

# Building value *together*

Empire’s strategic direction is to build long-term sustainable growth in sales and adjusted net earnings while prudently reinvesting the majority of our cash flow to grow and strengthen our food retailing and related real estate businesses.

## To our Shareholders

Empire posted a record performance in fiscal 2013 amid continued intense competition in the food retailing industry. Consolidated sales reached \$17.6 billion, an increase of 8.4 percent from the previous year. Excluding the impact of the acquisition of 236 retail gas locations and related convenience store operations from Shell Canada in the fourth quarter of fiscal 2012, consolidated sales increased by 2.9 percent. Net earnings, net of non-controlling interest, were \$384.8 million or \$5.65 per diluted share compared to \$339.4 million or \$4.99 per diluted share in fiscal 2012, an increase of 13.4 percent. Adjusted net earnings, net of non-controlling interest, which excludes items which are considered not indicative of underlying business operating performance, were \$367.3 million or \$5.39 per diluted share compared to \$322.7 million or \$4.74 per diluted share in fiscal 2012, a 13.8 percent increase. These financial results were reflected in Empire’s share price, which increased 19.0 percent during the fiscal year, capping a 20-year period in which shareholders have received a compound average annual total return on investment of 13.5 percent.

## Our Recipe for Success

Empire’s success has come from continuous investment and improvement in the businesses we know best – food retailing and related real estate. From the onset of our business, Frank H. Sobeys began to capitalize on the strategic advantages and investment potential that came from owning the property associated with Sobeys’ growing retail network and ever since, these two businesses have been the foundation of Empire’s ability to create sustainable long-term value. Along the way, we have been able to generate solid returns by reinvesting our cash flow and excess capital to support the growth and development of our food retailing and related real estate operations, which now, in aggregate, represent 98.7 percent of consolidated sales and 94.4 percent of adjusted net earnings.

## Food Retailing

Sobeys’ sales increased 8.3 percent to \$17.3 billion in fiscal 2013 driven by another year of positive same-store sales growth and the previously mentioned Shell acquisition. This is a solid performance given the intense level of promotional activity, virtual absence of price inflation in a food retailing market that continues to add new competitors and substantial new retail space. At the same time, the food retailing segment, through Sobeys, reported record operating income of \$515.3 million, an 8.3 percent increase over last year. Sobeys’ performance is a testament to the effectiveness of the food-focused growth strategy, strength and quality of our people, and significant investments made over the past six years in store and distribution infrastructure, business processes and systems, and sales and cost productivity initiatives. In the fast-paced food retailing business, however, little time is spent reflecting on past accomplishments.

## Consolidated Adjusted Net Earnings<sup>(1)</sup>

(\$ in millions)



(1) Net of non-controlling interest.

“Sobeys’ performance is a testament to the effectiveness of the food-focused growth strategy, strength and quality of our people, and significant investments made over the past six years.”

Paul D. Sobey  
President and CEO, Empire Company Limited



Marc Poulin (left)  
Paul D. Sobey (right)



# \$367.3m

Empire posted record adjusted net earnings in fiscal 2013

Fiscal 2013 was a busy year for Sobeys with the completion of the transition to a format-based operating structure, implementation of the SAP enterprise-wide business platform at Thrifty Foods and in our Québec operations, and completion of an automated distribution centre in Terrebonne, Québec. As a result, Sobeys is positioned to harness its potential as a \$17 billion organization as never before. Opportunities to enhance top and bottom line growth are abundant and include the integration of core business processes from coast to coast, the execution of nationally integrated commercial programs with our suppliers, and the benefits of Sobeys' leading customer insight capabilities in marketing and merchandising programs. Over the past few years, Sobeys' ability to consistently improve productivity has enabled the company to maintain its competitive price position while growing profitability. We expect that the important initiatives undertaken during the past year will allow this trend to continue.

## Investments and Other Operations

Empire's investments and other operations consist primarily of our 42.8 percent equity accounted interest in Crombie REIT, our equity interests in residential real estate through Genstar and wholly-owned Empire Theatres. While all these businesses have been solid investments, Crombie REIT plays a particularly important role supporting the growth of core operations given its strategic relationship with Sobeys.

For Empire, the creation of Crombie REIT has provided access to capital that has accelerated the pace of Sobeys' expansion as a leading national retailer while enabling Sobeys to realize the value of its real estate assets. For Crombie REIT investors,

the strategic relationship with Sobeys provides preferred access to some of the steadiest performing assets in commercial real estate – new, fully occupied grocery and drugstore-anchored community plazas and freestanding stores. During fiscal 2013, Crombie REIT purchased eight properties from Empire for \$106.0 million.

