# 1 Summary of significant accounting policies

## Basis of consolidation

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 by management in accordance with Canadian generally accepted accounting principles ("GAAP"), and include the accounts of the Company, all subsidiary companies, including 100 percent owned Sobeys Inc. ("Sobeys"), 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 using the equity method. Investments in significant joint ventures are consolidated on a proportionate basis.

The Company's fiscal year ends on the first Saturday in May. As a result, the fiscal year is usually 52 weeks but results in a duration of 53 weeks every five to six years.

## Changes in accounting policies

*Adopted during fiscal 2010*

### Goodwill and intangible assets

In February 2008, the Canadian Institute of Chartered Accountants ("CICA") issued Section 3064, "Goodwill and Intangible Assets", which replaced existing Section 3062, "Goodwill and Other Intangible Assets" and Section 3450, "Research and Development". The new standard provides guidance on the recognition, measurement, presentation and disclosure of goodwill and intangible assets. As a result of adopting Section 3064, Emerging Issues Committee ("EIC") Abstract 27, "Revenues and Expenditures During the Pre-Operating Period", no longer applies. The Company has implemented these requirements, in compliance with transitional provisions, effective for the first quarter of fiscal 2010 retrospectively with restatement of the comparative periods. The initial impact under the new standard as at May 2, 2009 was a decrease to prepaid expenses of $6.9, a decrease to other assets of $62.4, a decrease in property and equipment of $33.7, an increase to intangibles of $96.1, a decrease of future tax liabilities of $2.2 as well as a reduction of retained earnings of $4.7. For the year ended May 2, 2009, cost of sales, selling and administrative expenses decreased $9.4, depreciation and amortization expense increased $11.3 and income taxes decreased $0.7.

### Financial instruments – disclosures

In June 2009, the CICA issued amendments to the existing Section 3862, "Financial Instruments – Disclosures", to more closely align the section with those required under International Financial Reporting Standards ("IFRS"). The amendments include enhanced disclosure requirements relating to fair value measurements of financial instruments and liquidity risks. These amendments apply for annual financial statements with fiscal years ending after September 30, 2009. The Company has implemented these enhanced disclosure requirements in compliance with transitional provisions. The new disclosures did not have a material impact.

*Adopted during fiscal 2009*

### Inventories

In June 2007, the CICA issued Section 3031, "Inventories", which replaced Section 3030 with the same title. The Company, in accordance with transitional provisions, applied the standard prospectively to opening inventory and retained earnings for fiscal 2009. The initial impact of measuring inventories under the new standard using a consistent cost formula for inventories with a similar nature and use was a decrease to the carrying amount of opening inventories of $27.9 and a decrease to income taxes payable of $6.4. Opening retained earnings was reduced by $21.5, equal to the change in opening inventories, net of tax.

### Capital disclosures

In October 2006, the CICA issued Section 1535, "Capital Disclosures". This section established standards for disclosing information about an entity's capital and how it is managed. The standard was effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007 and was applicable for the Company's first quarter of fiscal 2009. The adoption of Section 1535 did not have an impact on the Company's financial results or position.

### Financial instruments – disclosure and financial instruments – presentation

Section 3862, "Financial Instruments – Disclosure", and Section 3863, "Financial Instruments – Presentation", replaced Section 3861, "Financial Instruments – Disclosure and Presentation". These standards were effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007 and were applicable for the Company's first quarter of fiscal 2009. Section 3862 requires increased disclosures regarding the risks associated with financial instruments such as credit risk, liquidity risk and market risk and the techniques used to identify, monitor and manage these risks. In accordance with the transitional provision of Section 3862, comparative information about the nature and extent of risks arising from financial instruments was not required in the year of adoption. Section 3863 carries forward standards for presentation of financial instruments and non-financial derivatives and provides additional guidance for the classification of financial instruments between liabilities and equity and had no significant impact on the Company's financial statements.

### Financial instruments – recognition and measurement

In January 2009, the CICA issued EIC 173, "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities". EIC 173 requires that a company take into account its own credit risk and the credit risk of its counterparty in determining the fair value of financial assets and financial liabilities. This abstract must be applied retrospectively without restatement of prior periods to all financial assets and liabilities measured at fair value in interim and annual financial statements for periods ending on or after January 20, 2009. The adoption of EIC 173 did not have a material impact on the Company's financial results, financial position or disclosures.

*Future changes in accounting policies*

### Business combinations, consolidated financial statements and non-controlling interests

In January 2009, the CICA issued three new accounting standards which are based on the International Accounting Standards Board's IFRS 3, "Business Combinations". Section 1582, "Business Combinations", which replaces Section 1581 with the same title, aims to improve the relevance, reliability and comparability of the information provided in financial statements about business combinations. This section is to be applied prospectively to business combinations for which the acquisition date is on or after January 1, 2011 and assets and liabilities that arose from business combinations that preceded the adoption of this standard should not be adjusted upon adoption. Section 1601, "Consolidated Financial Statements", and Section 1602, "Non-Controlling Interests", replace Section 1600, "Consolidated Financial Statements", and establish standards for the preparation of consolidated financial statements and accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards apply to interim and annual consolidated financial statements beginning on or after January 1, 2011. Earlier adoption of all three standards is permitted as of the beginning of a fiscal year, however if an entity chooses to early adopt, all three standards must be adopted concurrently. The Company is currently evaluating the impact of these new standards.

### Multiple deliverable revenue arrangements

In December 2009, the CICA issued EIC 175, "Multiple Deliverable Revenue Arrangements". EIC 175, which replaces EIC 142, "Revenue Arrangements with Multiple Deliverables", addresses some aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue-generating activities. This new standard is effective for the Company's annual consolidated financial statements commencing on January 1, 2011 with earlier adoption permitted as of the beginning of a fiscal year. The Company is assessing the impact of the new standard on its financial statements.

## 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 of cost and net realizable value with cost being determined on a weighted average cost basis. Retail inventories are valued at the lower of cost and net realizable value. Cost is determined using a weighted average cost using either the standard cost method or a retail method. The retail method uses the anticipated selling price less normal profit margins, on a weighted average cost basis.

The cost of inventories is comprised of directly attributable costs and includes the purchase price plus other costs incurred in bringing the inventories to their present location and condition, such as freight. The cost is reduced by the value of rebates and allowances received from vendors. The Company estimates net realizable value as the amount that inventories are expected to be sold taking into consideration fluctuations of retail price due to seasonality less estimated costs necessary to make the sale. Inventories are written down to net realizable value when the cost of inventories is estimated to not be recoverable due to obsolescence, damage or permanent declines in selling prices. When circumstances that previously caused inventories to be written down below cost no longer exist or when there is clear evidence of an increase in retail selling price, the amount of the write-down previously recorded is reversed. Costs that do not contribute to bringing inventories to their present location and condition, such as storage and administrative overheads, are specifically excluded from the cost of inventories and are expensed in the period incurred.

Real estate inventory of residential properties are carried at the lower of cost or net realizable value. Estimated net realizable value is based upon the net sales proceeds anticipated in the normal course of business, less estimated costs to complete or improve the property to the condition used in determining the estimated selling price. Capitalized costs include the cost of land and the cost of services, such as roads, sewerage and water systems on land under development, carrying and other costs, net of any rental income. Carrying costs include an allocation of interest on debt and property taxes, but do not include any allocation of administrative overhead. Interest cost generally is not allocated to raw land holdings until development commences. The cost of land is generally pro-rated to each phase of a project on an acreage basis. Cost of land sold, including development costs, is allocated within each phase to saleable lots in proportion to anticipated revenues.

## Long-lived assets

Long-lived assets are reviewed for impairment when events or changes in circumstances indicate that the book value of the assets may not be recoverable, as measured by comparing their net book value to the estimated undiscounted future cash flows generated by their use. Impaired assets are recorded at the lower of carrying and fair value, determined principally using discounted future cash flows expected from their use and eventual disposition, with the impairment loss charged to cost of sales, selling and administrative expenses.

## Property and equipment

Property and equipment is recorded at net book value, being original cost less accumulated depreciation and any writedowns for impairment.

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, fixtures and vehicles | 3 – 20 years |
| Buildings | 10 – 40 years |
| Leasehold improvements | Lesser of lease term and 7 – 20 years |

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 book value and fair value less cost of disposal.

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 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 $0.6 (2009 – $3.1).

### (b) Development properties and land held for future development

Interest, real estate taxes and other expenses are expensed, with the exception of property taxes which are capitalized during the construction period. Capitalization of all costs ceases when the development property is substantially complete and ready for productive use, at which time the properties are classified as commercial properties. No amounts were capitalized in fiscal 2010 ($nil in fiscal 2009).

## Deferred charges

Deferred store marketing costs, primarily comprised of major store renovation and expansion costs, are included with equipment, fixtures and vehicles as part of the Company's property and equipment balance sheet group.

## 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. Capital lease obligations are included in the long-term debt of the Company and are reduced by rental payments net of imputed interest. All other leases are accounted for as operating leases.

Lease allowances and incentives are recorded as other long-term liabilities and amortized as a reduction of lease expense over the term of the lease. Real estate lease expense is amortized straight-line over the entire term of the lease including free rent 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.

## 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, "Disposal of Long-lived Assets and Discontinued Operations". These assets are expected to be sold within a twelve-month period and are no longer productive assets with no interest to develop them for future use. Assets held for sale are valued at the lower of book value and fair value less cost of disposal. Liabilities assumed upon sale of assets or debts to be repaid as part of a sale transaction are also classified as "Liabilities relating to assets held for sale".

## Intangibles

Intangibles arise on the purchase of a new business, existing franchises, software and the acquisition of pharmacy prescription files. Amortization is recorded on limited life intangibles on a straight-line basis over the estimated useful life of the intangible as follows:

| | |
|---|---|
| Brand names | 10 years |
| Deferred purchase agreements | 5 – 10 years |
| Franchise rights/agreements | 10 years |
| Patient files | 15 years |
| Software | 3 – 7 years |
| Other | 5 – 10 years |

## Goodwill and intangibles with indefinite useful lives

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 not amortized but rather are subject to an annual impairment review or more frequently if circumstances exist that might indicate its value is impaired. Should the carrying value exceed the fair value of goodwill or intangible assets (e.g. trademarks), the carrying value will be written down to the fair value.

