

# EMPIRE

COMPANY LIMITED

## MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE 13 AND 26 WEEKS ENDED NOVEMBER 1, 2014

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# MANAGEMENT'S DISCUSSION AND ANALYSIS

The following is Management's Discussion and Analysis ("MD&A") of the consolidated financial results of Empire Company Limited and its subsidiaries, including wholly-owned Sobeys Inc. ("Empire", "Sobeys" or the "Company") for the 13 and 26 weeks ended November 1, 2014 as compared to the 13 and 26 weeks ended November 2, 2013. It should be read in conjunction with the Company's unaudited interim condensed consolidated financial statements and notes thereto for the 13 and 26 weeks ended November 1, 2014, compared to the 13 and 26 weeks ended November 2, 2013 and the audited annual consolidated financial statements for the 52 weeks ended May 3, 2014 and the related MD&A. Additional information about the Company can be found on SEDAR at [www.sedar.com](http://www.sedar.com).

The unaudited interim condensed consolidated financial statements and the accompanying notes are prepared in accordance with International Financial Reporting Standards ("IFRS" or "GAAP") and International Accounting Standard ("IAS") 34, "Interim Financial Reporting", as issued by the International Accounting Standards Board ("IASB") and are reported in Canadian dollars ("CAD"). These unaudited interim condensed consolidated financial statements include the accounts of Empire and its subsidiaries and Structured Entities ("SEs") which the Company is required to consolidate.

The information contained in this MD&A is current to December 12, 2014 unless otherwise noted. There have been no material changes to disclosures as contained in the "Outlook", "Critical Accounting Estimates", "Contingencies" or "Risk Management" sections of the Company's MD&A for the 52 weeks ended May 3, 2014 other than as noted in this MD&A.

## FORWARD-LOOKING INFORMATION

This discussion contains forward-looking statements which reflect management's expectations regarding the Company's objectives, plans, goals, strategies, future growth, financial condition, results of operations, cash flows, performance, business prospects and opportunities. Forward-looking statements are identified by words or phrases such as "anticipates", "expects", "believes", "estimates", "intends", "could", "may", "plans", "predicts", "projects", "will", "would", "foresees" and other similar expressions or the negative of these terms.

These forward-looking statements include the following items:

- Anticipated benefits from the Canada Safeway ULC ("Canada Safeway") acquisition such as growth prospects, benefits from economies of scale, future business strategy, and expectations regarding operations and strategic fit which may be impacted by the ability of the Company to predict and adapt to changing consumer tastes, preferences and spending patterns, and the anticipated retention of Canada Safeway's operational employees;
- The Company's expectation that its operational and capital structure is sufficient to meet its ongoing business requirements, which could be impacted by a significant change in the current economic environment in Canada;
- The Company's belief that its cash and cash equivalents on hand, unutilized credit facilities and cash generated from operating activities will enable the Company to fund future capital investments, pension plan contributions, working capital, current funded debt obligations and ongoing business requirements, and its belief that it has sufficient funding in place to meet these requirements and other short term and long term obligations, all of which could be impacted by changes in the economic environment;
- The Company's expected contributions to its registered defined benefit plans, which could be impacted by fluctuations in asset values due to market uncertainties;

- The Company's expected use and estimated fair values of financial instruments which could be impacted by, among other things, changes in interest rates, foreign exchange rates and commodity prices;
- The Company's expectations relating to administrative and business rationalization initiatives which could be impacted by the final scope and scale of these initiatives;
- The Company's expectations regarding the retail store network rationalization including the impact on future sales and net earnings which may be impacted by the timing of closures and realization of synergies;
- Timing and value of expected synergies from the Canada Safeway acquisition, which may be impacted by a number of factors, including the effectiveness of ongoing integration efforts;
- The Company's expectations regarding the value and timing of goodwill deductibility for income tax purposes, as it relates to the Canada Safeway acquisition, which is subject to assessment by the Canada Revenue Agency; and
- The Company's expectation relating to timing and completion of the proposed divestiture of Safeway dairy and bread manufacturing facilities.

These statements are based on management's assumptions and beliefs in light of the information currently available to them. The forward-looking information contained in this MD&A is presented for the purpose of assisting the Company's security holders in understanding its financial position and results of operations as at and for the periods ended on the dates presented and the Company's strategic priorities and objectives, and may not be appropriate for other purposes. By its very nature, forward-looking information requires the Company to make assumptions and is subject to inherent risks and uncertainties which give rise to the possibility that the Company's predictions, forecasts, expectations or conclusions will not prove to be accurate, that the Company's assumptions may not be correct and that the Company's objectives, strategic goals and priorities will not be achieved. Although the Company believes that the predictions, forecasts, expectations or conclusions reflected in the forward-looking information are reasonable, it can give no assurance that such matters will prove to have been correct. Such forward-looking information is not fact but only reflects management's estimates and expectations.

These forward-looking statements are subject to uncertainties and other factors that could cause actual results to differ materially from such statements. These factors include but are not limited to changes in general industry, market and economic conditions, competition from existing and new competitors, energy prices, supply issues, inventory management, changes in demand due to seasonality of the business, interest rates, changes in laws and regulations, operating efficiencies and cost saving initiatives. In addition, these uncertainties and risks are discussed in the Company's materials filed with the Canadian securities regulatory authorities from time to time, including the Risk Management section of this MD&A.

Empire cautions that the list of factors is not exhaustive and other factors could also adversely affect its results. Readers are urged to consider the risks, uncertainties and assumptions carefully in evaluating the forward-looking information and are cautioned not to place undue reliance on such forward-looking information. Forward-looking statements do not take into account the effect of transactions occurring after the statements have been made on the Company's business. For example, dispositions, acquisitions, asset write-downs or other changes announced or occurring after such statements are made may not be reflected in forward-looking statements. The forward-looking information in this MD&A reflects the Company's expectations as of December 12, 2014 and is subject to change after this date. The Company does not undertake to update any forward-looking statements that may be made from time to time by or on behalf of the Company other than as required by applicable securities laws.

## OVERVIEW OF THE BUSINESS

Empire's key businesses include food retailing and related real estate. The Company's financial results are segmented into two separate reportable segments: (1) Food Retailing and (2) Investments and Other Operations.

With over \$24 billion in annualized sales and \$12.1 billion in assets, Empire and its subsidiaries, franchisees and affiliates employ more than 125,000 people.

### **Food Retailing**

Empire's food retailing segment is carried out through its wholly-owned subsidiary, Sobeys Inc., which as of November 1, 2014, conducted business through more than 1,500 retail stores (corporate owned and franchised) as well as more than 350 retail fuel locations, operating in every province and in over 800 communities across Canada.

Sobeys' strategy is focused on delivering the best food shopping experience to its customers in the right-format, right-sized stores, supported by superior customer service. Sobeys operates distinct store formats to better tailor its offering to the various customer segments it serves and to satisfy its customers' principal shopping requirements. Sobeys remains focused on improving the product, service and merchandising offerings within each format by expanding and renovating its current store base, while continuing to build new stores. The primary focus of these format development efforts are Sobeys' eight major banners: Sobeys, Sobeys *extra*, IGA, IGA *extra*, Safeway, Thrifty Foods, Foodland and FreshCo.

In the second quarter of fiscal 2015, Sobeys continued to execute a number of initiatives in support of its food-focused strategy including product and service innovations, productivity initiatives and business process, supply chain and system upgrades.

During the 13 and 26 weeks ended November 1, 2014, Sobeys opened, relocated, acquired, expanded, rebannered, and/or redeveloped the banners in 26 and 52 stores (2014 – 18 and 39).

### **Significant Items**

#### *Divestiture of manufacturing facilities*

On July 8, 2014, Sobeys announced that it entered into an agreement with Agropur Cooperative to sell four Safeway dairy manufacturing facilities. In addition, long-term milk, yogurt and ice cream supply agreements will come into effect upon transfer of the facilities to Agropur Cooperative. The sales are expected to occur during the Company's third and fourth quarters of fiscal 2015. Total proceeds from the transaction will be approximately \$356.1 million, and will be used to repay bank borrowings.

Subsequent to the close of the second quarter ended November 1, 2014, Sobeys entered into an agreement with Canada Bread Company, Limited to sell two bread manufacturing facilities. The sales are expected to occur during the Company's fourth quarter of fiscal 2015. Total proceeds from the transaction will be approximately \$32.0 million.

Property and equipment of \$65.0 million, intangibles of \$15.8 million and goodwill of approximately \$250.0 million for the manufacturing facilities discussed above, as well as additional manufacturing facilities and equipment expected to be sold have been included in assets held for sale as at November 1, 2014.

### *Canada Safeway Acquisition*

On June 12, 2013, Sobeys entered into an Asset Purchase Agreement with Safeway Inc. and its subsidiaries to acquire substantially all of the assets and select liabilities of Canada Safeway for a cash purchase price of \$5.8 billion, subject to a working capital adjustment. The agreement provided for the purchase of 213 full service grocery stores under the Safeway banner in Western Canada, 200 in-store pharmacies, 62 co-located fuel stations, 10 liquor stores, 4 primary distribution centres and 12 manufacturing facilities plus the assumption of certain liabilities. The Canada Safeway acquisition closed effective November 3, 2013.

Acquisition costs of \$0.7 million and \$1.7 million (2014 – \$16.8 million and \$26.9 million) relating to external legal, consulting, due diligence, financial advisory and other closing costs incurred during the 13 and 26 weeks ended November 1, 2014 have been included in selling and administrative expenses in the unaudited interim condensed consolidated statements of earnings.

### *Competition Bureau Imposed Divestitures*

As a condition of the regulatory clearance from the Competition Bureau for Sobeys' acquisition of substantially all of the assets and select liabilities of Canada Safeway, the Company was required to divest 23 retail stores. On February 13, 2014, Sobeys announced that it entered into binding purchase agreements with Overweitea Food Group LP and Federated Co-operatives Limited to purchase 22 of the 23 retail stores that were required to be divested as a result of the Canada Safeway acquisition. In addition to the required divestitures, the Company agreed to sell an additional seven stores in British Columbia comprised of both Safeway and Sobeys locations. Sobeys also signed a binding purchase agreement with another retailer for the sale of one retail store which was also required to be divested as part of the Canada Safeway acquisition. The purchase agreements all received approval from the Competition Bureau.

During fiscal 2014 the Company divested 19 of the retail stores. The remaining 11 stores were divested during the first quarter of fiscal 2015 for cash proceeds of \$111.3 million. All proceeds were used to repay bank borrowings.