Crombie REIT has also proved to be an excellent investment in its own right, setting new performance records in its most recent fiscal year ending December 31, 2012. Crombie REIT's operating income contribution to Empire reached \$22.0 million, after adjusting for the impact of Crombie REIT's restatement in our fiscal 2013, compared to \$19.7 million the previous year, with cash flow contribution of \$33.4 million. At Empire's fiscal year-end, the value of our 42.8 percent equity accounted interest in Crombie REIT equalled \$622.7 million as Crombie REIT's total market capitalization reached more than \$1.4 billion.

Since the IPO of Crombie REIT in March 2006, Crombie REIT's net property income has increased at a 12.7 percent compound annual growth rate, while its market capitalization has increased at an average annual rate of 19.0 percent.

While Sobeys' development pipeline represents a unique competitive advantage for Crombie REIT, the company has also been steadily building its management capabilities and national presence in the broader commercial real estate market. During its fiscal year ending December 31, 2012, Crombie REIT acquired 26 grocery and drugstore-anchored plazas and freestanding store properties, 24 of which were from third parties, and all but one of which are located outside Atlantic Canada.



- Execution of brand strategy for the full service format
- Achieve operational excellence through harmonization and optimization of process and technology
- Launch national employee engagement initiative
- Focus on enhancing category management and merchandising programs to deliver innovative food offerings
- Develop Sobeys' property pipeline, first offering to Crombie REIT to support its geographic diversification strategy
- Reinvest cash distribution from Crombie REIT to support growth in related real estate



- Opened automated distribution centre in Terrebonne, Québec
- Ongoing training and development of employees, and investment in tools and processes
- Achieved nationwide SAP system implementation
- Completed FreshCo conversions, integrated Québec and Atlantic Canada Shell retail gas locations and launched Food for Fuel promotions
- Eight Empire properties sold to Crombie REIT for \$106.0 million
- Invested an additional \$38.3 million in Crombie REIT

## A Larger Platform for Growth

On June 12, 2013, subsequent to year-end, Empire and Sobeys announced a definitive agreement with Safeway Inc. to acquire substantially all of the assets of Canada Safeway Limited for a cash purchase price of \$5.8 billion, subject to a working capital adjustment, plus the assumption of certain liabilities. This acquisition represents a unique and highly strategic opportunity to significantly increase Sobeys' scale, establish a leading presence in Western Canada (including the number one market position in fast-growing Alberta) and create meaningful synergies and earnings accretion. More specifically, the acquisition of Canada Safeway will create an organization with pro forma sales of approximately \$24 billion and an immediately positive impact on adjusted net earnings per share. Management estimates annual synergies of approximately \$200 million and expects the synergies to be achievable over a 36 month period.

Above all, Sobeys and Canada Safeway are an ideal fit with highly compatible strategic objectives and similar corporate cultures. Both companies are focused on fresh food and superior service, with strong management and an operating approach that depends on advanced customer insight and loyalty program capabilities and an emphasis on employee development, rigorous cost control and strong private label programs. The acquisition of Canada Safeway includes owned real estate valued at \$1.8 billion.

Since the acquisition of The Oshawa Group in fiscal 1999, we have established a strong track record of successfully financing and integrating acquisitions to build shareholder value, achieving average annual adjusted net earnings per share growth of 14.8 percent per year over that time period.

## Outlook

The year ahead promises to be another active one for Empire, but with 106 years in the business, we are used to that. We recognize that Canadian consumers remain cautious and that new retail space continues to be added to the market. We remain confident that we will continue to be successful as a result of our food-focused strategy and the substantial investments we've made in Sobeys. Our food-focused strategy and our passion for food, as well as the dedication and commitment of our employees has struck a chord with customers in each of Sobeys' retail formats, allowing us to deliver a more fulfilling shopping experience. Going forward, we remain committed to further enriching the shopping experience of our customers and investing in additional infrastructure and productivity improvements.

Our greatest competitive strength of course, is the quality of our people. We are fortunate to have truly exceptional management teams in our operations and they are working more closely than ever before to realize the full potential of Empire's food retailing and related real estate businesses. I would also like to thank Marcel Côté for his many years of valued contribution as he will not be standing for re-election to the Board of Directors. His dedication and advice have been invaluable over 15 years of outstanding service to both Sobeys and Empire. Finally, I would also like to extend my sincere appreciation to all of our employees, franchisees and affiliates for helping Empire achieve record performance in fiscal 2013.

**PAUL D. SOBEEY**  
President and CEO  
Empire Company Limited  
June 27, 2013