## Financial instruments

The Company is required to recognize and measure all of its financial assets and liabilities, including derivatives and embedded derivatives in certain contracts, at fair value. Loans and receivables, held to maturity financial assets and other financial liabilities are subsequently measured at cost or amortized cost. Derivatives and non-financial derivatives must be recorded at fair value on the consolidated balance sheets unless they are exempt from derivative treatment based upon expected purchase, sale or usage requirements.

The Company classifies financial assets and liabilities according to their characteristics and management's choices and intentions related thereto for the purposes of ongoing measurements. Classification choices for financial assets include: a) held for trading – measured at fair value with changes in fair value recorded in net earnings; b) held to maturity – recorded at amortized cost with gains and losses recognized in net earnings in the period that the asset is derecognized or impaired; c) available-for-sale – measured at fair value with changes in fair value recognized in other comprehensive income for the current period until realized through disposal or impairment; and d) loans and receivables – recorded at amortized cost with gains and losses recognized in net earnings in the period that the asset is no longer recognized or impaired. Classification choices for financial liabilities include: a) held for trading – measured at fair value with changes in fair value recorded in net earnings; and b) other – measured at amortized cost with gains and losses recognized in net earnings in the period that the liability is no longer recognized. Any financial asset or liability can be classified as held for trading as long as its fair value is reliably determinable.

The Company's financial assets and liabilities are generally classified and measured as follows:

| Asset/Liability | Classification | Measurement |
|---|---|---|
| Cash and cash equivalents | Held for trading | Fair value |
| Receivables | Loans and receivables | Amortized cost |
| Loans and other receivables | Loans and receivables | Amortized cost |
| Investments | Available-for-sale | Fair value |
| Derivative other assets and liabilities | Held for trading | Fair value |
| Non-derivative other assets | Held for trading | Fair value |
| Bank indebtedness | Other liabilities | Amortized cost |
| Accounts payable and accrued liabilities | Other liabilities | Amortized cost |
| Long-term debt | Other liabilities | Amortized cost |

Transaction costs other than those related to financial instruments classified as held for trading, which are expensed as incurred, are added to the fair value of the financial asset or financial liability on initial recognition and amortized using the effective interest method.

In fiscal 2010, the Company adopted the recent amendments to Section 3862, "Financial Instruments – Disclosures", which more closely aligns the section with those required under IFRS. The amendments include enhanced disclosures about inputs to the fair value measurements, including classification within a hierarchy that prioritizes the inputs to fair value measurement. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The three levels of the fair value hierarchy are: level 1 – inputs that reflect unadjusted quoted prices in active markets for identical assets or liabilities; level 2 – inputs, other than quoted prices, that are observable for the asset or liability either directly or indirectly, including inputs in markets that are not considered to be active; or level 3 – inputs that are not based on observable market data. Inputs into the determination of fair value require significant management judgment or estimation.

If different levels of inputs are used to measure a financial instrument's fair value, the classification within the hierarchy is based on the lowest level of input that is significant to the fair value measurement. Changes in valuation methods may result in transfers into or out of an investment's assigned level. These amendments do not have any impact on the valuation of the Company's financial instruments and comparative information is not required in the first year of application. Refer to Note 21 for the classification of the Company's financial instruments.

## Guarantees

Obligations undertaken through issuance of a guarantee that meets the definition of a guarantee pursuant to Accounting Guideline ("AcG") 14, "Disclosure Guarantees", are recognized at fair value at inception with no subsequent re-measurement at fair value required unless the financial guarantee qualifies as a derivative.

### Hedges

The Company has cash flow hedges which are used to manage exposure to fluctuations in foreign currency exchange rates, variable interest rates and energy prices. For cash flow hedges, the effective portion of the change in fair value of the hedging item is recorded in other comprehensive income. To the extent the change in fair value of the derivative is not completely offset by the change in fair value of the hedged item, the ineffective portion of the hedging relationship is recorded immediately in net earnings. Amounts accumulated in other comprehensive income are reclassified to net earnings when the hedged item is recognized in net earnings. When a hedging instrument in a cash flow hedge expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss in accumulated other comprehensive income relating to the hedge is carried forward until the hedged item is recognized in net earnings. When the hedged item ceases to exist as a result of its expiry or sale, or if an anticipated transaction is no longer expected to occur, the cumulative gain or loss in accumulated other comprehensive income is immediately reclassified to net earnings.

Financial derivatives assigned as part of a cash flow hedging relationship are classified as either an other asset or other liability as required based on their fair market value determination.

Significant derivatives include the following:

(1) Foreign currency forward contracts for the primary purpose of limiting exposure to exchange rate fluctuations relating to expenditures denominated in foreign currencies. These contracts are designated as hedging instruments for accounting purposes. Accordingly, the effective portion of the change in the fair value of the forward contracts are accumulated in other comprehensive income until the variability in cash flows being hedged is recognized in earnings in future accounting periods.

(2) Electricity contracts to manage the cost of electricity designated as cash flow hedges of anticipated transactions. The portion of gain or loss on derivative instruments designated as cash flow hedges that are deferred in accumulated other comprehensive income is reclassified into other income/expense when the product containing the hedged item impacts earnings.

(3) Interest rate swaps designated as cash flow hedges to manage variable interest rates associated with some of the Company's debt portfolio. Hedge accounting treatment results in interest expense on the related debt being reflected at hedged rates rather than variable interest rates.

### Customer loyalty programs

A Club Sobeys loyalty card program (the "Program") was launched during fiscal 2009. The Program allows members to earn points on their purchases in certain Sobeys stores. As well, a Club Sobeys credit card entitles the customer to earn points for their purchases on the credit card. Members can redeem these points, in accordance with the Program rewards schedule, for discounts on future grocery purchases, purchase products or services or elect to convert the points into Aeroplan miles which is a loyalty program run by a third party. When points are earned by Program members, the Company records an expense in its consolidated statements of earnings and establishes a liability for future redemptions by multiplying the number of points issued by the estimated cost per point. The Program liability is included in accounts payable and accrued liabilities on the Company's consolidated balance sheets. The actual cost of Program redemptions is charged against the liability account. During fiscal 2010, a loyalty card program, Club Thrifty Foods, was launched. It follows a similar point earning and redemption structure as the Club Sobeys loyalty card program.

The estimated cost per point is determined based on many factors, primarily related to the expected future redemption patterns and associated costs. The Company monitors, on an ongoing basis, trends in redemption rates (points redeemed as a percentage of points issued) and net cost per point redeemed and adjusts the estimated cost per point based upon expected future activity. Any difference in the cost per point is recognized in cost of sales, selling and administrative expenses in the Company's consolidated statements of earnings. To the extent that estimates differ from actual experience, the Program expense could be higher or lower. The Company continues to evaluate and revise certain assumptions used to calculate the Program liability, based on redemption experience and expected future activity.

An AIR MILES® reward program is also used by the Company. AIR MILES® are earned by certain Sobeys customers based on purchases in stores. The Company pays a per point fee under the terms of the agreement with AIR MILES®. The cost of this program is expensed as incurred as cost of sales, selling and administrative expenses in the consolidated statements of earnings.

### Future income taxes

The Company uses the asset and liability method of accounting for income taxes, under which future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Future tax assets are recognized to the extent that it is more likely than not that they will be recovered. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the year that includes the date of enactment or substantive enactment.

### Deferred revenue

Deferred revenue consists of long-term supplier purchase agreements, rental revenue arising from the sale of subsidiaries and gains on sale leaseback transactions. Deferred revenue is being taken into income on a straight-line basis over the term of the related agreements and is included in other long-term liabilities.

### 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 in accumulated other comprehensive income.

Other assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the foreign currency exchange rate in effect at each period end date. Exchange gains or losses arising from the translation of these balances denominated in foreign currencies 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.

Revenue from the sale of residential lots and development properties is recognized in the period in which the transaction occurs, provided the earnings process is completed and the collection of the proceeds is reasonably assured. As required under GAAP, any gains on sale of properties to Crombie REIT, which is accounted for using the equity method, are not included in net earnings. Gains are applied to reduce the carrying value of the Company's equity investment in Crombie REIT. Commercial real estate revenue is recognized in accordance with the lease agreements with tenants on a straight-line basis.

### Pension benefit plans and other benefit plans

The cost of the Company's pension benefits for defined contribution plans are expensed at the time active employees are compensated. 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 percent 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 the Company's Supplemental Executive Retirement Plan ("SERP"), the impact of changes in the plan provisions are amortized over five years.

### 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. The Company recognizes these allowances as a reduction of cost of sales, selling and administrative expenses and related inventories in accordance with EIC 144, "Accounting by a Customer (including a Reseller) for Certain Consideration Received from a Vendor". Certain allowances from vendors are contingent on the Company achieving minimum purchase levels. These allowances are recognized 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 1, 2010, the Company has recognized $4.8 (2009 – $5.7) of allowances in income where it is probable that the minimum purchase level will be met and the amount of allowance can be estimated.

### Use of estimates

The preparation of consolidated financial statements, in conformity with GAAP, requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Certain of these estimates require subjective or complex judgements by management that may be uncertain. Some of these items include the valuation of inventories, goodwill, employee future benefits, stock-based compensation, valuation of asset-backed commercial paper, loyalty programs and income taxes. Changes to these estimates could materially impact the financial statements. These estimates are based on management's best knowledge of current events and actions that the Company may undertake in the future. Actual results could differ from these estimates.

### 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 determined based on the treasury stock method which assumes that all outstanding stock options with an exercise price below the average market price are exercised and the assumed proceeds are used to purchase the Company's common shares at the average market price during the year.

## 2 Earnings per share

Earnings applicable to common shares is comprised of the following:

| | 2010 | 2009 Restated (Note 1) |
|---|---|---|
| Operating earnings | $ 284.5 | $ 261.7 |
| Capital gains and other items, net of income taxes of $(18.0) (2009 – $(0.2)) | 17.4 | 3.0 |
| Net earnings | 301.9 | 264.7 |
| Preferred share dividends | (0.1) | (0.1) |
| Earnings applicable to common shares | $ 301.8 | $ 264.6 |

Included in income taxes of $(18.0) for the year ended May 1, 2010 is an income tax recovery of $17.0 (refer to Note 17).