### *Retail Store Network Rationalization*

During the fourth quarter of fiscal 2014, Sobeys completed a detailed full review of its retail store network. This review aligns with management's ongoing focus of enhancing the productivity and performance of the network and logically follows the acquisition of Canada Safeway. Based on this detailed review, Sobeys has determined that consistently underperforming retail stores, representing approximately 50 stores (1.5 million of total gross square footage) and 3.8 percent of the total retail network gross square footage, were to close. Approximately sixty percent of the affected stores are located in Western Canada. This rationalization will strengthen the quality of Sobeys' store network and is expected to improve net earnings as a result of cost savings; however, it will result in a reduction in future sales of approximately \$400 million or 1.9 percent of total sales on an annual basis. As of November 1, 2014, 30 retail stores representing 893,000 square feet have been closed.

The rationalization and restructuring costs associated with these store closures amounted to \$169.8 million and were included in selling and administrative expenses for the fourth quarter ended May 3, 2014. This expense consisted of \$137.1 million for severance, site closing and other costs, \$35.8 million associated with the write-down of property, equipment and intangible assets, and a \$3.1 million reversal of straight-line lease provisions.

During the 13 and 26 weeks ended November 1, 2014, \$1.6 million and \$3.2 million (2014 – \$ nil and \$ nil) in financing costs were incurred in relation to the network rationalization.

## *Business Process*

Following the close of the Canada Safeway acquisition, the Company began the process of integrating the acquired business with the Company's current operations. For the 13 and 26 weeks ended November 1, 2014, the Company recorded pre-tax integration costs of \$9.2 million and \$18.9 million (2014 – \$ nil and \$ nil), which have been included in selling and administrative expenses in the condensed consolidated statement of earnings.

## **Investments and Other Operations**

Empire's investments and other operations segment includes its equity investments in real estate, which are focused on: (i) the ownership of income-producing retail, office and mixed-use properties through an equity accounted ownership interest in Crombie Real Estate Investment Trust ("Crombie REIT") and (ii) residential land development principally in select communities in Ontario, Western Canada and the United States through its investments in Genstar.

Empire's investments and other operations segment, as of November 1, 2014 specifically included:

1. A 41.5 percent (39.3 percent fully diluted) equity accounted interest in Crombie REIT, a Canadian real estate investment trust. Crombie REIT currently owns a portfolio of 246 retail and office properties across Canada, comprising approximately 17.1 million square feet with a strategy to own and operate a portfolio of high quality grocery and drug store anchored shopping centres and freestanding stores primarily in Canada's top 36 markets; and
2. A 40.7 percent equity accounted interest in Genstar Development Partnership, a 48.6 percent equity accounted interest in Genstar Development Partnership II, a 42.1 percent equity accounted interest in each of GDC Investments 4, L.P. and GDC Investments 6, L.P., a 45.8 percent equity accounted interest in GDC Investments 7, L.P., a 43.7 percent equity accounted interest in GDC Investments 8, L.P., and a 49.0 percent equity accounted interest in The Fraipont Partnership (collectively referred to as "Genstar"). Genstar is a residential property developer with operations in select markets in Ontario, Western Canada and the United States.

## **DISCONTINUED OPERATIONS**

On June 27, 2013, the Company announced that it had reached a definitive agreement with Cineplex Inc. for the sale of 24 theatres and 170 screens in Atlantic Canada and 2 theatres with 48 screens in Ontario. The Company had also reached a separate definitive agreement with Landmark Cinemas for the sale of 20 theatres and 179 screens in Ontario and Western Canada. On November 1, 2013, the Company announced that Empire Theatres completed the sale of 46 theatres with 397 screens in separate transactions with Cineplex Inc. and Landmark Cinemas. The aggregate gross purchase price paid to Empire Theatres in the two transactions was approximately \$259.2 million in cash.

As a result of the sale, financial results related to Empire Theatres, as previously reported in the investments and other operations segment, have been included in discontinued operations in the unaudited interim condensed consolidated statements of earnings for the 13 and 26 weeks ended November 2, 2013. Discontinued operations are discussed and referenced throughout this MD&A. Please refer to Note 10 of the unaudited interim condensed consolidated financial statements for the 13 and 26 weeks ended November 1, 2014 for greater detail on the operating results from discontinued operations.

## CONSOLIDATED OPERATING RESULTS

The following is a summary of selected financial information from the Company's unaudited interim condensed consolidated financial statements for the 13 and 26 weeks ended November 1, 2014 compared to the 13 and 26 weeks ended November 2, 2013.

(\$ in millions, except per share amounts)	13 Weeks Ended				26 Weeks Ended			
	Nov. 1, 2014		Nov. 2, 2013 <sup>(1)</sup>		Nov. 1, 2014		Nov. 2, 2013 <sup>(1)</sup>	
		% of Sales		% of Sales		% of Sales		% of Sales
Sales	\$ 5,995.1	100.00%	\$ 4,414.3	100.00%	\$ 12,217.8	100.00%	\$ 9,009.6	100.00%
EBITDA <sup>(2)</sup>	324.3	5.41%	196.8	4.46%	667.0	5.46%	419.0	4.65%
Adjusted EBITDA <sup>(2)</sup>	332.2	5.54%	222.0	5.03%	676.9	5.54%	454.3	5.04%
Operating income <sup>(2)</sup>	204.2	3.41%	106.4	2.41%	423.8	3.47%	240.3	2.67%
Finance costs, net	41.0	0.68%	21.1	0.48%	84.8	0.69%	35.9	0.40%
Income taxes	41.2	0.69%	22.4	0.51%	85.6	0.70%	51.7	0.57%
Net earnings from continuing operations <sup>(3)</sup>	116.9	1.95%	60.5	1.37%	240.0	1.96%	143.1	1.59%
Net earnings from discontinued operations	-	-	108.7	2.46%	-	-	91.1	1.01%
Net earnings <sup>(3)</sup>	116.9	1.95%	169.2	3.83%	240.0	1.96%	234.2	2.60%
Adjusted net earnings from continuing operations <sup>(2)(3)</sup>	128.2	2.14%	83.4	1.89%	259.9	2.13%	173.1	1.92%
<b>Basic earnings per share</b>								
Net earnings from continuing operations <sup>(3)</sup>	\$ 1.27		\$ 0.89		\$ 2.60		\$ 2.11	
Net earnings from discontinued operations	\$ -		\$ 1.60		\$ -		\$ 1.34	
Net earnings <sup>(3)</sup>	\$ 1.27		\$ 2.49		\$ 2.60		\$ 3.45	
Adjusted net earnings from continuing operations <sup>(2)(3)</sup>	\$ 1.39		\$ 1.23		\$ 2.82		\$ 2.55	
Basic weighted average number of shares outstanding (in millions)	92.3		68.0		92.3		68.0	
<b>Diluted earnings per share</b>								
Net earnings from continuing operations <sup>(3)</sup>	\$ 1.27		\$ 0.89		\$ 2.60		\$ 2.10	
Net earnings from discontinued operations	\$ -		\$ 1.59		\$ -		\$ 1.34	
Net earnings <sup>(3)</sup>	\$ 1.27		\$ 2.48		\$ 2.60		\$ 3.44	
Adjusted net earnings from continuing operations <sup>(2)(3)</sup>	\$ 1.39		\$ 1.22		\$ 2.81		\$ 2.54	
Diluted weighted average number of shares outstanding (in millions)	92.3		68.2		92.4		68.1	
Dividend per share	\$ 0.27		\$ 0.26		\$ 0.54		\$ 0.52	

(1) Amounts have been reclassified to correspond to the current presentation on the condensed consolidated statement of earnings.

(2) See "Non-GAAP Financial Measures" section of this MD&A.

(3) Net of non-controlling interest.

## MANAGEMENT’S EXPLANATION OF CONSOLIDATED OPERATING RESULTS

The following is a review of the Company’s consolidated financial performance for the 13 and 26 weeks ended November 1, 2014 compared to the 13 and 26 weeks ended November 2, 2013.

The financial performance of each of the Company’s segments (food retailing and investments and other operations) is discussed in detail in the section entitled “Financial Performance by Segment” of this MD&A.

### Sales

Consolidated sales for the second quarter of fiscal 2015 were \$5,995.1 million compared to \$4,414.3 million in the second quarter of fiscal 2014, an increase of \$1,580.8 million or 35.8 percent. The growth in sales is primarily the result of sales from Safeway operations in the food retailing segment.

Consolidated sales for the first half of fiscal 2015 were \$12,217.8 million compared to \$9,009.6 million in the first half of fiscal 2014, an increase of \$3,208.2 million or 35.6 percent. As noted in the paragraph above, the growth in sales is primarily the result of sales from Safeway operations in the food retailing segment.

During the second quarter and first half of fiscal 2015, same-store sales <sup>(1)</sup> in the food retailing segment increased 1.7 and 1.6 percent from the same periods last year.

The table below presents Empire’s segmented and consolidated sales for the 13 and 26 weeks ended November 1, 2014 relative to the 13 and 26 weeks ended November 2, 2013.

(\$ in millions)	13 Weeks Ended				26 Weeks Ended			
	Nov. 1, 2014	Nov. 2, 2013 <sup>(2)</sup>	(\$) Change	(%) Change	Nov. 1, 2014	Nov. 2, 2013 <sup>(2)</sup>	(\$) Change	(%) Change
<b>Segment Sales</b>								
Food Retailing	\$ 5,995.1	\$ 4,416.8	\$ 1,578.3	35.7%	\$ 12,217.8	\$ 9,011.7	\$ 3,206.1	35.6%
Investments and other operations	-	0.8	(0.8)		-	4.2	(4.2)	
	<b>5,995.1</b>	<b>4,417.6</b>	<b>1,577.5</b>	<b>35.7%</b>	<b>12,217.8</b>	<b>9,015.9</b>	<b>3,201.9</b>	<b>35.5%</b>
Elimination of sales to discontinued operations	-	(3.3)	3.3		-	(6.3)	6.3	
<b>Empire consolidated sales</b>	<b>\$ 5,995.1</b>	<b>\$ 4,414.3</b>	<b>\$ 1,580.8</b>	<b>35.8%</b>	<b>\$ 12,217.8</b>	<b>\$ 9,009.6</b>	<b>\$ 3,208.2</b>	<b>35.6%</b>

(1) See “Non-GAAP Financial Measures” section of this MD&A.

(2) Amounts have been reclassified to correspond to the current presentation on the condensed consolidated statement of earnings.

