$ 1.0
Growth rate of health costs <sup>(2)</sup>			10.00%	10.00%
Impact of: 1% increase			\$ 18.0	\$ 2.1
1% decrease			\$ (14.7)	\$ (1.6)

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

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

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

	2006	2005
Cash and short-term investments	3.34%	7.06%
Bonds, debenture, fixed income pooled funds and real estate funds	18.04%	17.71%
Equities and pooled equities fund	78.42%	74.96%
Accrued interest and dividends	0.20%	0.27%
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:

	2006	% of plan assets	2005	% of plan assets
	\$ 93.4	10.3%	\$ 80.2	10.0%

### 23. Business acquisitions

#### Sobeys Inc.

During fiscal 2006 the Company increased its ownership interest in Sobeys Inc. from 68.4% to 70.3% by way of purchase of shares on the open market. The acquisition was accounted 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 \$49.5, goodwill increased by \$13.2 and minority interest decreased by \$36.3.

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 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.

#### Other acquisitions

On September 30, 2005, ETL Canada Holdings 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 ETL Canada Holdings Limited further acquired one theatre with 4 screens in Western Canada from Motion Picture Distribution LP. The total cash consideration of the acquisitions was \$87.8. The acquisitions were accounted using the purchase method with net identifiable assets recorded at \$51.5 (including intangible assets of \$6.0) and goodwill recorded at \$36.3.

During fiscal 2006 Sobeys Inc. acquired franchisee stores and prescription files as part of its normal course of operations for total cash consideration of \$5.3. The acquisitions were accounted using the purchase method with net identifiable assets recorded at \$5.0 (including intangible assets of \$1.2) and goodwill recorded at \$0.3.

During fiscal 2005 the Company acquired franchisee stores and prescription files in its food 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.

### 24. Stock-based compensation

#### Deferred share units

Members of the Board of Directors may elect to receive all or any portion of their fees in Deferred Share Units ("DSUs") in lieu of cash. The number of DSUs received is determined by the market value of the Company's Non-Voting Class A shares on each director's fee payment date. Additional DSUs are received as dividend equivalents. DSUs 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 an Empire Company Limited Non-Voting Class A share at the time of the redemption. On an ongoing basis, the Company values the DSU obligation at the current market value of a Non-Voting Class A share and records any increase in the DSU obligation as an operating expense. At May 6, 2006, there were 60,470 (May 7, 2005 – 50,420) DSUs outstanding. During the year, the stock-based compensation expense was \$1.0 (2005 – \$0.9).

#### Share purchase loans

The Company has a Share Purchase Loan plan for employees of the Company whereby loans are granted to purchase Non-Voting Class A Shares. These loans have been treated as stock-based compensation in accordance with EIC Abstract 132. The application was on a prospective basis beginning in fiscal 2005 as it was determined that the application on a retroactive basis would not result in a material change.

The compensation cost relating to the 2006 Share Purchase Loans was determined to be \$0.2 (2005 – \$0.2) with amortization of the cost over 7 years. The total increase in contributed surplus in relation to the Share Purchase Loan compensation cost for 2006 is \$0.2. The compensation cost was calculated using the Black-Scholes model with the following assumptions:

	2006	2005
Expected life	7 years	7 years
Risk-free interest rate	4.25%	4.25%
Expected volatility	21.8%	22.7%
Dividend yield	1.5%	1.9%

## 25. 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 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 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 were accounted for on a retroactive basis with restatement resulting in the Company recording a decrease in opening retained earnings for fiscal 2005 of \$5.4 (net of minority interest of \$2.9). These lease accounting adjustments did not have any material impact on the Company's current or prior year's net earnings.

## 26. 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 2005 of \$3.8 (net of minority interest of \$2.1). The implementation of EIC-144 did not result in a material change in the 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 can be estimated. As of the year ended May 6, 2006, the Company has recognized \$3.5 of allowances in income where it is probable that the minimum purchase level will be met and the amount of allowance can be estimated.

## 27. 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 VIE were consolidated in the Company's results effective for the fourth quarter of fiscal 2005.

The Company has identified the following entities as VIEs:

### Franchise Affiliates

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

### Warehouse and Distribution Agreement

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

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

## Notes to the Consolidated Financial Statements

Consolidated Balance Sheet as at May 6, 2006

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

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

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

A charge of \$9.5 (net of minority interest of \$5.0) had been recorded to opening retained earnings for fiscal year 2005 to reflect:

1. The reduction of inventory values of the franchise affiliates that include charges from the Company for distribution costs and vendor allowances that are not recognized by the Company until final sale to customers,
2. Goodwill that is carried on the accounts of stores determined to be VIEs has been assessed as being impaired with no fair market value and, as such, has been eliminated.

It has been determined that a charge of \$3.7 (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 VIEs. Additional adjustments of \$0.1 (net of minority interest of \$0.1) to retained earnings are reflective of changes in the amount of VIE entities required to be consolidated.

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

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

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

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

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

#### 28. Change in fiscal year end

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

#### 29. Comparative figures

Comparative figures have been reclassified, where necessary, to reflect the current year's presentation.