Earnings per share is comprised of the following:

| | | |
|---|---|---|
| Operating earnings | $ 4.16 | $ 3.98 |
| Net capital gains and other items | 0.25 | 0.05 |
| Basic earnings per share | $ 4.41 | $ 4.03 |
| Operating earnings | $ 4.15 | $ 3.97 |
| Net capital gains and other items | 0.25 | 0.05 |
| Diluted earnings per share | $ 4.40 | $ 4.02 |

## 3 Inventories

The cost of inventories recognized as an expense during the year was $11,616.1 (2009 – $11,232.5). The cost of inventories recognized as an expense during the year included $36.2 (2009 – $45.5) for the write-down of inventories below cost to net realizable value. There were no reversals of inventories written down previously (2009 – $nil).

## 4 Investments, at equity

| | May 1, 2010 | May 2, 2009 |
|---|---|---|
| Wajax Income Fund (27.6% interest) | $ 30.8 | $ 31.0 |
| Crombie REIT (47.4% interest) | 8.4 | (19.7) |
| U.S. residential real estate partnerships | 17.6 | 7.5 |
| | $ 56.8 | $ 18.8 |

The Company's carrying value of its investment in Wajax Income Fund is as follows:

| | May 1, 2010 | May 2, 2009 |
|---|---|---|
| Balance, beginning of year | $ 31.0 | $ 31.6 |
| Equity earnings | 9.2 | 18.5 |
| Share of comprehensive loss | (0.2) | (0.5) |
| Distributions received | (9.2) | (18.6) |
| Balance, end of year | $ 30.8 | $ 31.0 |

The Company's carrying value of its investment in Crombie REIT is as follows:

| | May 1, 2010 | May 2, 2009 |
|---|---|---|
| Balance, beginning of year | $ (19.7) | $ 9.5 |
| Equity earnings | | |
| Continuing operations | 18.6 | 19.8 |
| Other expenses | (4.7) | – |
| Share of comprehensive income (loss) | 11.8 | (20.8) |
| Distributions received | (24.9) | (21.8) |
| Deferral of gains on sale of property | (2.7) | (6.4) |
| Interest acquired in Crombie REIT | 30.0 | – |
| Balance, end of year | $ 8.4 | $ (19.7) |

On June 25, 2009, Crombie REIT closed a bought-deal public offering of units at a price of $7.80 per unit. In satisfaction of its pre-emptive right with respect to the public offering, the Company subscribed for $30.0 of Class B Units (which are convertible on a one-for-one basis into units of Crombie REIT). Consequently the Company's interest in Crombie REIT was reduced from 47.9% to 47.4%.

## 5 Loans and other receivables

| | May 1, 2010 | May 2, 2009 |
|---|---|---|
| Loans and mortgages receivable | $ 110.5 | $ 86.9 |
| Notes receivable and other | 74.5 | 54.0 |
| | 185.0 | 140.9 |
| Less amount due within one year | 105.8 | 65.6 |
| | $ 79.2 | $ 75.3 |

### Loans and mortgages receivable

Loans and mortgages receivable represent long-term financing to certain retail associates. These loans and mortgages 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 and mortgages receivable approximates fair value based on the variable interest rates charged on the loans and the operating relationship of the associates with the Company.

## 6 Other assets

| | May 1, 2010 | May 2, 2009 Restated (Note 1) |
|---|---|---|
| Accrued benefit asset *(Note 24)* | $ 60.4 | $ 63.1 |
| Asset-backed commercial paper | 21.2 | 17.8 |
| Restricted cash | 10.6 | 3.6 |
| Derivative assets | – | 1.7 |
| Other | 2.3 | 2.8 |
| | $ 94.5 | $ 89.0 |

**Asset-backed commercial paper**

Included in other assets is $30.0 (2009 – $30.0) of third-party asset-backed commercial paper ("ABCP") which the Company estimates the fair value to be $21.2 (2009 – $17.8), approximately 71 percent (2009 – 59 percent) of the face value. On January 21, 2009, the Company derecognized the existing held to maturity assets and received restructured ABCP MAV II notes: A1 – $7.8, A2 – $17.5, B – $3.2, C – $0.9 and $0.6 of tracking notes (the "restructured notes") as designated in the Montreal Accord as well as accrued interest. The A1 and A2 notes received an A rating from the Dominion Bond Rating Service ("DBRS"). The remaining notes have not yet been rated. The restructured notes are floating rate notes with expected payouts in January 2017.

On August 11, 2009, DBRS downgraded the A2 notes from A to BBB (low) under a negative watch. The downgrade did not have a material change in the fair value of the notes. Continuing uncertainties regarding the value of assets which underlie the ABCP, the amount and timing of cash flows and the outcome of the restructuring process could give rise to a further material change in the value of the Company's investment in ABCP which could impact the Company's future earnings. The Company believes it has sufficient credit facilities to satisfy its financial obligations as they come due and does not expect there will be a material adverse impact on its business as a result of this current third party ABCP liquidity issue.

The Company has classified these notes as held for trading and as a result are fair valued at each reporting period. During fiscal 2009, the Company received $1.0 of interest and recorded a $4.7 pre-tax provision. The Company updated its analysis of the fair value of the restructured notes, including factors such as estimated cash flow scenarios and risk adjusted discount rates, and a pre-tax gain of $3.4 was recorded in the year ended May 1, 2010. Discount rates vary depending upon the credit rating of the restructured long-term floating rate notes. Discount rates have been estimated using Government of Canada benchmark rates plus expected spreads for similarly rated instruments with similar maturities and structure. The Company has performed a sensitivity analysis on estimated discount rates used in the fair value analysis and determined that a change of one percent would result in a pre-tax change in the fair value of these investments of approximately $1.6 (2009 – $1.3).

## 7 Property and equipment

| | | | May 1, 2010 |
|---|---|---|---|
| | Cost | Accumulated Depreciation | Net Book Value |
| Food segment | | | |
| Land | $ 263.4 | $ – | $ 263.4 |
| Land held for development | 60.8 | – | 60.8 |
| Buildings | 959.9 | 260.0 | 699.9 |
| Equipment, fixtures and vehicles | 2,304.6 | 1,463.8 | 840.8 |
| Leasehold improvements | 530.5 | 312.0 | 218.5 |
| Construction in progress | 91.0 | – | 91.0 |
| Assets under capital leases | 119.0 | 65.1 | 53.9 |
| | 4,329.2 | 2,100.9 | 2,228.3 |
| Real estate and other segments | | | |
| Land | 6.5 | – | 6.5 |
| Land held for development | 57.6 | – | 57.6 |
| Buildings | 73.7 | 27.9 | 45.8 |
| Equipment | 84.7 | 47.3 | 37.4 |
| Leasehold improvements | 78.7 | 24.2 | 54.5 |
| Construction in progress | 69.5 | – | 69.5 |
| Petroleum and natural gas costs | 84.6 | 35.5 | 49.1 |
| | 455.3 | 134.9 | 320.4 |
| Total | $ 4,784.5 | $ 2,235.8 | $ 2,548.7 |

| | | | May 2, 2009 Restated (Note 1) |
|---|---|---|---|
| | Cost | Accumulated Depreciation | Net Book Value |
| Food segment | | | |
| Land | $ 270.7 | $ – | $ 270.7 |
| Land held for development | 57.2 | – | 57.2 |
| Buildings | 909.8 | 238.0 | 671.8 |
| Equipment, fixtures and vehicles | 2,192.6 | 1,409.2 | 783.4 |
| Leasehold improvements | 488.2 | 288.2 | 200.0 |
| Construction in progress | 227.1 | – | 227.1 |
| Assets under capital leases | 113.8 | 52.1 | 61.7 |
| | 4,259.4 | 1,987.5 | 2,271.9 |
| Real estate and other segments | | | |
| Land | 6.5 | – | 6.5 |
| Land held for development | 57.5 | – | 57.5 |
| Buildings | 72.9 | 25.1 | 47.8 |
| Equipment | 78.1 | 41.6 | 36.5 |
| Leasehold improvements | 59.1 | 19.7 | 39.4 |
| Construction in progress | 54.1 | – | 54.1 |
| Petroleum and natural gas costs | 83.9 | 29.8 | 54.1 |
| | 412.1 | 116.2 | 295.9 |
| Total | $ 4,671.5 | $ 2,103.7 | $ 2,567.8 |

## 8 Intangibles

| | | | May 1, 2010 |
|---|---|---|---|
| | Cost | Accumulated Amortization | Net Book Value |
| Brand names | $ 201.0 | $ 8.2 | $ 192.8 |
| Deferred purchase agreements | 56.4 | 18.4 | 38.0 |
| Franchise rights/agreements | 57.9 | 18.6 | 39.3 |
| Loyalty programs | 11.4 | – | 11.4 |
| Patient files | 33.1 | 8.3 | 24.8 |
| Private labels | 59.5 | – | 59.5 |
| Software | 125.9 | 74.9 | 51.0 |
| Other | 71.6 | 33.4 | 38.2 |
| | $ 616.8 | $ 161.8 | $ 455.0 |

| | | | May 2, 2009 Restated (Note 1) |
|---|---|---|---|
| | Cost | Accumulated Amortization | Net Book Value |
| Brand names | $ 201.0 | $ 5.3 | $ 195.7 |
| Deferred purchase agreements | 49.3 | 12.1 | 37.2 |
| Franchise rights/agreements | 52.8 | 13.4 | 39.4 |
| Loyalty programs | 11.4 | – | 11.4 |
| Patient files | 26.6 | 6.6 | 20.0 |
| Private labels | 59.5 | – | 59.5 |
| Software | 96.6 | 62.9 | 33.7 |
| Other | 74.8 | 30.2 | 44.6 |
| | $ 572.0 | $ 130.5 | $ 441.5 |

Included in intangibles as at May 1, 2010 and May 2, 2009 are the following amounts with indefinite useful lives: Brand names – $172.8; Loyalty programs $11.4; and Private Labels $59.5.