## EBITDA

Consolidated EBITDA for the 13 weeks ended November 1, 2014 was \$324.3 million compared to \$196.8 million in the same period last year, an increase of \$127.5 million or 64.8 percent. EBITDA margin increased to 5.41 percent in the second quarter of fiscal 2015 from 4.46 percent in the same period of the prior year. These increases relate to the food retailing segment, and the impact of the Safeway operations and synergies realized since the acquisition.

Consolidated EBITDA for the 26 weeks ended November 1, 2014 was \$667.0 million compared to \$419.0 million in the same period last year, an increase of \$248.0 million or 59.2 percent. EBITDA margin increased to 5.46 percent in the first half of fiscal 2015 from 4.65 percent in the same period of the prior year. These increases can be attributed to the reasons as noted in the above paragraph.

The following table adjusts reported EBITDA for items which are considered not indicative of underlying business operating performance.

(\$ in millions)	13 Weeks Ended		26 Weeks Ended	
	Nov. 1, 2014	Nov. 2, 2013	Nov. 1, 2014	Nov. 2, 2013
EBITDA <sup>(1)</sup> (consolidated)	\$ 324.3	\$ 196.8	\$ 667.0	\$ 419.0
Adjustments:				
Loss on disposal of manufacturing facilities	7.2	-	7.2	-
Transaction costs associated with the Canada Safeway acquisition	0.7	16.8	1.7	26.9
Organizational realignment and restructuring costs	-	8.4	-	8.4
Plant closure	-	-	1.0	-
	7.9	25.2	9.9	35.3
Adjusted EBITDA (consolidated)	\$ 332.2	\$ 222.0	\$ 676.9	\$ 454.3

(1) EBITDA generated from Empire Theatres has been recorded in discontinued operations.

After adjusting for items which are considered not indicative of underlying business operating performance, consolidated adjusted EBITDA for the second quarter of fiscal 2015 was \$332.2 million compared to \$222.0 million last year, an increase of \$110.2 million or 49.6 percent. Adjusted EBITDA margin was 5.54 percent at the end of the second quarter compared to 5.03 percent last year.

Consolidated adjusted EBITDA for the first half of fiscal 2015 was \$676.9 million compared to \$454.3 million last year, an increase of \$222.6 million or 49.0 percent. Adjusted EBITDA margin for the first half of fiscal 2015 was 5.54 percent compared to 5.04 percent last year.

## Operating Income

For the second quarter of fiscal 2015, operating income increased \$97.8 million or 91.9 percent to \$204.2 million from \$106.4 million reported in the same period last year. Operating income was impacted primarily by the factors affecting EBITDA, offset by depreciation and amortization expenses related to the food retailing operating segment, when compared to the same period last year.

For the first half of fiscal 2015, operating income increased \$183.5 million or 76.4 percent to \$423.8 million from \$240.3 million reported in the same period last year for the same reasons as noted in the paragraph above.

## Finance Costs

For the second quarter of fiscal 2015, finance costs, net of finance income, increased \$19.9 million to \$41.0 million compared to \$21.1 million during the same period last year. This increase is primarily the result of higher interest expense due to increased debt levels as a result of financing for the Canada Safeway acquisition.

During the 26 weeks ended November 1, 2014, finance costs, net of finance income, increased \$48.9 million to \$84.8 million compared to \$35.9 million during the same period last year. As noted in the paragraph above, this increase is primarily the result of higher interest expense due to increased debt levels as a result of financing for the Canada Safeway acquisition.

## Income Taxes

The Company's effective income tax rate for the second quarter of fiscal 2015 was 25.2 percent compared to 26.3 percent in the same period last year. The decrease in the effective income tax rate is primarily due to the timing of the realization of tax benefits compared to the same period in the prior year.

## Net Earnings and Adjusted Net Earnings from Continuing Operations

Consolidated net earnings from continuing operations, net of non-controlling interest for the second quarter and first half of fiscal 2015 equaled \$116.9 million and \$240.0 million (\$1.27 and \$2.60 per diluted share) compared to \$60.5 million and \$143.1 million (\$0.89 and \$2.10 per diluted share) in the same periods last year.

The table below adjusts reported net earnings from continuing operations, net of non-controlling interest, for items which are considered not indicative of underlying business operating performance.

(\$ in millions, except per share amounts, net of tax)	13 Weeks Ended		26 Weeks Ended	
	Nov. 1, 2014	Nov. 2, 2013	Nov. 1, 2014	Nov. 2, 2013
Net earnings from continuing operations by segment <sup>(1)</sup> :				
Food retailing	\$ 100.4	\$ 56.3	\$ 213.9	\$ 135.5
Investments and other operations	16.5	4.2	26.1	7.6
Net earnings from continuing operations <sup>(1)</sup>	\$ 116.9	\$ 60.5	\$ 240.0	\$ 143.1
EPS <sup>(3)</sup> from continuing operations (fully diluted) <sup>(2)</sup>	\$ 1.27	\$ 0.89	\$ 2.60	\$ 2.10
Adjustments:				
Loss on disposal of manufacturing facilities	5.0	-	5.0	-
Intangible amortization associated with the Canada Safeway acquisition	4.7	-	10.7	-
Finance costs associated with the network rationalization	1.1	-	2.3	-
Transaction costs associated with the Canada Safeway acquisition	0.5	12.4	1.2	19.5
Plant closure	-	-	0.7	-
Finance costs associated with the Canada Safeway acquisition	-	5.4	-	5.4
Organizational realignment and restructuring costs	-	5.1	-	5.1
	11.3	22.9	19.9	30.0
Adjusted net earnings from continuing operations <sup>(1)</sup>	\$ 128.2	\$ 83.4	\$ 259.9	\$ 173.1
Adjusted net earnings from continuing operations by segment <sup>(1)</sup> :				
Food retailing	\$ 111.7	\$ 74.1	\$ 233.8	\$ 160.4
Investments and other operations	16.5	9.3	26.1	12.7
Adjusted net earnings from continuing operations <sup>(1)</sup>	\$ 128.2	\$ 83.4	\$ 259.9	\$ 173.1
Adjusted EPS from continuing operations (fully diluted) <sup>(2)</sup>	\$ 1.39	\$ 1.22	\$ 2.81	\$ 2.54

(1) Net of non-controlling interest.

(2) Empire had a weighted average number of shares outstanding (fully diluted) of 92.3 million in the second quarter, compared to 68.2 million in the second quarter of last year. This increase is due to the acquisition of Canada Safeway and the issuance of 24,265,000 Non-Voting Class A shares in the third quarter of fiscal 2014.

(3) Earnings per share ("EPS")

## Net Earnings

The following table reconciles Empire's segmented net earnings from continuing operations, net of non-controlling interest, to net earnings, net of non-controlling interest, for 13 and 26 weeks ended November 1, 2014 compared to the 13 and 26 weeks ended November 2, 2013.

(\$ in millions, except per share amounts, net of tax)	13 Weeks Ended			(\$)	26 Weeks Ended			(\$)
	Nov. 1, 2014	Nov. 2, 2013	Change		Nov. 1, 2014	Nov. 2, 2013	Change	
Net earnings from continuing operations <sup>(1)</sup>	\$ 116.9	\$ 60.5	\$ 56.4	\$ 240.0	\$ 143.1	\$ 96.9		
Net earnings from discontinued operations	-	108.7	(108.7)	-	91.1	(91.1)		
Net earnings <sup>(1)</sup>	\$ 116.9	\$ 169.2	\$ (52.3)	\$ 240.0	\$ 234.2	\$ 5.8		
Net earnings by segment <sup>(1)</sup> :								
Food retailing	\$ 100.4	\$ 56.3	\$ 44.1	\$ 213.9	\$ 135.5	\$ 78.4		
Investments and other operations	16.5	112.9	(96.4)	26.1	98.7	(72.6)		
Net earnings <sup>(1)</sup>	\$ 116.9	\$ 169.2	\$ (52.3)	\$ 240.0	\$ 234.2	\$ 5.8		
EPS (fully diluted) <sup>(2)</sup>	\$ 1.27	\$ 2.48	\$ (1.21)	\$ 2.60	\$ 3.44	\$ (0.84)		

(1) Net of non-controlling interest.

(2) Empire had a weighted average number of shares outstanding (fully diluted) of 92.3 million compared to 68.2 million in the second quarter of fiscal 2014. This increase is due to the acquisition of Canada Safeway and the issuance of 24,265,000 Non-Voting Class A shares in the third quarter of fiscal 2014.

Net earnings from discontinued operations for the second quarter and first half of fiscal 2015 equaled \$ nil and \$ nil (\$ nil and \$ nil per diluted share) compared to \$108.7 million and \$91.1 million respectively (\$1.59 and \$1.34 per diluted share) in the comparable periods last year.

## FINANCIAL PERFORMANCE BY SEGMENT

### Food Retailing

The following is a review of Empire's food retailing segment's financial performance for the 13 and 26 weeks ended November 1, 2014 compared to the 13 and 26 weeks ended November 2, 2013.

The table below summarizes Sobeys' contribution to Empire's consolidated sales, gross profit, EBITDA, adjusted EBITDA, operating income, net earnings, net of non-controlling interest, and adjusted net earnings, net of non-controlling interest.

(\$ in millions)	13 Weeks Ended <sup>(1)</sup>				26 Weeks Ended <sup>(1)</sup>			
	Nov. 1, 2014		Nov. 2, 2013		Nov. 1, 2014		Nov. 2, 2013	
		% of Sales		% of Sales		% of Sales		% of Sales
Sales	\$ 5,995.1	100.00%	\$ 4,416.8	100.00%	\$ 12,217.8	100.00%	\$ 9,011.7	100.00%
Gross Profit	1,480.9	24.70%	993.3	22.49%	3,026.8	24.77%	2,031.1	22.54%
EBITDA	301.5	5.03%	190.1	4.30%	630.7	5.16%	405.3	4.50%
Adjusted EBITDA	309.4	5.16%	206.9	4.68%	640.6	5.24%	432.2	4.80%
Operating income	181.6	3.03%	99.8	2.26%	387.8	3.17%	226.8	2.52%
Net earnings <sup>(2)</sup>	100.4	1.67%	56.3	1.27%	213.9	1.75%	135.5	1.50%
Adjusted net earnings <sup>(2)</sup>	111.7	1.86%	74.1	1.68%	233.8	1.91%	160.4	1.78%

(1) Net of consolidation adjustments which include a purchase price allocation from the privatization of Sobeys.

(2) Net of non-controlling interest.