## 9 Bank indebtedness

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

## 10 Long-term debt

| | **May 1, 2010** | May 2, 2009 |
|---|---|---|
| | **Total** | Total |
| First mortgage loans, average interest rate 9.0%, due 2011 – 2021 | **$ 65.7** | $ 71.5 |
| Medium Term Notes, interest rate 5.8%, due October 6, 2036 | **125.0** | 125.0 |
| 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 |
| Debentures, average interest rate 9.9%, due 2011 – 2016 | **48.2** | 62.6 |
| Notes payable and other debt primarily at interest rates fluctuating with the prime rate | **149.8** | 146.2 |
| Credit facility, floating interest rate tied to bankers' acceptance rates, due June 8, 2010 | **294.5** | 244.0 |
| Credit facility, floating interest rate tied to bankers' acceptance rates, due July 23, 2012 | **200.0** | 200.0 |
| Credit facility, floating interest rate tied to bankers' acceptance rates, due November 8, 2010 | **–** | 75.0 |
| Unamortized financing costs | **(2.0)** | (3.0) |
| Capital lease obligations, weighted average interest rate 5.38%, due 2010 – 2040 | **52.2** | 60.7 |
| | **1,208.4** | 1,257.0 |
| Less amount due within one year | **379.4** | 133.0 |
| | **$ 829.0** | $ 1,124.0 |

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.

During fiscal 2008, in relation to the privatization of Sobeys, the Company entered into new credit facilities (the "Credit Facilities") consisting of a $950.0 unsecured revolving term credit maturing June 8, 2010 (subject to annual one-year extensions at the request of the Company). The Credit Facilities are subject to certain financial covenants. Interest on the debt varies based on the designation of the loan (bankers' acceptances ("BA") rate loans, Canadian prime rate loans, U.S. base rate loans or LIBOR loans), fluctuations in the underlying rates, and in the case of the BA rate loans or LIBOR loans, the margin applicable to the financial covenants. On June 18, 2007, the Company entered into two delayed fixed rate interest swaps. The first swap, in an amount of $200.0, is for a period of three years at a fixed interest rate of 4.998%. The second swap, in an amount of $200.0, is for a period of five years at a fixed interest rate of 5.051%. Both swaps became effective on July 23, 2007.

On June 27, 2007, pursuant to the terms of the Credit Facilities, the Company and Sobeys filed notice with the lenders requesting the establishment of a new $300.0 five-year credit in favour of Sobeys at the same interest rate and substantially on the same terms and conditions as the Credit Facilities. At July 23, 2007, Sobeys drew down $300.0 from its new credit facility, the proceeds of which were used to pay a dividend to the Company. The Company used the proceeds from the dividend to reduce its indebtedness under the Credit Facilities and the Credit Facilities were reduced to $650.0 accordingly. On that date, the Company also transferred the second swap to Sobeys. At May 1, 2010, the Credit Facilities have a balance outstanding of $294.5 (May 2, 2009 – $244.0). Subsequent to year-end, the Credit Facilities were renewed (refer to Note 29).

On July 30, 2007, Sobeys exercised an option under its new credit facility to increase the size of the credit from $300.0 to $600.0. At the same time, Sobeys terminated its previously existing $300.0 operating credit which would have expired on December 20, 2010. At May 1, 2010, $200.0 (May 2, 2009 – $200.0) of this new credit facility has been drawn down and classified as long-term debt. Sobeys has also issued $36.8 in letters of credit against the facility at May 1, 2010 ($40.1 at May 2, 2009).

On November 8, 2007, Sobeys established a revolving credit facility of $75.0 that is currently unutilized. The maturity date is November 8, 2010. The interest rate is floating and fluctuates with changes in the bankers' acceptance rate, Canadian prime rate or LIBOR. On June 12, 2009, Sobeys repaid, although did not cancel, this facility.

During fiscal 2010, Sobeys increased its capital lease obligation by $7.1 (2009 – $12.6) with a similar increase in assets under capital leases. These additions are non-cash in nature, therefore have been excluded from the statements of cash flows.

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

| | Long-Term Debt | Capital Leases |
|---|---|---|
| 2011 | $ 364.2 | $ 17.6 |
| 2012 | 23.8 | 14.1 |
| 2013 | 218.0 | 9.7 |
| 2014 | 32.6 | 6.4 |
| 2015 | 25.1 | 5.1 |
| Thereafter | 494.5 | 6.2 |
| Total minimum lease payments | | 59.1 |
| Financial expenses included in minimum lease payments | | 6.9 |
| | | $ 52.2 |

## 11 Other long-term liabilities

| | May 1, 2010 | May 2, 2009 |
|---|---|---|
| Deferred lease obligation | $ 66.8 | $ 54.4 |
| Deferred revenue | 13.3 | 7.8 |
| Accrued benefit liability *(Note 24)* | 25.4 | 24.3 |
| Derivative liabilities | 17.2 | 39.8 |
| Other | 7.9 | 8.7 |
| | $ 130.6 | $ 135.0 |

## 12 Capital stock

### Authorized

| | No. of Shares | May 1, 2010 | May 2, 2009 |
|---|---|---|---|
| Preferred shares, par value of $25 each, issuable in series. | | | |
| Series 2 cumulative, redeemable, rate of 75% of prime. | 2,682,100 | | |
| 2002 preferred shares, par value of $25 each, issuable in series. | 992,000,000 | | |
| Non-Voting Class A shares, without par value. | 259,107,435 | | |
| Class B common shares, without par value, voting. | 40,800,000 | | |
| **Issued and outstanding:** | | | |
| Preferred shares, Series 2 | 168,000 | $ 4.2 | $ 4.2 |
| Non-Voting Class A | 34,197,498 | 316.2 | 316.1 |
| Class B common | 34,260,763 | 7.6 | 7.6 |
| | | 328.0 | 327.9 |
| Employees' share purchase plan | | (2.9) | (3.4) |
| | | $ 325.1 | $ 324.5 |

The Series 2 preferred shares are redeemable at par. During the year, the Company purchased for cancellation nil (2009 – 90,200) Series 2 preferred shares for $nil (2009 – $2.3).

Loans receivable from officers and employees of $2.9 (2009 – $3.4) 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 101,510 (2009 – 110,148) Non-Voting Class A shares. The market value of the shares at May 1, 2010 was $5.4 (May 2, 2009 – $5.5).

On April 24, 2009, the Company closed a bought-deal public offering of Non-Voting Class A shares at a price of $49.75 per share. The underwriters elected to exercise their over-allotment option in full resulting in a total of 2,713,000 shares being issued for net proceeds of $129.1.

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.

## 13 Accumulated other comprehensive loss

The following table provides further detail regarding the composition of accumulated other comprehensive loss:

| | May 1, 2010 | May 2, 2009 |
|---|---|---|
| Balance, beginning of year | $ (48.5) | $ (21.5) |
| Other comprehensive income (loss) for the year | 20.4 | (27.0) |
| Balance, end of year | $ (28.1) | $ (48.5) |

An estimated net loss of $6.0 recorded in accumulated other comprehensive loss related to the cash flow hedges as at May 1, 2010 (May 2, 2009 – $4.6), is expected to be reclassified to net earnings during the next 12 months. Remaining amounts will be reclassified to net earnings over periods up to nine years.

## 14 Capital management

The Company's objectives when managing capital are: (i) to ensure sufficient liquidity to support its financial obligations and execute its operating and strategic plans, (ii) to minimize the cost of capital while taking into consideration current and future industry, market and economic risks and conditions, (iii) to maintain an optimal capital structure that provides necessary financial flexibility while also ensuring compliance with any financial covenants, and; (iv) to maintain an investment grade credit rating with each rating agency that assesses the credit worthiness of Sobeys Inc. No changes were made to these objectives in the current year.

The Company monitors and makes adjustments to its capital structure, when necessary, in light of changes in economic conditions, the objectives of its shareholders, the cash requirements of the business and the condition of capital markets.

The Company considers its total capitalization to include all interest bearing debt, including bank loans, bankers' acceptances, long-term debt (including the current portion thereof) and shareholders' equity, net of cash. The calculation is set out in the following table:

| | May 1, 2010 | May 2, 2009 Restated (Note 1) |
|---|---|---|
| Bank indebtedness | $ 17.8 | $ 45.9 |
| Long-term debt due within one year | 379.4 | 133.0 |
| Long-term debt | 829.0 | 1,124.0 |
| Funded debt | 1,226.2 | 1,302.9 |
| Less cash and cash equivalents | (401.0) | (231.6) |
| Net funded debt | 825.2 | 1,071.3 |
| Shareholders' equity | 2,952.4 | 2,678.8 |
| Capital under management | $ 3,777.6 | $ 3,750.1 |

Although the Company does not include operating leases in its definition of capital, the Company does give consideration to its obligations under operating leases when assessing its total capitalization.

The primary investments undertaken by the Company include additions to the selling square footage of its store network via the construction of new, relocated and expanded stores, including related leasehold improvements and features and the purchase of land bank sites for future store construction. The Company makes capital investments in information technology and its distribution capabilities to support an expanding store network. In addition, the Company makes capital expenditures in support of its real estate and other operations. The Company largely relies on its cash flow from operations to fund its capital investment program and dividend distributions to its shareholders. This cash flow is supplemented, when necessary, through the borrowing of additional debt or the issuance of additional capital stock.

Management monitors certain key ratios to effectively manage capital:

| | May 1, 2010 | May 2, 2009 Restated (Note 1) |
|---|---|---|
| Funded debt to total capital[1] | **29.3%** | 32.7% |
| Funded debt to EBITDA[2] | **1.50x** | 1.62x |
| EBITDA to interest expense | **11.30x** | 9.95x |

(1) Total capital is funded debt plus shareholders' equity.

(2) EBITDA and interest expense are comprised of EBITDA and interest expense for each of the 52 week periods then ended. EBITDA (operating income plus depreciation and amortization) is a non-GAAP financial measure. Non-GAAP financial measures do not have standardized meanings prescribed by GAAP and therefore may not be comparable to similar measures presented by other reporting issuers.