## **Sales**

During the second quarter of fiscal 2015, Sobeys reported sales of \$5,995.1 million, an increase of \$1,578.3 million or 35.7 percent, compared to \$4,416.8 million recorded in the second quarter of fiscal 2014. The growth in sales is primarily the result of sales from Safeway operations and food inflation, slightly offset by increased competitive square footage in the market, store closures and divestitures and ongoing competitive intensity. During the second quarter of fiscal 2015, same-store sales increased 1.7 percent from the same period last year.

Sobeys reported sales of \$12,217.8 million during the 26 weeks ended November 1, 2014, an increase of \$3,206.1 million or 35.6 percent compared to \$9,011.7 million recorded in the first half of fiscal 2014. The increase was the result of the reasons noted in the paragraph above. During the first half of fiscal 2015, same-store sales increased 1.6 percent from the same period last year.

## **Gross Profit**

For the second quarter of fiscal 2015, Sobeys' gross profit was \$1,480.9 million, an increase of \$487.6 million or 49.1 percent compared to \$993.3 million for the same period in the prior year. For the second quarter of fiscal 2015, gross margin increased 221 basis points to 24.70 percent compared to 22.49 percent for the second quarter of fiscal 2014. The increase in gross margin is significantly impacted by gross profit contribution related to Safeway operations.

Sobeys' gross profit for the first half of fiscal 2015 was \$3,026.8 million, an increase of \$995.7 million or 49.0 percent compared to \$2,031.1 million for the same period in the prior year. For the first half of fiscal 2015, gross margin increased 223 basis points to 24.77 percent compared to 22.54 percent for the first half of fiscal 2014.

Overall Sobeys' gross profit and gross margin were impacted during the second quarter and first half of 2015 by the following factors:

- (i) The Canada Safeway acquisition and related synergies;
- (ii) Inflation; and
- (iii) A highly promotional environment.

## **EBITDA**

Sobeys contributed EBITDA for the second quarter of fiscal 2015 was \$301.5 million, an increase of \$111.4 million or 58.6 percent compared to \$190.1 million for the same period last year. EBITDA was impacted mainly by Safeway operations as well as synergies of \$31.5 million (2014 – \$ nil) realized during the second quarter of fiscal 2015 related to the acquisition. These combined with the other factors affecting gross profit, as mentioned previously, had a net positive effect on EBITDA.

For the second quarter of fiscal 2015, Sobeys' contributed EBITDA margin increased 73 basis points to 5.03 percent from 4.30 percent. Excluding items which are considered not indicative of underlying business operating performance summarized in the following table, adjusted EBITDA for the second quarter of fiscal 2015 and 2014 were \$309.4 million and \$206.9 million, respectively. Adjusted EBITDA was impacted by the loss on disposal of manufacturing facilities combined with reduced transaction costs related to the Canada Safeway acquisition of \$0.7 million (2014 – \$16.8 million). Adjusted EBITDA margin for the second quarter of fiscal 2015 was 5.16 percent, an increase of 48 basis points over the same period last year.

Sobeys contributed EBITDA for the 26 weeks ended November 1, 2014 was \$630.7 million, an increase of \$225.4 million or 55.6 percent compared to \$405.3 million for the same period last year. EBITDA was impacted mainly by Safeway operations as well as synergies of \$59.7 million (2014 – \$ nil) realized during the 26 weeks ended November 1, 2014 related to the acquisition.

For the first half of fiscal 2015, Sobeys' contributed EBITDA margin increased 66 basis points to 5.16 percent from 4.50 percent. Excluding items which are considered not indicative of underlying business operating performance summarized in the table below, adjusted EBITDA for the first half of fiscal 2015 and 2014 was \$640.6 million and \$432.2 million, respectively. Adjusted EBITDA was impacted by reduced transaction costs related to the Canada Safeway acquisition of \$1.7 million (2014 – \$26.9 million). Adjusted EBITDA margin for the first half of fiscal 2015 was 5.24 percent, an increase of 44 basis points over the same period last year.

(\$ in millions)	13 Weeks Ended		26 Weeks Ended	
	Nov. 1, 2014	Nov. 2, 2013	Nov. 1, 2014	Nov. 2, 2013
EBITDA (contributed by Sobeys)	\$ 301.5	\$ 190.1	\$ 630.7	\$ 405.3
Adjustments:				
Loss on disposal of manufacturing facilities	7.2	-	7.2	-
Transaction costs associated with the Canada Safeway acquisition	0.7	16.8	1.7	26.9
Plant closure	-	-	1.0	-
	7.9	16.8	9.9	26.9
Adjusted EBITDA	\$ 309.4	\$ 206.9	\$ 640.6	\$ 432.2

## Operating Income

Sobeys' contribution to operating income increased \$81.8 million or 82.0 percent, to \$181.6 million in the second quarter of fiscal 2015 compared to \$99.8 million reported in the same period last year. Operating income was impacted primarily by Safeway operations combined with the factors affecting EBITDA, offset by depreciation and amortization expenses of \$21.1 million and \$6.3 million, respectively, related to the Canada Safeway acquisition, when compared to the same period last year.

For the first half of fiscal 2015, Sobeys' contribution to operating income increased \$161.0 million or 71.0 percent, to \$387.8 million from \$226.8 million reported in the same period last year for the same reasons as noted in the paragraph above.

## Net Earnings

Sobeys contributed net earnings, net of non-controlling interest, for the second quarter of fiscal 2015 were \$100.4 million, an increase of \$44.1 million or 78.3 percent over the same period last year. This increase is mainly the result of the inclusion of Safeway operations. Adjusted net earnings for the second quarter of fiscal 2015 were \$111.7 million or \$37.6 million higher than the same period last year.

Sobeys contributed net earnings, net of non-controlling interest, for the first half of fiscal 2015 were \$213.9 million, an increase of 57.9 percent or \$78.4 million over the same period last year. Adjusted net earnings for the first half of fiscal 2015 were \$233.8 million or \$73.4 million higher than the same period last year.

(\$ in millions)	13 Weeks Ended		26 Weeks Ended	
	Nov. 1, 2014	Nov. 2, 2013	Nov. 1, 2014	Nov. 2, 2013
Net earnings <sup>(1)</sup> (contributed by Sobeys)	\$ 100.4	\$ 56.3	\$ 213.9	\$ 135.5
Adjustments: <sup>(2)</sup>				
Loss on disposal of manufacturing facilities	5.0	-	5.0	-
Intangible amortization associated with the Canada Safeway acquisition	4.7	-	10.7	-
Finance costs associated with the network rationalization	1.1	-	2.3	-
Transaction costs associated with the Canada Safeway acquisition	0.5	12.4	1.2	19.5
Plant closure	-	-	0.7	-
Finance costs associated with the Canada Safeway acquisition	-	5.4	-	5.4
	11.3	17.8	19.9	24.9
Adjusted net earnings <sup>(1)</sup>	\$ 111.7	\$ 74.1	\$ 233.8	\$ 160.4

(1) Net of non-controlling interest.

(2) All adjustments are net of income taxes.

## Investments and Other Operations

The table below presents sales, EBITDA, operating income, net earnings from continuing operations, net earnings from discontinued operations, and net earnings, for the investments and other operations segment.

(\$ in millions)	13 Weeks Ended			26 Weeks Ended		
	Nov. 1, 2014	Nov. 2, 2013	(\$) Change	Nov. 1, 2014	Nov. 2, 2013	(\$) Change
Sales <sup>(1)</sup>	\$ -	\$ 0.8	\$ (0.8)	\$ -	\$ 4.2	\$ (4.2)
EBITDA <sup>(1)</sup>	22.8	6.7	16.1	36.3	13.7	22.6
Operating income (loss)						
Crombie REIT <sup>(2)</sup>	9.0	5.4	3.6	16.3	12.1	4.2
Real estate partnerships <sup>(3)</sup>	11.4	8.0	3.4	19.4	11.1	8.3
Other operations, net of corporate expenses	2.2	(6.8)	9.0	0.3	(9.7)	10.0
	22.6	6.6	16.0	36.0	13.5	22.5
Net earnings from continuing operations	16.5	4.2	12.3	26.1	7.6	18.5
Net earnings from discontinued operations	-	108.7	(108.7)	-	91.1	(91.1)
Net earnings	16.5	112.9	(96.4)	26.1	98.7	(72.6)

(1) Results generated from Empire Theatres have been recorded in discontinued operations for fiscal 2014.

(2) 41.5 percent equity accounted interest in Crombie REIT (November 2, 2013 – 42.1 percent interest).

(3) Interests in Genstar.

At November 1, 2014, Empire's investment portfolio, including equity accounted investments in Crombie REIT and Genstar, consisted of:

(\$ in millions)	November 1, 2014			May 3, 2014			November 2, 2013		
	Fair Value	Carrying Value	Unrealized Gain	Fair Value	Carrying Value	Unrealized Gain	Fair Value	Carrying Value	Unrealized Gain
<b>Investment in associates</b>									
Crombie REIT	\$ 708.0	\$ 369.4	\$ 338.6	\$ 682.9	\$ 333.5	\$ 349.4	\$ 527.1	\$ 195.1	\$ 332.0
Canadian real estate partnerships <sup>(1)</sup>	140.7	140.7	-	143.7	143.7	-	143.3	143.3	-
U.S. real estate partnerships <sup>(1)</sup>	62.2	62.2	-	67.3	67.3	-	69.3	69.3	-
Other investments <sup>(1)(2)</sup>	24.6	24.6	-	24.8	24.8	-	24.3	24.3	-
<b>Investment in joint ventures</b>									
Canadian Digital Cinema Partnership <sup>(1)</sup>	9.7	9.7	-	9.7	9.7	-	9.8	9.8	-
	\$ 945.2	\$ 606.6	\$ 338.6	\$ 928.4	\$ 579.0	\$ 349.4	\$ 773.8	\$ 441.8	\$ 332.0

(1) Assumes fair value equals carrying value.

(2) Includes an investment in Crombie REIT Series D convertible unsecured subordinated debentures (the "Debentures") with a market value of \$24.6 million (November 2, 2013 – \$24.3 million). During the first quarter of fiscal 2013, the Company purchased \$24.0 million of Debentures, which as at November 2, 2013 had a market value of \$24.3 million, as at May 3, 2014 had a market value of \$24.8 million, and at November 1, 2014 had a market value of \$24.6 million.

## Operating Income

Investments and other operations reported operating income of \$22.6 million in the second quarter of fiscal 2015 versus \$6.6 million in the same period last year, an increase of \$16.0 million.