As part of existing debt agreements, two financial covenants are monitored and communicated, as required by the terms of credit agreements, on a quarterly basis by management to ensure compliance with the agreements. The covenants are: (i) adjusted total debt/EBITDA – calculated as funded debt plus letters of credit, guarantees and commitments divided by EBITDA (for previous 52 weeks); and (ii) debt service coverage ratio – calculated as EBITDA divided by interest expense plus repayments of long-term debt (all amounts are based on previous 52 weeks).

The Company was in compliance with these covenants as at May 1, 2010.

## 15 Investment income

| | 2010 | 2009 |
|---|---|---|
| Dividend and interest income | **$ 3.3** | $ 0.5 |
| Share of earnings of entities accounted using the equity method | **28.1** | 38.4 |
| | **$ 31.4** | $ 38.9 |

## 16 Capital (losses) gains and other items

| | 2010 | 2009 |
|---|---|---|
| Equity share of Crombie REIT's other expenses | **$ (4.7)** | $ – |
| Change in fair value of Canadian third-party asset-backed commercial paper *(Note 6)* | **3.4** | (3.7) |
| Loss on sale of investments | **(0.3)** | – |
| Gain on sale of property | **0.1** | 7.5 |
| Foreign exchange gains (losses) | **0.9** | (1.0) |
| | **$ (0.6)** | $ 2.8 |

## 17 Income taxes

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

| | 2010 | 2009 Restated (Note 1) |
|---|---|---|
| Income tax expense according to combined statutory rate of 30.9% (2009 – 31.1%) | **$ 126.0** | $ 120.0 |
| Income taxes resulting from: | | |
| Non-deductible amounts | **1.1** | 1.2 |
| Capital gains and other items | **(1.0)** | (0.2) |
| Hannaford tax settlement | **(17.0)** | – |
| Impact of statutory income tax rate changes | **(4.7)** | 0.3 |
| Other | **(5.3)** | (5.9) |
| Total income taxes, combined effective tax rate of 24.4% (2009 – 29.7%) | **$ 99.1** | $ 115.4 |

The Company had been reassessed in respect to the tax treatment of gains on the sale of shares in Hannaford Bros. Co. ("Hannaford") in fiscal 2001. The Company had appealed the reassessments in respect of the sale of Hannaford shares. During the first quarter of fiscal 2010, the Company and Canada Revenue Agency ("CRA") concluded negotiations and settled the matter. Income tax expense was reduced by $17.0 as a result of this settlement.

May 1, 2010 income tax expense attributable to net earnings consists of:

| | Current | Future | Total |
|---|---|---|---|
| Operations | **$ 123.6** | **$ (6.5)** | **$ 117.1** |
| Capital gains and other items | **(14.4)** | **(3.6)** | **(18.0)** |
| | **$ 109.2** | **$ (10.1)** | **$ 99.1** |

May 2, 2009 income tax expense attributable to net earnings consists of:

| | Current | Future | Total |
|---|---|---|---|
| Operations | $ 121.4 | $ (5.8) | $ 115.6 |
| Capital gains and other items | 0.7 | (0.9) | (0.2) |
| | $ 122.1 | $ (6.7) | $ 115.4 |

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

| | May 1, 2010 | May 2, 2009 Restated (Note 1) |
|---|---|---|
| Investments | $ (3.5) | $ 6.5 |
| Other assets | 18.2 | 19.4 |
| Property and equipment | 104.0 | 119.6 |
| Goodwill and intangibles | 36.9 | 37.5 |
| Accounts payable and accrued liabilities | (10.8) | (14.9) |
| Long-term debt | (2.2) | (2.3) |
| Employee future benefits obligation | (33.7) | (33.3) |
| Other long-term liabilities | (36.5) | (50.6) |
| Other | 64.9 | 48.1 |
| | $ 137.3 | $ 130.0 |
| Future income taxes – current liabilities | $ 50.9 | $ 40.5 |
| Future income taxes – non-current liabilities | 86.4 | 89.5 |
| | $ 137.3 | $ 130.0 |

In the ordinary course of business, the Company is subject to ongoing audits by tax authorities. While the Company believes that its tax filing positions are appropriate and supportable, from time to time certain matters are reviewed and challenged by the tax authorities.

## 18 Supplementary cash flow information

| | 2010 | 2009 Restated (Note 1) |
|---|---|---|
| **a) Items not affecting cash** | | |
| Depreciation | $ 307.8 | $ 303.4 |
| Amortization of intangibles | 31.9 | 32.7 |
| Future income taxes | (10.1) | (6.7) |
| Loss (gain) on disposal of assets | 2.2 | (5.1) |
| Amortization of other assets | 3.3 | (8.1) |
| Provision on asset-backed commercial paper | (3.4) | 3.7 |
| Equity in earnings of other entities, net of dividends received | 10.7 | 2.4 |
| Minority interest | 5.6 | 8.3 |
| Stock-based compensation | 1.6 | 1.2 |
| Long-term lease obligation | 12.4 | 7.1 |
| Employee future benefits obligation | 6.7 | 7.7 |
| Rationalization costs *(Note 27)* | (10.7) | 6.3 |
| | $ 358.0 | $ 352.9 |
| **b) Other cash flow information** | | |
| Net interest paid | $ 69.9 | $ 80.5 |
| Net income taxes paid | $ 91.6 | $ 117.2 |

## 19 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 1, 2010 | May 2, 2009 |
|---|---|---|
| Assets | | |
| Current | $ 137.9 | $ 116.1 |
| Non-current | 6.0 | 0.6 |
| | $ 143.9 | $ 116.7 |
| Liabilities | | |
| Current | $ 30.3 | $ 14.0 |
| Non-current | 3.4 | 3.3 |
| Equity and advances | 110.2 | 99.4 |
| | $ 143.9 | $ 116.7 |

| | 2010 | 2009 |
|---|---|---|
| Revenues | $ 66.2 | $ 58.3 |
| Expenses | 34.9 | 23.9 |
| Income before income taxes | $ 31.3 | $ 34.4 |
| Cash provided (used) | | |
| Operating activities | $ 18.8 | $ 35.4 |
| Investing activities | (11.6) | (5.3) |
| Financing activities | 13.2 | (9.7) |
| | $ 20.4 | $ 20.4 |

## 20 Segmented information

### Revenue

| | 2010 | 2009 |
|---|---|---|
| Food retailing | $ 15,243.0 | $ 14,764.8 |
| Real estate | | |
| Residential | 63.3 | 54.6 |
| Commercial | 17.3 | 19.3 |
| | 80.6 | 73.9 |
| Investment and other operations | 202.2 | 179.3 |
| | 15,525.8 | 15,018.0 |
| Elimination of inter-segment | (9.6) | (2.9) |
| | $ 15,516.2 | $ 15,015.1 |

### Operating income

| | 2010 | 2009 Restated (Note 1) |
|---|---|---|
| Food retailing | $ 425.3 | $ 399.5 |
| Real estate | | |
| Residential | 31.0 | 33.6 |
| Crombie REIT | 18.6 | 19.8 |
| Commercial | 1.2 | 2.5 |
| Investment and other operations | | |
| Wajax Income Fund | 9.2 | 18.5 |
| Other operations, net of corporate expenses | (5.6) | (7.7) |
| | $ 479.7 | $ 466.2 |

### Identifiable assets

| | May 1, 2010 | May 2, 2009 Restated (Note 1) |
|---|---|---|
| Food retailing (excluding goodwill) | $ 4,524.0 | $ 4,272.1 |
| Goodwill | 1,131.8 | 1,130.6 |
| Food retailing | 5,655.8 | 5,402.7 |
| Real estate | 315.5 | 223.1 |
| Investment and other operations (including goodwill of $40.8; May 2, 2009 – $40.8) | 277.0 | 265.3 |
| | $ 6,248.3 | $ 5,891.1 |

### Inventories

| | May 1, 2010 | May 2, 2009 |
|---|---|---|
| Food retailing | $ 780.4 | $ 750.7 |
| Real estate – residential | 98.9 | 90.4 |
| Other operations | 1.0 | 1.7 |
| | $ 880.3 | $ 842.8 |

### Depreciation and amortization

| | 2010 | 2009 Restated (Note 1) |
|---|---|---|
| Food retailing | $ 318.3 | $ 313.1 |
| Real estate | 1.3 | 1.8 |
| Investment and other operations | 20.1 | 21.2 |
| | $ 339.7 | $ 336.1 |

### Capital expenditures

| | 2010 | 2009 Restated (Note 1) |
|---|---|---|
| Food retailing | $ 341.4 | $ 354.1 |
| Real estate | 68.1 | 36.9 |
| Investment and other operations | 24.5 | 9.6 |
| | $ 434.0 | $ 400.6 |

The Company operates principally in two business segments: food retailing and real estate. The food retailing 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 land held for the development of food-anchored retail strip plazas. Residential real estate is the development of housing lots for resale. Inter-segment transactions are recorded at amounts equivalent to transactions with outside parties.

## 21 Financial instruments

### Credit risk

Credit risk is the risk of an unexpected loss if a customer or counterparty to a financial instrument fails to meet its contractual obligations. The Company's financial instruments that are exposed to concentrations of credit risk are primarily ABCP (Note 6), accounts receivable, loans and other receivables, derivative contracts and guarantees.

The Company's maximum exposure to credit risk corresponds to the carrying amount for all loans and receivables, the fair market value of derivative contracts represented on the balance sheet and guarantee contracts for franchise affiliates.

The Company mitigates credit risk associated with its trade accounts receivable, loans and other receivables through established credit approvals, limits and a regular monitoring process. The Company generally considers the credit quality of its financial assets that are neither past due or impaired to be solid. The Company regularly monitors collection performance and pledged security for all of its accounts receivable, loans and other receivables to ensure adequate payments are being received and adequate security is available. Pledged security can vary by agreement, but generally includes inventory, fixed assets including land and/or building, as well as personal guarantees. Credit risk is further mitigated due to the large number of customers and their dispersion across geographic areas. The Company only enters into derivative contracts with Canadian chartered banks to minimize credit risk.