The contributors to operating income in the second quarter of fiscal 2015 were as follows:

- Equity accounted earnings from the Company's investment in Crombie REIT were \$9.0 million in the second quarter of fiscal 2015, an increase of \$3.6 million from the \$5.4 million recorded in the second quarter of fiscal 2014. This was driven primarily by gains on property sales.
- Equity accounted earnings from the Company's investments in real estate partnerships (Genstar) were \$11.4 million in the second quarter of fiscal 2015, an increase of \$3.4 million compared to \$8.0 million recorded in the same period last year, primarily as a result of stronger lot and housing sales.
- Other operations, net of corporate expenses, contributed operating income (loss) of \$2.2 million in the second quarter of fiscal 2015, an improvement of \$9.0 million from the \$(6.8) million recorded in the same period last year. The improvement in operating income can be attributed to organizational realignment and restructuring costs of \$ nil in the current quarter compared to costs incurred of \$8.4 million in the same period last year.

Investments and other operations reported operating income of \$36.0 million in the first half of fiscal 2015 compared to \$13.5 million in the same period last year, an increase of \$22.5 million.

The contributors to operating income in the first half of fiscal 2015 were as follows:

- Equity accounted earnings from the Company's investment in Crombie REIT were \$16.3 million in the first half of fiscal 2015, up \$4.2 million from the \$12.1 million recorded in the same period last year. This was driven primarily by gains on property sales as discussed above.
- Equity accounted earnings from the Company's investments in real estate partnerships (Genstar) were \$19.4 million in the first half of fiscal 2015, an increase of \$8.3 million compared to \$11.1 million recorded in the same period last year, primarily as a result of stronger lot and housing sales, as mentioned above.
- Other operations, net of corporate expenses, contributed operating income (loss) of \$0.3 million in the first half of fiscal 2015, an improvement of \$10.0 million from the \$(9.7) million recorded in the same period last year. The improvement in operating income can be attributed to organizational realignment and restructuring costs of \$ nil in the first half of fiscal 2015 compared to costs incurred of \$8.4 million in the same period last year.

### **Net Earnings**

Investments and other operations contributed \$16.5 million to Empire's consolidated net earnings in the second quarter of fiscal 2015 compared to \$112.9 million in second quarter of fiscal 2014. The \$96.4 million decline is attributed to a decrease in net earnings from discontinued operations of \$108.7 million and is partially offset by an increase in net earnings from continuing operations of \$12.3 million. The \$108.7 million decrease in net earnings from discontinued operations can be attributed to a \$105.3 million gain on disposal of assets relating to the sale of Empire Theatres in fiscal 2014.

Investments and other operations contributed \$26.1 million to Empire's consolidated net earnings in the first half of fiscal 2015 compared to \$98.7 million in the first half of fiscal 2014. The \$72.6 million decline is attributed to a decrease in net earnings from discontinued operations of \$91.1 million and is partially offset by an increase in net earnings from continuing operations of \$18.5 million. The \$91.1 million decrease in net earnings from discontinued operations can be attributed to a \$105.3 million gain on disposal of assets relating to the sale of Empire Theatres in fiscal 2014.

## QUARTERLY RESULTS OF OPERATIONS

The following table is a summary of selected financial information from the Company's unaudited interim condensed consolidated financial statements for each of the eight most recently completed quarters:

(\$ in millions, except per share amounts)	Fiscal 2015			Fiscal 2014			Fiscal 2013 <sup>(1)</sup>		
	Q2 Nov. 1, 2014	Q1 Aug. 2, 2014	Q4 May 3, 2014	Q3 Feb. 1, 2014	Q2 Nov. 2, 2013	Q1 Aug. 3, 2013	Q4 May 4, 2013	Q3 Feb. 2, 2013	
Sales <sup>(2)</sup>	\$ 5,995.1	\$ 6,222.7	\$ 5,945.9	\$ 6,004.1	\$ 4,414.3	\$ 4,595.3	\$ 4,242.7	\$ 4,271.6	
EBITDA	324.3	342.7	147.4	188.9	196.8	222.2	238.6	195.6	
Operating income	204.2	219.6	22.9	65.3	106.4	133.9	150.3	109.7	
Net earnings from continuing operations <sup>(3)</sup>	116.9	123.1	1.5	6.4	60.5	82.6	102.5	71.4	
Net earnings (loss) from discontinued operations	-	-	(0.7)	(6.0)	108.7	(17.6)	3.4	2.7	
Net earnings <sup>(3)</sup>	\$ 116.9	\$ 123.1	\$ 0.8	\$ 0.4	\$ 169.2	\$ 65.0	\$ 105.9	\$ 74.1	
<b>Per share information, basic</b>									
Net earnings from continuing operations <sup>(3)</sup>	\$ 1.27	\$ 1.33	\$ 0.02	\$ 0.07	\$ 0.89	\$ 1.22	\$ 1.51	\$ 1.05	
Net earnings (loss) from discontinued operations	-	-	(0.01)	(0.07)	1.60	(0.26)	0.05	0.04	
Net earnings <sup>(3)</sup>	\$ 1.27	\$ 1.33	\$ 0.01	\$ -	\$ 2.49	\$ 0.96	\$ 1.56	\$ 1.09	
Basic weighted average number of shares outstanding (in millions)	92.3	92.3	92.3	92.0	68.0	67.9	67.9	67.9	
<b>Per share information, diluted</b>									
Net earnings from continuing operations <sup>(3)</sup>	\$ 1.27	\$ 1.33	\$ 0.02	\$ 0.07	\$ 0.89	\$ 1.21	\$ 1.51	\$ 1.05	
Net earnings (loss) from discontinued operations	-	-	(0.01)	(0.07)	1.59	(0.26)	0.05	0.04	
Net earnings <sup>(3)</sup>	\$ 1.27	\$ 1.33	\$ 0.01	\$ -	\$ 2.48	\$ 0.95	\$ 1.56	\$ 1.09	
Diluted weighted average number of shares outstanding (in millions)	92.3	92.3	92.4	92.1	68.2	68.2	68.1	68.1	

(1) Amounts have been restated as a result of a change in accounting policy. Please see the section entitled "Accounting Standards and Policies Adopted During Fiscal 2014" in the fiscal 2014 MD&A.

(2) Amounts have been reclassified to correspond to the current period presentation on condensed consolidated statement of earnings.

(3) Net of non-controlling interest.

For these most recent eight quarters, the Company's sales have continued to show improvement compared to the same quarter of the prior year. The ongoing improvement in sales is driven primarily by acquisition activity and organic growth as a result of the Company's adherence to a competitive pricing posture, increased retail selling square footage from new stores and enlargements, improved store level execution and product and services innovation.

Sales include fluctuations in quarter-to-quarter inflationary and deflationary market pressures. Sobeys does experience some seasonality as evidenced in the results presented above, in particular during the summer months and over the holidays.

The quarter ended February 1, 2014 is the first quarter to include Safeway operations. Consolidated sales and net earnings, net of non-controlling interest, have been influenced by Safeway operations, the Company's other investing activities, the competitive environment, cost management initiatives, food price and general industry trends, the cyclical nature of both residential and commercial real estate, and by other risk factors as outlined in the fiscal 2014 MD&A.

## LIQUIDITY AND CAPITAL RESOURCES

The table below highlights major cash flow components for the 13 and 26 weeks ended November 1, 2014 compared to the 13 and 26 weeks ended November 2, 2013.

(\$ in millions)	13 Weeks Ended		26 Weeks Ended	
	Nov. 1, 2014	Nov. 2, 2013	Nov. 1, 2014	Nov. 2, 2013
Net earnings	\$ 122.0	\$ 171.6	\$ 253.4	\$ 243.8
Non-cash and other cash items	190.4	24.8	422.9	190.1
Net change in non-cash working capital	(101.7)	(152.7)	(69.1)	(108.6)
Income taxes paid, net	(29.6)	(32.9)	(48.1)	(146.5)
Cash flows from operating activities	181.1	10.8	559.1	178.8
Cash flows used in investing activities	(62.5)	(819.7)	(104.7)	(929.5)
Cash flows (used in) from financing activities	(132.3)	1,134.2	(507.2)	1,088.0
(Decrease) increase in cash and cash equivalents	\$ (13.7)	\$ 325.3	\$ (52.8)	\$ 337.3

### Operations

Cash flows from operating activities for the second quarter generated \$181.1 million compared to \$10.8 million in the same period in fiscal 2014, an increase of \$170.3 million. This increase was mainly the result of an increase in non-cash and other cash items, net change in non-cash working capital, offset by a decrease in net earnings, for the second quarter of fiscal 2015.

During the 26 weeks ended November 1, 2014, cash flows from operating activities were \$559.1 million compared to \$178.8 million in the prior year, an increase of \$380.3 million. This increase was primarily the result of an increase in non-cash and other items, and a decrease in the net income taxes paid for the first half of fiscal 2015.

The following table presents non-cash working capital and the breakdown of net change in non-cash working capital in the second quarter of fiscal 2015 compared to the net change in the second quarter of fiscal 2014.

(\$ in millions)	13 Weeks Ended			
	Nov. 1, 2014		Nov. 2, 2013	
	Nov. 1, 2014	Aug. 2, 2014	Q2 F2015 Change	Q2 F2014 Change
Receivables	\$ 485.4	\$ 485.0	\$ (0.4)	\$ (22.1)
Inventories	1,383.0	1,295.4	(87.6)	(49.9)
Prepaid expenses	107.3	127.8	20.5	(20.9)
Accounts payable and accrued liabilities	(2,288.3)	(2,324.5)	(36.2)	(33.6)
Provisions	(73.6)	(74.6)	(1.0)	(3.8)
Impact of reclassifications on working capital	(3.0)	-	3.0	(22.4)
Total	\$ (389.2)	\$ (490.9)	\$ (101.7)	\$ (152.7)

In the second quarter of fiscal 2015:

- Inventories increased \$87.6 million compared to an increase of \$49.9 million during the same period last year. This increase is the result of the addition of Safeway operations in the current period when compared to the same period in the prior year.
- Prepaid expenses decreased by \$20.5 million compared to an increase of \$20.9 million during the same period last year. The decrease in prepaid expenses from the prior year was primarily related to a reduction in costs required for the Canada Safeway acquisition and a timing difference with prepaid rent.

## Investment

Cash used in investing activities of \$62.5 million in the second quarter of fiscal 2015 decreased \$757.2 million compared to cash used of \$819.7 million in the comparable period last year. The decrease in cash used in investing activities in the quarter was primarily due to the \$987.1 million net proceeds from the private placement of unsecured notes being held in escrow, offset by a decrease in proceeds on disposal of property, equipment and investment property \$45.2 million (2014 – \$271.1 million). The net cash used in the second quarter of fiscal 2014 was due to the increase in funds held in escrow described above which were subsequently used in the Canada Safeway acquisition

For the 26 weeks ended November 1, 2014, cash used in investing activities was \$104.7 million compared to cash used of \$929.5 million last year, a decrease of \$824.8 million. The decrease in cash from investing activities in the first half of fiscal 2015 was primarily due to the reasons noted in the paragraph above, slightly offset by a decrease in proceeds on disposal of property, equipment and investment property of \$165.0 million (2014 – \$279.5 million) related to divested sites in the first quarter of fiscal 2015 and by an equity investment in Crombie REIT of approximately \$40.0 million (2014 – \$1.6 million).

The table below outlines the number of stores Sobeys invested in during the 13 and 26 weeks ended November 1, 2014 compared to the 13 and 26 weeks ended November 2, 2013:

# of stores	13 Weeks Ended		26 Weeks Ended	
	Nov. 1, 2014	Nov. 2, 2013	Nov. 1, 2014	Nov. 2, 2013
Opened/relocated/acquired	14	15	38	32
Expanded	2	-	2	-
Rebannered/redeveloped	10	3	12	7
Closed – normal course of operations	6	6	15	16
Divested – Competition Bureau imposed	-	-	11	-
Closed – network rationalization	7	-	30	-

The following table shows Sobeys' square footage changes for the 13 and 52 weeks ended November 1, 2014, by type:

Square feet (in thousands)	13 Weeks Ended November 1, 2014	52 Weeks Ended November 1, 2014
Opened	113	865
Relocated	-	52
Acquired – normal course of operations	18	146
Rebannered	-	13
Converted	-	(2)
Expanded	5	39
Closed – normal course of operations	(24)	(436)
Net change before the impact of the Canada Safeway acquisition and network rationalization	112	677
Acquired – Canada Safeway acquisition	-	9,269
Divested – Competition Bureau imposed	-	(1,173)
Closed – network rationalization	(267)	(893)
Net change with the impact of the Canada Safeway acquisition	(155)	7,880

At November 1, 2014, Sobeys' square footage totaled 37.6 million square feet, a 26.2 percent increase over the 29.8 million square feet operated at the end of the second quarter last year. This increase in square footage over the same period last year was primarily due to the Canada Safeway acquisition, net of divested stores, and stores closed due to network rationalization.

Excluding the impact of the Canada Safeway acquisition, the Competition Bureau imposed divestitures and the network rationalization, Sobeys' square footage at November 1, 2014 increased 2.0 percent compared to square footage operated at November 2, 2013.

## Financing

During the second quarter of fiscal 2015, financing resulted in cash used of \$132.3 million compared to cash generated of \$1,134.2 million in the second quarter of fiscal 2014. This decrease was mainly the result of \$999.8 million of notes payable issued in 2014. The issuance of notes payable was made for funds held in escrow as part of the private placement of unsecured notes to partially fund the Canada Safeway acquisition.

For the first half of fiscal 2015, cash used in financing activities equaled \$507.2 million compared to cash generated from financing activities of \$1,088.0 million in the same period last year. The increase in cash used of \$1,595.2 million is primarily the result of an increase in repayment of long-term debt of \$758.0 million (2014 – \$85.3 million), issuance of notes payable of \$999.8 million in the prior fiscal year, offset by issuance of long-term debt of \$368.0 million (2014 – \$259.7 million).

During the first half of fiscal 2015, the Company completed a private placement of \$300.0 million aggregate principal amount of floating rate senior unsecured notes. The net proceeds from this issuance of debt, combined with cash from operations and proceeds from the sale of divested stores were applied against bank borrowings.

## Free Cash Flow

Free cash flow <sup>(1)</sup> is used to measure the change in the Company's cash available for additional investing, dividends and/or debt reduction. The following table reconciles free cash flow to GAAP cash flows from operating activities for the 13 and 26 weeks ended November 1, 2014 and the 13 and 26 weeks ended November 2, 2013.

(\$ in millions)	13 Weeks Ended		26 Weeks Ended	
	Nov. 1, 2014	Nov. 2, 2013	Nov. 1, 2014	Nov. 2, 2013
Cash flows from operating activities	\$ 181.1	\$ 10.8	\$ 559.1	\$ 178.8
Add: proceeds on disposal of property, equipment and investment property	45.2	271.1	165.0	279.5
Less: property, equipment and investment property purchases	(86.3)	(112.3)	(192.1)	(220.5)
Free cash flow	\$ 140.0	\$ 169.6	\$ 532.0	\$ 237.8

(1) See "Non-GAAP Financial Measures" section of this MD&A.

Free cash flow for the second quarter of fiscal 2015 was \$140.0 million compared to \$169.6 million in the second quarter of fiscal 2014. This decrease in free cash flow was mainly the result of a decrease in proceeds on disposal of property, equipment and investment property offset by an increase in cash flows from operating activities.

For the 26 weeks ended November 1, 2014, free cash flow was \$532.0 million compared to \$237.8 million in the same period last year. This increase in free cash flow was mainly the result of an increase in cash flows from operating activities, offset by a decrease in proceeds on disposal of property, equipment and investment property.

## CONSOLIDATED FINANCIAL CONDITION

### Capital Structure

The Company's share capital was comprised of the following on November 1, 2014:

	Authorized Number of Shares	Issued and Outstanding Number of Shares	\$ in Millions
2002 Preferred shares, par value of \$25 each, issuable in series	991,980,000	-	\$ -
Non-Voting Class A shares, without par value	257,044,056	58,071,388	2,101.8
Class B common shares, without par value, voting	40,800,000	34,260,763	7.6
			\$ 2,109.4

## Key Financial Condition Measures

The key financial condition measures are presented in the table below.

(\$ in millions, except per share and ratio calculations)	Nov. 1, 2014	May 3, 2014	Nov. 2, 2013
Shareholders' equity,			
net of non-controlling interest	\$ 5,872.1	\$ 5,700.5	\$ 3,957.7
Book value per common share <sup>(1)</sup>	\$ 63.60	\$ 61.75	\$ 58.23
Long-term debt, including current portion	\$ 3,123.6	\$ 3,497.9	\$ 1,140.5
Funded debt to total capital <sup>(1)</sup>	34.7%	38.0%	22.4%
Net funded debt to net total capital <sup>(1)</sup>	31.9%	35.0%	8.1%
Funded debt to EBITDA <sup>(1)(2)(3)</sup>	3.1x	4.6x	1.3x
EBITDA to interest expense <sup>(1)(2)(4)</sup>	6.1x	5.8x	13.5x
Current assets to current liabilities	1.2x	1.0x	1.1x
Total assets	\$ 12,140.8	\$ 12,238.0	\$ 10,279.7

(1) See "Non-GAAP Financial Measures" section of this MD&A.

(2) Ratios for May 3, 2014 and November 2, 2013 exclude EBITDA and interest expense relating to discontinued operations.

(3) Calculation uses trailing four-quarter EBITDA.

(4) Calculation uses trailing four-quarter EBITDA and interest expense.

The ratio of funded debt to total capital decreased 3.3 percentage points to 34.7 percent at November 1, 2014 from 38.0 percent at May 3, 2014. This reduction largely reflects a decline in long-term debt as a result of \$390.0 million in debt repayments net of debt issued in the first half of the fiscal year and an increase in retained earnings. The funded debt to EBITDA ratio declined to 3.1 times compared to 4.6 times at May 3, 2014 as a result of the decrease in long-term debt and increased earnings for the year. An increase in the EBITDA to interest expense coverage ratio (6.1 times versus 5.8 times at May 3, 2014) was the result of a higher 12-month trailing EBITDA (\$1,003.3 million versus \$755.3 million at May 3, 2014).

The Company's ratio of current assets to current liabilities was 1.2 times at November 1, 2014 compared to 1.0 times at May 3, 2014 and 1.1 times at November 2, 2013.

On November 4, 2013, the Company extended the term of its credit facilities to a maturity date of November 4, 2017. On June 6, 2014, an amendment was made to the credit facility to reduce the amount available from \$450.0 million to \$250.0 million.

Pursuant to an agreement dated October 30, 2013, Sobeys established new credit facilities in connection with the Canada Safeway acquisition. The agreement provided for a non-revolving, amortizing term credit facility (the "Acquisition Facility") in the amount of \$1,825.0 million; a non-revolving, non-amortizing term bridge facility (the "Bridge Facility") in the amount of \$1,327.9 million; and a revolving term credit facility (the "RT Facility") in the amount of \$450.0 million.

On November 4, 2013, the RT Facility replaced Sobeys' previous unsecured revolving term credit facility of \$450.0 million, the Acquisition Facility was fully drawn for \$1,825.0 million and the Bridge Facility was drawn for \$200.0 million in order to partially finance the Canada Safeway acquisition. As of November 1, 2014, the outstanding amount of the Acquisition Facility was \$975.0 million, the Bridge Facility was fully repaid and matured, and the Company had issued \$55.4 million in letters of credit against the RT facility (May 3, 2014 – \$79.0 million). Interest payable on the Acquisition and RT Facilities fluctuates with changes in the bankers' acceptance rate or Canadian prime rate, and both facilities mature on November 4, 2017.

On July 14, 2014, Sobeys completed a private placement of \$300.0 million aggregate principal amount of floating rate senior unsecured notes, due July 14, 2016. The senior unsecured notes bear an interest rate equal to the three-month bankers' acceptance rate plus 63 basis points, to be set quarterly. The net proceeds were used to repay outstanding debt on the Acquisition Facility. Deferred financing fees in the amount of \$0.9 million were incurred on the draw down of the senior unsecured notes and have been offset against long-term debt amounts for presentation purposes.

Sobeys current credit ratings are BBB (low) with a stable trend from Dominion Bond Rating Service ("DBRS") and BBB- with a negative trend from Standard and Poor's ("S&P").

The Company believes that its cash and cash equivalents on hand, unutilized bank credit facilities and cash generated from operating activities will enable the Company to fund future capital investments, pension plan contributions, working capital, current funded debt obligations and ongoing business requirements. The Company also believes it has sufficient funding in place to meet these requirements and other short-term and long-term financial obligations. The Company mitigates potential liquidity risk by ensuring its various sources of funds are diversified by term to maturity and source of credit.

The Company has provided covenants to its lenders in support of various financing facilities. All covenants were complied with for the 13 and 26 weeks ended November 1, 2014.