Receivables are substantially comprised of balances due from independent accounts, franchisee or affiliate locations as well as rebates and allowances from vendors. The due date of these amounts can vary by agreement but in general balances over 30 days are considered past due. The aging of the receivables is as follows:

| | May 1, 2010 | May 2, 2009 |
|---|---|---|
| 0 – 30 days | $ 280.7 | $ 239.1 |
| 31 – 90 days | 28.9 | 32.5 |
| Greater than 90 days | 47.4 | 68.5 |
| Total receivables before allowance for doubtful accounts | 357.0 | 340.1 |
| Less: allowance for doubtful accounts | (20.1) | (31.2) |
| Receivables | $ 336.9 | $ 308.9 |

Interest earned on past due accounts is recorded as a reduction to cost of sales, selling and administrative expenses in the statements of earnings. Loans and other receivables are all current as of May 1, 2010.

Allowance for doubtful accounts is reviewed at each balance sheet date. An allowance is taken on accounts receivable from independent accounts, as well as accounts receivable, loans and other receivables from franchise or affiliate locations, and is recorded as a reduction to its respective receivable account on the balance sheet. The Company updates its estimate of allowance for doubtful accounts based on past due balances from independent accounts and based on an evaluation of recoverability net of security assigned for franchise or affiliate locations. Current and long-term accounts receivable, loans and other receivables are reviewed on a regular basis and are written-off when collection is considered unlikely. The change in allowance for doubtful accounts is recorded as cost of sales, selling and administrative expenses in the statements of earnings and is presented as follows:

| | May 1, 2010 | May 2, 2009 |
|---|---|---|
| Allowance, beginning of year | $ 31.2 | $ 28.7 |
| Provision for losses | 8.9 | 11.6 |
| Recoveries | (7.0) | (2.4) |
| Write-offs | (13.0) | (6.7) |
| Allowance, end of year | $ 20.1 | $ 31.2 |

## Liquidity risk

Liquidity risk is the risk that the Company may not have cash available to satisfy financial liabilities as they come due. The Company actively maintains committed credit facilities to ensure that it has sufficient available funds to meet current and foreseeable future financial requirements at a reasonable cost.

The Company monitors capital markets and the related conditions. Market conditions allowing, the Company will access debt capital markets for various long-term debt maturities and as other liabilities come due or as assessed to be appropriate in order to minimize risk and optimize pricing.

The following table summarizes the carrying amount and the contractual maturities of both the interest and principal portion of significant financial liabilities on an undiscounted basis as at May 1, 2010:

| | 2011 | 2012 | 2013 | 2014 | 2015 | Thereafter | Total |
|---|---|---|---|---|---|---|---|
| Derivative financial liabilities | | | | | | | |
| Interest rate swaps payable(1) | $ 13.5 | $ 10.7 | $ 2.5 | $ – | $ – | $ – | $ 26.7 |
| Energy hedge contracts(2) | 1.3 | – | – | – | – | – | 1.3 |
| Non-derivative financial liabilities | | | | | | | |
| Accounts payable and accrued liabilities | 1,621.6 | – | – | – | – | – | 1,621.6 |
| Long-term debt | 429.4 | 82.2 | 262.3 | 69.4 | 59.1 | 1,051.0 | 1,953.4 |
| Total | $ 2,065.8 | $ 92.9 | $ 264.8 | $ 69.4 | $ 59.1 | $ 1,051.0 | $ 3,603.0 |

(1) Represents the payable fixed interest (will be partially offset by the floating interest received).

(2) Based on market values as of May 1, 2010.

## Fair value of financial instruments

The fair value of a financial instrument is the estimated amount that the Company would receive or pay to settle the financial assets and financial liabilities as at the reporting date.

The book value of cash and cash equivalents, receivables, loans and other receivables, and accounts payable and accrued liabilities approximate fair values at the balance sheet dates.

The fair value of the variable rate long-term debt is assumed to approximate its carrying amount. The fair value of other long-term liabilities has been estimated by discounting future cash flows at a rate offered for debt of similar maturities and credit quality.

The following table summarizes the classification of the Company's financial instruments, as well as their carrying amounts and fair values:

| May 1, 2010 | Held for Trading (Required) | Held for Trading (Designated) | Available-for-Sale | Loans and Receivables | Other Financial Liabilities | Total Carry Amount | Fair Value |
|---|---|---|---|---|---|---|---|
| **Financial assets** | | | | | | | |
| Cash and cash equivalents | $ – | $ 401.0 | $ – | $ – | $ – | $ 401.0 | $ 401.0 |
| Receivables | – | – | – | 336.9 | – | 336.9 | 336.9 |
| Loans and other receivables | – | – | – | 185.0 | – | 185.0 | 185.0 |
| Investments | – | – | 10.9 | – | – | 10.9 | 10.9 |
| Other assets(1) | – | 31.8 | – | – | – | 31.8 | 31.8 |
| Total financial assets | $ – | $ 432.8 | $ 10.9 | $ 521.9 | $ – | $ 965.6 | $ 965.6 |
| Fair value level 1 | $ – | $ 411.6 | $ 10.9 | | | | $ 422.5 |
| Fair value level 2 | – | – | – | | | | – |
| Fair value level 3 | – | 21.2 | – | | | | 21.2 |
| Total fair value | $ – | $ 432.8 | $ 10.9 | | | | $ 443.7 |
| **Financial liabilities** | | | | | | | |
| Bank indebtedness | $ – | $ – | $ – | $ – | $ 17.8 | $ 17.8 | $ 17.8 |
| Accounts payable and accrued liabilities | – | – | – | – | 1,621.6 | 1,621.6 | 1,621.6 |
| Long-term debt | – | – | – | – | 1,208.4 | 1,208.4 | 1,231.1 |
| Other long-term liabilities(2) | 17.2 | – | – | – | – | 17.2 | 17.2 |
| Total financial liabilities | $ 17.2 | $ – | $ – | $ – | $ 2,847.8 | $ 2,865.0 | $ 2,887.7 |
| Fair value level 1 | $ – | $ – | $ – | | | | $ – |
| Fair value level 2 | 17.2 | – | – | | | | 17.2 |
| Fair value level 3 | – | – | – | | | | – |
| Total fair value | $ 17.2 | $ – | $ – | | | | $ 17.2 |

(1) The total carrying value of financial assets included in other assets is $31.8.

(2) Only the derivative liability portion is presented here.

| May 2, 2009 | Held for Trading (Required) | Held for Trading (Designated) | Available-for-Sale | Loans and Receivables | Other Financial Liabilities | Total Carry Amount | Fair Value |
|---|---|---|---|---|---|---|---|
| **Financial assets** | | | | | | | |
| Cash and cash equivalents | $ – | $ 231.6 | $ – | $ – | $ – | $ 231.6 | $ 231.6 |
| Receivables | – | – | – | 308.9 | – | 308.9 | 308.9 |
| Loans and other receivables | – | – | – | 140.9 | – | 140.9 | 140.9 |
| Investments | – | – | 1.1 | – | – | 1.1 | 1.1 |
| Other assets(1) | 1.7 | 21.4 | – | – | – | 23.1 | 23.1 |
| Total financial assets | $ 1.7 | $ 253.0 | $ 1.1 | $ 449.8 | $ – | $ 705.6 | $ 705.6 |
| **Financial liabilities** | | | | | | | |
| Bank indebtedness | $ – | $ – | $ – | $ – | $ 45.9 | $ 45.9 | $ 45.9 |
| Accounts payable and accrued liabilities | – | – | – | – | 1,487.1 | 1,487.1 | 1,487.1 |
| Long-term debt | – | – | – | – | 1,257.0 | 1,257.0 | 1,168.8 |
| Other long-term liabilities(2) | 39.8 | – | – | – | – | 39.8 | 39.8 |
| Total financial liabilities | $ 39.8 | $ – | $ – | $ – | $ 2,790.0 | $ 2,829.8 | $ 2,741.6 |

(1) The total carrying value of financial assets included in other assets is $23.1.

(2) Only the derivative liability portion is presented here.

### Derivative financial instruments

Derivative financial instruments are recorded on the consolidated balance sheet at fair value unless the derivative instrument is a contract to buy or sell a non-financial item in accordance with the Company's expected purchase, sale or usage requirements, referred to as a "normal purchase or normal sale". Changes in the fair values of derivative financial instruments are recognized in earnings unless it qualifies and is designated as an effective cash flow hedge or a normal purchase or normal sale. Normal purchases and normal sales are exempt from the application of the standard and are accounted for as executory contracts. Changes in fair value of a derivative financial instrument designated as a cash flow hedge are recorded in other assets and liabilities with the effective portion recorded in accumulated other comprehensive income.

### Interest rate risk

Interest rate risk is the potential for financial loss arising from changes in interest rates. Financial instruments that potentially subject the Company to interest rate risk include financial liabilities with floating interest rates. The majority of the Company's long-term debt is at a fixed interest rate or hedged with interest rate swaps. Bank indebtedness and approximately 17 percent (2009 – 20 percent) of the Company's long-term debt is exposed to interest rate risk due to floating rates.

Net earnings is sensitive to the impact of a change in interest rates on the average balance of interest bearing financial liabilities during the period. During the year, the Company recognized $3.8 (2009 – $nil) directly into income as the result of ineffective hedging contracts. Accordingly, a difference of 0.25 percent in the applicable interest rate would impact net earnings by $0.3 (2009 – $0.6) and other comprehensive income by $0.9 (2009 – $1.5).

### Foreign currency exchange risk

The Company conducts the vast majority of its business in Canadian dollars. The Company's foreign currency exchange risk principally relates to purchases made in U.S. dollars. In addition, the Company also uses forward contracts to fix the exchange rate on some of its expected requirements for Euros and U.S. dollars. Amounts received or paid related to instruments used to hedge foreign exchange, including any gains and losses, are recognized in the cost of purchases. During the year, the Company recognized $nil (2009 – $nil) directly into income as the result of ineffective hedging contracts. Those contracts outstanding as of May 1, 2010 will expire on or before August 16, 2010. The Company estimates that a 10 percent change in applicable foreign currency exchange rates would impact net earnings by $5.2 (2009 – $6.1) and other comprehensive income by $0.9 (2009– $1.6).