### Shareholders' Equity

The increase in shareholders' equity of \$1,914.4 million from the second quarter of fiscal 2014 largely reflects the increase in the Company's capital stock from the \$1,844.1 million offering of Subscription Receipts in July 2013 which were exchanged for Non-Voting Class A shares on November 4, 2013 and growth in retained earnings. Book value per common share was \$63.60 at November 1, 2014 compared to \$58.23 at November 2, 2013.

The Company's share capital on November 1, 2014 compared to the same period in the last fiscal year is shown in the table below:

(Number of Shares)	13 Weeks Ended	
	Nov. 1, 2014	Nov. 2, 2013
<b>Non-Voting Class A shares</b>		
Issued and outstanding, beginning of period	58,068,709	33,687,747
Issued during period	2,679	22,249
Issued and outstanding, end of period	58,071,388	33,709,996
<b>Class B common shares</b>		
Issued and outstanding, beginning of period	34,260,763	34,260,763
Issued during period	-	-
Total Issued and outstanding, end of period	34,260,763	34,260,763

On June 11, 2014, 77,039 options were exercised resulting in an additional 19,225 Non-Voting Class A shares being issued.

Dividends paid to Non-Voting Class A and Class B common shareholders amounted to \$25.0 million in the second quarter of fiscal 2015 (\$0.27 per share) versus \$17.6 million (\$0.26 per share) in the second quarter of fiscal 2014.

On July 31, 2013, in connection with Sobeys' acquisition of substantially all of the assets and select liabilities of Canada Safeway, the Company announced that it closed its previously announced offering of 21.1 million Subscription Receipts at a price of \$76.00 per Subscription Receipt, along with the syndicate of underwriters exercising in full their over-allotment option of 3.165 million Subscription Receipts, for a total of 24,265,000 Subscription Receipts. The total gross proceeds were approximately \$1,844.1 million. Upon closing of the Canada Safeway acquisition, the 24,265,000 Subscription Receipts were exchanged for Non-Voting Class A shares and net proceeds were used to partially finance the Canada Safeway acquisition. Further information on the Canada Safeway acquisition can be found in the "Business Acquisition" section of the fiscal 2014 MD&A.

As at December 12, 2014, the Company had Non-Voting Class A and Class B common shares outstanding of 58,071,388 and 34,260,763, respectively, as well as 1,127,760 options to acquire in aggregate 1,127,760 Non-Voting Class A shares.

## Financial Instruments

As part of Empire's risk management strategy, the Company actively monitors its exposures to various financial risks including interest rate risk, foreign exchange risk and commodity risk. From time to time, the Company utilizes hedging instruments as deemed appropriate to mitigate risk exposure and not for speculative purposes. The Company's use of these instruments has not had a material impact on consolidated earnings for the 13 and 26 weeks ended November 1, 2014 or for the comparative period in fiscal 2014.

When the Company, or its subsidiaries, enter into a financial instrument contract, it is exposed to potential credit risk associated with the counterparty of the contract defaulting. To mitigate this risk exposure, the Company monitors the credit worthiness of its various contractual counterparties on an ongoing basis and will take corrective actions as deemed appropriate should a counterparty's credit profile change materially.

In July 2008, the Company entered into a floating-for-floating currency swap with a fixed rate of \$1.015 CAD/United States Dollar ("USD") to mitigate the currency risk associated with a USD denominated variable rate lease. The term of the swap matches the term of the variable rate lease. As of November 1, 2014, the Company recognized an asset of \$0.3 million relating to this instrument. The Company estimates that a 10.0 percent increase (decrease) in applicable foreign currency exchange rates would impact fair value of the instrument by \$0.5 million (\$0.5 million). An increase (decrease) of 10.0 percent would impact other comprehensive income by \$0.3 million (\$0.3 million).

During the first quarter of fiscal 2015, the Company entered into an amortizing interest rate swap for an original notional amount of \$598.7 million at a fixed interest rate of 1.4 percent effective May 12, 2014 to hedge the interest rate on a portion of the Company's Acquisition Facility. The notional amount outstanding at the end of the second quarter is \$386.7 million. The interest rate swap matures on December 31, 2015.

As of November 1, 2014, the Company recognized a liability of \$0.3 million relating to this instrument. The Company estimates that an increase (decrease) of 25 basis points in applicable forward interest rates would impact fair value of the instrument by \$0.6 million (\$0.6 million). An increase (decrease) of 25 basis points would impact other comprehensive income by \$0.4 million (\$0.4 million).

To mitigate the currency risk associated with some of the Company's British Pound ("GBP") purchases, Sobeys enters into forward currency contracts with staggered maturities to hedge against the effect of the changes in the value of the CAD relative to the GBP. As of November 1, 2014, the Company recognized an asset of \$0.1 million representing the fair value of GBP denominated forward currency contracts. The Company estimates that a 10.0 percent increase (decrease) in applicable exchange rates would impact fair value by \$0.3 million (\$0.3 million). An increase (decrease) of 10.0 percent would impact other comprehensive income by \$0.2 million (\$0.2 million).

To mitigate the currency risk associated with some of the Company's Euro purchases, Sobeys enters into forward currency contracts with staggered maturities to hedge against the effect of the changes in the value of the CAD relative to the Euro. As of November 1, 2014, the Company recognized a liability of \$2.4 million representing the fair value of Euro denominated forward currency contracts. The Company estimates that a 10.0 percent increase (decrease) in applicable exchange rates would impact fair value by \$3.8 million (\$3.8 million). An increase (decrease) of 10.0 percent would impact other comprehensive income by \$2.7 million (\$2.7 million).

## Fair Value Methodology

When a financial instrument is designated as a hedge for financial accounting purposes, it is classified as fair value through profit and loss on the balance sheets and recorded at fair value. The estimated fair values of the financial instruments as at November 1, 2014 were based on relevant market prices and information available at the reporting date. The Company determines the fair value of each financial instrument by reference to external and third party quoted bid, ask and mean prices, as appropriate, in an active market. In inactive markets, fair values are based on internal and external valuation models, such as discounted cash flows using market observed inputs. Fair values determined using valuation models require the use of assumptions to determine the amount and timing of forecasted future cash flows and discount rates. The Company primarily uses external market inputs, including factors such as interest yield curves and forward exchange rates to determine the fair values. Changes in interest rates and exchange rates, along with other factors, may cause the fair value amounts to change in subsequent periods. The fair value of these financial instruments reflects the estimated amount the Company would pay or receive if it were to settle the contracts at the reporting date.

## BUSINESS ACQUISITION

### Canada Safeway Acquisition

During the second quarter of fiscal 2015, management finalized the purchase price allocation related to the Canada Safeway acquisition. As a result, the condensed consolidated balance sheet as at November 1, 2014 was adjusted by an increase to intangibles of \$42.8 million, an increase to property and equipment of \$43.2 million, an increase to accounts payable and accrued liabilities of \$1.0 million, a decrease to deferred tax assets of \$4.8 million, an increase to deferred tax liabilities of \$4.5 million, a decrease to other assets and liabilities of \$11.4 million and goodwill decreased \$64.3 million.

The fair value of the identifiable assets acquired and liabilities assumed as at the acquisition date are as follows:

(\$ in millions)	
Inventories	\$ 451.0
Property, equipment and investment property	1,139.8
Assets held for sale	391.4
Assets acquired for sale-leaseback	991.3
Intangibles	487.6
Deferred tax assets	35.5
Accounts payable and accrued liabilities	(398.7)
Pension obligations	(137.5)
Deferred tax liabilities	(13.2)
Other assets and liabilities	38.1
<b>Total identifiable net assets</b>	<b>\$ 2,985.3</b>
<b>Excess consideration paid over identifiable net assets acquired allocated to goodwill</b>	<b>\$ 2,814.7</b>

Goodwill of \$2,814.7 million was recognized as the excess of the acquisition cost over the fair value of the identifiable net assets at the date of the acquisition. The goodwill recognized is attributable mainly to the expected synergies from integration, the expected future growth potential in grocery store operations and the customer base of the acquired retail store locations. Approximately \$2,102.2 million of goodwill is expected to be deductible for income tax purposes.

## **ACCOUNTING STANDARDS AND POLICIES**

### **Accounting Standards and Policies Adopted During Fiscal 2015**

#### *(i) Financial instruments: asset and liability offsetting*

In December 2011, the IASB amended IAS 32, "Financial Instruments: Presentation", to clarify the requirements which permit offsetting a financial asset and liability in the financial statements. The amendments became effective in the first quarter of 2015 and had no significant impact on the Company's financial results and disclosures.

#### *(ii) Levies*

In May 2013, the IASB issued IFRIC 21, "Levies", which is an interpretation of IAS 37, "Provisions, Contingent Liabilities and Contingent Assets". A levy is an outflow of resources embodying economic benefits that is imposed by governments on entities in accordance with legislation, other than income taxes within the scope of IAS 12, "Income Taxes", and fines or other penalties imposed for breaches of legislation. IFRIC 21 clarifies that the obligating event that gives rise to a liability to pay a levy is the activity described in the relevant legislation that triggers the payment of the levy. This interpretation became effective in the first quarter of 2015 and it had no significant impact on the Company's financial results.

#### *(iii) Impairment of assets*

In May 2013, the IASB amended IAS 36 "Impairment of Assets", to clarify the disclosure requirements for recoverable amounts for the assets or cash generating units for which an impairment loss has been recognized or reversed during the period. The amendments became effective in the first quarter of 2015 and had no significant impact on the Company's financial results and disclosures.

### **Future Accounting Policies**

#### *(i) Financial instruments*

In July 2014, the IASB issued the final version of IFRS 9, "Financial Instruments", which replaces IAS 39, "Financial Instruments: Recognition and Measurement". IFRS 9 provides guidance on the classification and measurement of financial assets and financial liabilities, establishes an expected credit losses impairment model and a new hedge accounting model with corresponding risk management activity disclosures. The standard is effective for annual periods beginning on or after January 1, 2018. IFRS 9 allows for early adoption, but the Company does not intend to do so at this time.

#### *(ii) Revenue*

In May 2014, the IASB issued IFRS 15, "Revenue from Contracts with Customers". IFRS 15 replaces IAS 18, "Revenue", IAS 11, "Construction Contracts", and some revenue related Interpretations. IFRS 15 establishes a new control-based revenue recognition model and provides a comprehensive framework for recognition, measurement and disclosure of revenue from contracts with customers, excluding contracts within the scope of the standards on leases, insurance contracts and financial instruments. The new standard is effective for annual periods beginning on or after January 1, 2017. IFRS 15 allows for early adoption, but the Company does not intend to do so at this time.