### Commodity price risk

Commodity price risk is the risk that the fair value of certain financial instruments or the Company's future cash flows will fluctuate as a result of changes in the market price of commodities. The Company has attempted to mitigate commodity price risk to electricity prices through the use of financial derivative swap contracts while closely monitoring other commodity prices to determine the appropriate course of action. During the year, the Company recognized $nil (2009 – $nil) directly into income as the result of ineffective hedging contracts. The Company estimates that a 10 percent change in applicable commodity prices would impact other comprehensive income by $0.1 (2009 – $0.6).

## 22 Guarantees, commitments and contingent liabilities

### Guarantees and commitments

At May 1, 2010, the Company was contingently liable for letters of credit issued in the aggregate amount of $50.1 (May 2, 2009 – $55.3).

Sobeys has guaranteed certain bank loans contracted by franchise affiliates. As at May 1, 2010, these loans amounted to approximately $0.2 (May 2, 2009 – $0.5).

During fiscal 2008, Sobeys entered into an additional guarantee contract. Under the terms of the guarantee should franchise affiliates be unable to fulfil their lease obligations, Sobeys would be required to fund the greater of $7.0 or 9.9 percent (2009 – $6.0 or 9.9 percent) of the authorized and outstanding obligation. The terms of the guarantee contract are reviewed annually each August. As at May 1, 2010, the amount of the guarantee was $7.0 (May 2, 2009 – $6.0).

Sobeys has guaranteed certain equipment leases of its franchise affiliates. Under the terms of the guarantee should franchise affiliates be unable to fulfil their lease obligation, Sobeys would be required to fund the difference of the lease commitments up to a maximum of $70.0 on a cumulative basis. Sobeys approves each of the contracts.

During fiscal 2009, Sobeys entered into an additional credit enhancement contract in the form of a standby letter of credit for certain independent franchisees for the purchase and installation of equipment. Under the terms of the contract should franchisee affiliates be unable to fulfill their lease obligations or other remedy, Sobeys would be required to fund the greater of $4.0 or 10 percent (2009 – $4.0 or 10.0 percent) of the authorized and outstanding obligation annually. Under the terms of the agreement, Sobeys is required to obtain a letter of credit in the amount of the outstanding guarantee, to be revisited each calendar year. This credit enhancement allows Sobeys to provide favorable financing terms to certain independent franchisees. The contract terms have been reviewed and Sobeys determined that there were no material implications with respect to the consolidation of VIEs. As at May 1, 2010, the amount of the guarantee was $4.0 (May 2, 2009 – $4.0).

The aggregate, annual, minimum rent payable under the guaranteed operating equipment leases for fiscal 2011 is approximately $22.1. The guaranteed lease commitments over the next five years are:

| | Third Parties |
|---|---|
| 2011 | $ 22.1 |
| 2012 | 16.2 |
| 2013 | 10.2 |
| 2014 | 3.3 |
| 2015 | 0.4 |
| Thereafter | 1.2 |

The net aggregate, annual, minimum rent payable under operating leases for fiscal 2011 is approximately $233.1 ($326.5 gross less expected sub-lease income of $93.4). The net commitments over the next five fiscal years are:

| | Third Parties | | Related Parties | |
|---|---|---|---|---|
| | Net Lease Obligation | Gross Lease Obligation | Net Lease Obligation | Gross Lease Obligation |
| 2011 | $ 187.9 | $ 281.3 | $ 45.2 | $ 45.2 |
| 2012 | 180.0 | 268.0 | 37.2 | 37.2 |
| 2013 | 170.8 | 250.5 | 37.2 | 37.2 |
| 2014 | 161.9 | 232.9 | 38.1 | 38.1 |
| 2015 | 153.3 | 216.7 | 38.2 | 38.2 |
| Thereafter | 1,013.0 | 1,432.7 | 440.2 | 440.2 |

Upon entering into the lease of its Mississauga distribution centre in March 2000, Sobeys guaranteed to the landlord the performance, by Serca Foodservice Inc., of all of its obligations under the lease. The remaining term of the lease is 10 years with an aggregate obligation of $31.6 (2009 – $34.6). At the time of the sale of assets of Serca Foodservice Inc. 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 harmless from any liability it may incur pursuant to its guarantee.

### Contingencies

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

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.

## 23 Related-party transactions

Related party transactions are with Crombie REIT. The Company holds a 47.4 percent ownership interest and accounts for its investment using the equity method.

The Company rents premises from Crombie REIT, at amounts in management's opinion which approximate fair market value. Managment has determined these amounts to be fair value due to the significant number of leases negotiated with third parties in each market it operates. During fiscal year 2010, the aggregate net payments under these leases, which are measured at exchange amounts, were $57.3 (2009 – $46.4).

In addition, Crombie REIT provides administrative and management services to the Company. The charges incurred for administrative and management services are on a cost recovery basis. The Company has provided Crombie REIT with fixed rate second mortgages in the amount of $5.9 (May 2, 2009 – $6.2). The second mortgages have a weighted average interest rate of 5.38% with a maturity date of March 2014.

On September 30, 2009, the Company purchased $10.0 of convertible unsecured subordinated debentures (the "Debentures") from Crombie REIT, pursuant to a bought-deal prospectus offering for a total of $85.0. The Debentures have a maturity date of June 30, 2015. The Debentures have a coupon of 6.25% per annum and each $1,000 principal amount of Debenture is convertible into approximately 90.9091 units of Crombie REIT, at any time, at the option of the holder, based on a conversion price of $11.00 per unit. The Debentures have been classified as available-for-sale and are included in investments, at realizable value.

During fiscal 2010, the Company sold eight commercial properties to Crombie REIT for net cash proceeds of $56.7, which was fair market value. Since the sale was to an equity accounted investment, no gain was recorded on the sale.

## 24 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.

### Other benefit plans

The Company also offers certain employee post-retirement and post-employment benefit plans which are not funded and include health care, life insurance and dental benefits.

### 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 April 30th as an actuarial valuation date and May 1st as a measurement date for accounting purposes for its defined benefit pension plans.

| | Most Recent Valuation Date | Next Required Valuation Date |
|---|---|---|
| Retirement Pension Plan | May 1, 2008 | May 1, 2011 |
| Senior Management Pension Plan | May 1, 2008 | May 1, 2011 |
| Other Benefit Plans | May 1, 2008 | May 1, 2011 |

### Defined contribution plans

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

| | | |
|---|---|---|
| **2010** | **$** | **20.5** |
| 2009 | $ | 19.1 |

## Defined benefit plans

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

| | Pension Benefit Plans 2010 | Pension Benefit Plans 2009 | Other Benefit Plans 2010 | Other Benefit Plans 2009 |
|---|---|---|---|---|
| **Accrued benefit obligation** | | | | |
| Balance, beginning of year | $ 249.8 | $ 269.1 | $ 108.5 | $ 116.4 |
| Current service cost, net of employee contributions | 1.9 | 1.8 | 3.0 | 3.8 |
| Interest cost | 14.9 | 14.3 | 7.0 | 6.7 |
| Employee contributions | 0.2 | 0.3 | – | – |
| Benefits paid | (24.9) | (20.2) | (3.3) | (3.3) |
| Past service costs | 1.5 | 0.2 | – | – |
| Actuarial losses (gains) | 21.3 | (15.7) | 18.5 | (15.1) |
| Balance, end of year | $ 264.7 | $ 249.8 | $ 133.7 | $ 108.5 |

| | Pension Benefit Plans 2010 | Pension Benefit Plans 2009 | Other Benefit Plans 2010 | Other Benefit Plans 2009 |
|---|---|---|---|---|
| **Plan assets** | | | | |
| Market value, beginning of year | $ 202.1 | $ 252.5 | $ – | $ – |
| Actual return on plan assets | 38.5 | (36.4) | – | – |
| Employer contributions | 6.0 | 5.8 | 3.3 | 3.3 |
| Employee contributions | 0.2 | 0.3 | – | – |
| Benefits paid | (25.0) | (20.1) | (3.3) | (3.3) |
| Surplus payments to members | – | – | – | – |
| Market value, end of year | $ 221.8 | $ 202.1 | $ – | $ – |
| **Funded status** | | | | |
| Deficit | $ (42.9) | $ (47.7) | $ (133.7) | $ (108.5) |
| Unamortized past service cost | 1.5 | 0.4 | 0.5 | 0.6 |
| Unamortized actuarial losses (gains) | 76.4 | 86.1 | 8.1 | (10.5) |
| Accrued benefit asset (liability) | $ 35.0 | $ 38.8 | $ (125.1) | $ (118.4) |

| | Pension Benefit Plans 2010 | Pension Benefit Plans 2009 | Other Benefit Plans 2010 | Other Benefit Plans 2009 |
|---|---|---|---|---|
| **Expense** | | | | |
| Current service cost, net of employee contributions | **$ 2.0** | $ 1.8 | **$ 3.0** | $ 3.8 |
| Interest cost | **14.9** | 14.3 | **7.0** | 6.6 |
| Actual return on plan assets | **(38.5)** | 36.4 | **–** | – |
| Actuarial losses (gains) | **21.3** | (15.6) | **18.4** | (15.0) |
| Past service costs | **1.5** | 0.1 | **–** | – |
| Surplus payments to members | **–** | – | **–** | – |
| Expense (income) before adjustments | **1.2** | 37.0 | **28.4** | (4.6) |
| Expected vs. actual return on plan assets | **25.0** | (53.4) | **–** | – |
| Recognized vs. actual past service costs | **(1.1)** | 0.1 | **0.1** | 0.1 |
| Recognized vs. actuarial losses (gains) | **(15.2)** | 18.0 | **(18.5)** | 15.5 |
| Net expense | **$ 9.9** | $ 1.7 | **$ 10.0** | $ 11.0 |
| **Classification of accrued benefit asset (liability)** | | | | |
| Other asset | **$ 60.4** | $ 63.1 | **$ –** | $ – |
| Other liability | **(25.4)** | (24.3) | **(125.1)** | (118.4) |
| Accrued benefit asset (liability) | **$ 35.0** | $ 38.8 | **$ (125.1)** | $ (118.4) |

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

| | Pension Benefit Plans 2010 | Pension Benefit Plans 2009 | Other Benefit Plans 2010 | Other Benefit Plans 2009 |
|---|---|---|---|---|
| Accrued benefit obligation | **$ 25.4** | $ 24.3 | **$ 125.1** | $ 118.4 |

The significant actuarial assumptions adopted in measuring the Company's accrued benefit obligation are as follows (weighted-average assumptions as of May 1, 2010):

| | Pension Benefit Plans 2010 | Pension Benefit Plans 2009 | Other Benefit Plans 2010 | Other Benefit Plans 2009 |
|---|---|---|---|---|
| Discount rate | **5.50%** | 6.25% | **6.25%** | 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 9% annual rate of increase in the per capita cost of covered health care benefits was assumed for fiscal 2010 and 2011, with the rate reducing by 0.5% per annum for an ultimate rate of 5% in fiscal 2019. The EARSL of the active employees covered by the pension benefit plans ranges from 10 to 12 years with a weighted average of 10 years at year end. The EARSL of the active employees covered by the other benefit plans range from 11 to 15 years with a weighted average of 14 years at year end.

The table below outlines the sensitivity of the fiscal 2010 key economic assumptions used in measuring the accrued benefit plan obligation and related expense of the Company's pension and other benefit plans. The sensitivity of each key assumption has been calculated independently. Changes to more than one assumption simultaneously may amplify or reduce impact on the accrued benefit obligation or benefit plan expense.

| | Pension Plans | | Other Benefit Plans | |
|---|---|---|---|---|
| | Benefit Obligation | Benefit Cost(1) | Benefit Obligation | Benefit Cost(1) |
| Expected long-term rate of return on plan assets | | 7.00% | | |
| Impact of: 1% increase | | $ (2.2) | | |
| 1% decrease | | $ 2.2 | | |
| Discount rate(2) | 5.50% | 5.50% | 5.75% | 6.75% |
| Impact of: 1% increase | $ (28.1) | $ 0.4 | $ (20.1) | $ (0.8) |
| 1% decrease | $ 31.8 | $ (0.7) | $ 24.2 | $ 1.0 |
| Growth rate of health costs(3) | | | 9.00% | 9.00% |
| Impact of: 1% increase | | | $ 23.7 | $ 2.2 |
| 1% decrease | | | $ (18.4) | $ (1.6) |

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

(2) 5.25% for the Senior Management Plan, Oshawa SERP and Post-Retirement Benefits, 5.75% for the Empire Post-Retirement Benefit Plan and 4.50% for the Post-Employment Plan.

(3) Gradually decreasing to 5.00% in 2019 and remaining at that level thereafter.

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

| | **2010** | 2009 |
|---|---|---|
| Cash and short-term investments | **1.78%** | 3.43% |
| Bonds, debentures, fixed income pooled funds and real estate funds | **35.52%** | 36.09% |
| Equities and pooled equities fund | **61.38%** | 60.52% |
| Accrued interest and dividends | **0.21%** | 0.21% |
| Foreign currency hedges | **1.11%** | (0.25%) |
| Total investments | **100.00%** | 100.00% |

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

| | **2010** | **% of Plan Assets** | 2009 | % of Plan Assets |
|---|---|---|---|---|
| | **$ 115.5** | **12.7%** | $ 104.4 | 13.7% |

# 25 Business acquisitions

Sobeys acquires franchisee and non-franchisee stores and prescription files. The results of these acquisitions have been included in the consolidated financial results of the Company since their acquisition dates, and were accounted for through the use of the purchase method. As illustrated in the table below, the acquisition of certain franchisee stores and non-franchisee stores resulted in the acquisition of intangible assets. The method of amortization of limited life intangibles is on a straight-line basis over its estimated useful life.

| | 2010 | 2009 |
|---|---|---|
| **Franchisees** | | |
| Inventory | $ 6.0 | $ 8.7 |
| Property and equipment | 7.1 | 5.9 |
| Intangibles | 3.9 | 7.6 |
| Goodwill | 1.2 | 14.3 |
| Other (liabilities) assets | (8.3) | 0.9 |
| | 9.9 | 37.4 |
| **Prescription files** | | |
| Intangibles | 6.9 | 3.2 |
| Net assets acquired | 16.8 | 40.6 |
| Less promissory note issued | – | (3.5) |
| Cash consideration | $ 16.8 | $ 37.1 |

ECL Properties Limited (a subsidiary of the Company) acquired additional units of two residential partnerships already co-owned by the Company for cash consideration of $17.2. The acquisitions were accounted for using the purchase method with net identifiable assets, primarily land inventory, recorded at $22.6 and future income taxes recorded at $5.4.

During fiscal 2009, ETL Canada Holdings Limited (a subsidiary of the Company) acquired all of the outstanding shares of an incorporated joint venture already co-owned by the Company for cash consideration of $4.3. The acquisition was accounted for using the purchase method with net identifiable assets recorded at $3.6 (including intangible assets of $0.2) and goodwill at $0.7.

# 26 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 corresponding number of Non-Voting Class A shares and records any increase in the DSU obligation as an operating expense. At May 1, 2010, there were 104,527 (May 2, 2009 – 84,195) DSUs outstanding. During the year, the compensation expense was $1.3 (2009 – $1.8).

## Stock option plan

During fiscal 2010, the Company granted an additional 162,389 options under the stock option plan for employees of the Company whereby options are granted to purchase Non-Voting Class A Shares. These options allow holders to purchase Non-Voting Class A Shares at $46.04 per share and expire in June 2017. The options vest over four years with 50 percent of the options vesting only if certain financial targets are attained in a given fiscal year. These options have been treated as stock-based compensation.

The compensation expense relating to the year was determined to be $1.6 (2009 – $1.2) with amortization of the expense over the vesting period. The total increase in contributed surplus in relation to the stock option compensation expense was $1.6 (2009 – $1.2). The compensation expense was calculated using the Black-Scholes model with the following assumptions:

| | |
|---|---|
| Expected life | 5.25 years |
| Risk-free interest rate | 2.625% |
| Expected volatility | 22.8% |
| Dividend yield | 1.60% |

The outstanding options at May 1, 2010 were granted at prices between $40.26 and $46.04 and expire between June 2015 and June 2017. Stock option transactions during 2010 and 2009 were as follows:

| | 2010 | | 2009 | |
|---|---|---|---|---|
| | Number of Options | Weighted Average Exercise Price | Number of Options | Weighted Average Exercise Price |
| Balance, beginning of year | 282,733 | $ 41.47 | 92,766 | $ 43.96 |
| Granted | 162,399 | 46.04 | 189,967 | 40.26 |
| Forfeited | (11,923) | 40.26 | – | – |
| Balance, end of year | 433,209 | $ 43.22 | 282,733 | $ 41.47 |
| Stock options exercisable, end of year | 90,894 | | 23,192 | |

The following table summarizes information about stock options outstanding at May 1, 2010:

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| | Number of Outstanding Options | Weighted Average Remaining Contractual Life(1) | Weighted Average Exercise Price | Number Exercisable at May 1, 2010 | Weighted Average Exercise Price |
| | 92,766 | 5.17 | $ 43.96 | 46,383 | $ 43.96 |
| | 178,044 | 6.17 | 40.26 | 44,511 | 40.26 |
| | 162,399 | 7.17 | 46.04 | – | – |
| | 433,209 | 6.33 | $ 43.22 | 90,894 | $ 42.15 |

(1) Weighted average remaining contractual life is expressed in years.

### Share purchase plan

The Company has a share purchase 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 Company's current practice is to use only the stock option plan to provide long-term incentive for employees. As a result, outstanding loans under the stock purchase plan will be repaid at the employees' option, but no later than the expiry date of the loans which were originally set for 10 years.

### Phantom performance option plan

Sobeys has a Phantom Performance Option Plan for eligible employees of Sobeys. Under the plan, units are granted at the discretion of the Board based on a notional equity value of Sobeys tied to a specified formula. Upon implementation, the units had a three year vesting period with 33.3 percent of the units vesting each year. Subsequent issuances have a four year vesting period with 25.0 percent of the units vesting each year. As the notional fair value of Sobeys changes, the employees are entitled to the incremental increase in the notional equity value over a five year period. The Company recognizes a compensation expense equal to the change in notional value over the original grant value on a straight-line basis over the vesting period. After the vesting period, any change in incremental notional equity value is recognized as a compensation expense immediately. This is recorded as an accrued liability until settlement and is remeasured at each interim and annual reporting period of the Company. As at May 1, 2010, 1,379,175 (May 2, 2009 – 1,069,413) units were outstanding. For the year ended May 1, 2010, the Company recognized $11.5 (2009 – $6.1) of compensation expense associated with this plan.

## 27 Business rationalization costs

For the year ended May 1, 2010, severance costs of $nil have been incurred and recognized (2009 – $10.7). The costs associated with the organizational change are recorded as incurred as cost of sales, selling and administrative expenses in the statement of earnings. The liability as of May 1, 2010 is $1.5 (2009 – $12.2). Total costs incurred as a result of this change to May 1, 2010 were $24.9.

## 28 Variable interest entities

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

The Company has identified the following entities as VIEs:

### Franchise affiliates

The Company has identified 273 (May 2, 2009 – 271) 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.

## 29 Subsequent events

(a) On May 25, 2010, Sobeys filed a short form prospectus providing for the issuance of up to $500.0 of unsecured Medium Term Notes. On June 7, 2010, Sobeys issued new Medium Term Notes of $150.0, bearing an interest rate of 6.64%, maturing on June 7, 2040.

(b) On June 4, 2010, the Company renewed its Credit Facilities which were reduced from $650.0 to $450.0, maturing on June 30, 2013.

(c) On July 8, 2010, it was announced that Sobeys entered into a non-binding letter of intent to sell 11 retail properties to Crombie REIT for proceeds of approximately $102.0. Crombie REIT also agreed to issue, on a bought-deal basis, additional units at a price of $11.05 per unit. In satisfaction of its pre-emptive right with respect to the public offering, the Company will subscribe for approximately $20.5 of Class B units. The Company's interest in Crombie REIT will reduce from 47.4% to 47.0%.

## 30 Comparative figures

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