The Company is currently evaluating the impact of the new standards on its consolidated financial statements.

### **Critical Accounting Estimates**

Critical accounting estimates used by the Company's management are discussed in detail in the fiscal 2014 annual MD&A.

## **Internal Control over Financial Reporting**

Management of the Company, which includes the Chief Executive Officer (“CEO”) and Chief Financial and Administrative Officer (“CFAO”), is responsible for establishing and maintaining Internal Control over Financial Reporting (“ICFR”), as that term is defined in National Instrument 52-109, “Certification of Disclosure in Issuers’ Annual and Interim Filings”. The control framework management used to design and assess the effectiveness of ICFR is “The Internal Control Integrated Framework (1992)” published by the Committee of Sponsoring Organizations of the Treadway Commission.

There have been no changes in the Company’s ICFR during the period beginning August 3, 2014 and ended November 1, 2014 that have materially affected, or are reasonably likely to materially affect, the Company’s ICFR.

## **RELATED PARTY TRANSACTIONS**

The Company has related party transactions with Crombie REIT. At the end of the second quarter of fiscal 2015, the Company holds a 41.5 percent ownership interest and accounts for its investment using the equity method.

On May 30, 2014, Crombie REIT closed a bought-deal public offering of units at a price of \$13.25 per unit. Concurrent with the public offering, a wholly-owned subsidiary of the Company purchased approximately \$40.0 million of Class B LP units (which are convertible on a one-for-one basis into units of Crombie REIT). Consequently, the Company’s interest in Crombie REIT decreased from 41.6 to 41.5 percent.

During the second quarter of fiscal 2015, the Company exited a sub-lease agreement with Crombie REIT and incurred a charge of \$2.7 million. This charge is included in selling and administrative expense on the condensed consolidated statement of earnings.

Subsequent to the quarter ended November 1, 2014, Sobeys sold and leased back eight properties from Crombie REIT. See “Subsequent Events” section for further detail on this transaction.

## **CONTINGENCIES**

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.

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.

## **RISK MANAGEMENT**

Risk and uncertainties related to economic and industry factors and the Company’s management of risk are discussed in detail in the fiscal 2014 annual MD&A.

## **EMPLOYEE FUTURE BENEFIT OBLIGATIONS**

For the 13 and 26 weeks ended November 1, 2014, the Company contributed \$1.6 million and \$4.3 million (2014 – \$1.9 million and \$3.8 million) to its registered defined benefit plans. The Company expects to contribute approximately \$6.8 million in fiscal 2015 to these plans. The Company continues to assess the impact of the capital markets on its funding requirement.

## **SUBSEQUENT EVENTS**

Subsequent to close of the second quarter ended November 1, 2014, Sobeys sold and leased back eight properties from Crombie REIT. Total proceeds from the transaction were \$101.0 million, the majority of which was used to repay bank borrowings. Assets of \$96.9 million have been included in assets held for sale for these properties as at November 1, 2014.

Subsequent to close of the second quarter ended November 1, 2014, Sobeys entered into an agreement with Canada Bread Company, Limited to sell two bread manufacturing facilities. The sales are expected to occur during the Company's fourth quarter of fiscal 2015. Total proceeds from the transaction will be approximately \$32.0 million.

## **DESIGNATION FOR ELIGIBLE DIVIDENDS**

"Eligible dividends" receive favourable treatment for income tax purposes. To be considered an eligible dividend, a dividend must be designated as such at the time of payment.

Empire has, in accordance with the administrative position of CRA, included the appropriate language on its website to designate the dividends paid by Empire as eligible dividends unless otherwise designated.

## **NON-GAAP FINANCIAL MEASURES**

There are measures included in this MD&A that do not have a standardized meaning under GAAP and therefore may not be comparable to similarly titled measures presented by other publicly traded companies. Management believes that certain of these measures, including gross profit, operating income and EBITDA are important indicators of Empire's ability to generate liquidity through operating cash flow to fund future working capital needs, service outstanding debt, and fund future capital expenditures and uses these metrics for these purposes.

In addition, management undertakes to adjust certain of these and other measures, including EBITDA and net earnings from continuing operations in an effort to provide investors and analysts with a more comparable year-over-year performance metric than the basic measure, by excluding items which are considered not indicative of underlying business operating performance.

The intent of non-GAAP financial measures is to provide additional useful information to investors and analysts and these measures are also used by investors and analysts for the purpose of valuing the Company. Non-GAAP financial measures should not be considered in isolation or used as a substitute for measures of performance prepared in accordance with GAAP. Empire's definition of the non-GAAP terms included in this MD&A are as follows:

- Same-store sales are sales from stores in the same location in both reporting periods.
- Gross profit is calculated as sales less cost of sales.
- Gross margin is gross profit divided by sales. Management believes that gross margin is an important indicator of cost control and can help management, analysts and investors assess the competitive landscape and promotional environment of the industry in which the Company operates. An increasing percentage indicates lower cost of sales as a percentage of sales.
- Earnings before interest, taxes, depreciation and amortization ("EBITDA"), is calculated as net earnings from continuing operations, before finance costs (net of finance income), income taxes, and depreciation and amortization of intangibles. The exclusion of depreciation and amortization partially eliminates the non-cash impact from operating income.

- EBITDA margin is EBITDA divided by sales. Management believes that EBITDA margin is an important indicator of overall fixed and variable cost control (excluding depreciation and amortization of intangibles) and can help management, analysts and investors assess the competitive landscape, promotional environment of the industry, and overall management of fixed and variable operating costs. An increasing percentage indicates lower operating costs as a percentage of sales. The following table reconciles EBITDA to GAAP measures:

(\$ in millions)	13 Weeks Ended		26 Weeks Ended	
	Nov. 1, 2014	Nov. 2, 2013	Nov. 1, 2014	Nov. 2, 2013
Operating income	\$ 204.2	\$ 106.4	\$ 423.8	\$ 240.3
Depreciation <sup>(1)</sup>	99.3	78.3	200.2	154.1
Amortization of intangibles <sup>(1)</sup>	20.8	12.1	43.0	24.6
<b>EBITDA</b>	<b>\$ 324.3</b>	<b>\$ 196.8</b>	<b>\$ 667.0</b>	<b>\$ 419.0</b>

(1) Depreciation and amortization of intangibles from Empire Theatres have been recorded in discontinued operations and, as a result, these figures will not reflect those presented on the Company's condensed consolidated statements of cash flows.

- Adjusted EBITDA is EBITDA excluding items which are considered not indicative of underlying business operating performance. Adjusted EBITDA is reconciled to EBITDA in its respective subsection of the "Management's Explanation of Consolidated Operating Results", "Food Retailing" and "Investments and Other Operations" sections of this MD&A.
- Adjusted EBITDA margin is adjusted EBITDA divided by sales.
- Operating income, or earnings before interest and taxes ("EBIT"), is calculated as net earnings from continuing operations before finance costs (net of finance income) and income taxes.
- Operating income margin is operating income divided by sales.
- Interest expense is calculated as interest expense on financial liabilities measured at amortized cost plus losses on cash flow hedges reclassified from other comprehensive income. Management believes that interest expense represents a true measure of the Company's debt service expense, without the offsetting total finance income. The following table reconciles interest expense to GAAP measures.

(\$ in millions)	13 Weeks Ended		26 Weeks Ended	
	Nov. 1, 2014	Nov. 2, 2013	Nov. 1, 2014	Nov. 2, 2013
Finance costs, net	\$ 41.0	\$ 21.1	\$ 84.8	\$ 35.9
Plus: finance income	0.2	8.9	0.7	9.4
Less: fair value gains (losses) on forward contracts	0.2	(0.2)	0.2	(0.5)
Less: fair value losses on cash flow hedges	-	(0.1)	-	(0.1)
Less: net pension finance costs	(3.1)	(1.8)	(6.2)	(3.7)
Less: accretion expense on provisions	(2.5)	(0.8)	(4.9)	(1.4)
<b>Interest expense</b>	<b>\$ 35.8</b>	<b>\$ 27.1</b>	<b>\$ 74.6</b>	<b>\$ 39.6</b>
Interest expense on financial liabilities measured at amortized cost	\$ 35.6	\$ 27.1	\$ 74.3	\$ 39.6
Losses on cash flow hedges reclassified from other comprehensive income	0.2	-	0.3	-
<b>Interest expense</b>	<b>\$ 35.8</b>	<b>\$ 27.1</b>	<b>\$ 74.6</b>	<b>\$ 39.6</b>

- Interest coverage is calculated as operating income divided by interest expense.

- Adjusted net earnings from continuing operations is net earnings from continuing operations, net of non-controlling interest, excluding items which are considered not indicative of underlying business operating performance. These adjustments include items which are non-recurring or one time in nature and items that result in a truer economic representation of the underlying business on a comparative basis. Adjusted net earnings from continuing operations is reconciled to net earnings from continuing operations, net of non-controlling interest, in its respective subsection of the "Management's Explanation of Consolidated Operating Results", "Food Retailing" and "Investments and Other Operations" sections of this MD&A.
- Funded debt is all interest bearing debt, which includes bank loans, bankers' acceptances and long-term debt. Management believes that funded debt represents the best indicator of the Company's total financial obligations on which interest payments are made.
- Net funded debt is calculated as funded debt less cash and cash equivalents. Management believes that the deduction of cash and cash equivalents from funded debt represents a more accurate measure of the Company's financial obligations after 100 percent of cash and cash equivalents are applied against the total obligation.
- Total capital is calculated as funded debt plus shareholders' equity, net of non-controlling interest.
- Net total capital is total capital less cash and cash equivalents.
- Funded debt to total capital ratio is funded debt divided by total capital.
- Net funded debt to net total capital ratio is net funded debt divided by net total capital. Management believes that funded debt to total capital and net funded debt to net total capital ratios represent measures upon which the Company's changing capital structure can be analyzed over time. Increasing ratios would indicate that the Company is using an increasing amount of debt in its capital structure to fund its operations.

The following tables reconcile Empire's funded debt, net funded debt, net total capital and total capital to GAAP measures as reported on the balance sheets as at November 1, 2014, May 3, 2014 and November 2, 2013, respectively.

(\$ in millions)	Nov. 1, 2014	May 3, 2014	Nov. 2, 2013
Long-term debt due within one year	\$ 19.8	\$ 218.0	\$ 50.1
Long-term debt	3,103.8	3,279.9	1,090.4
Funded debt	3,123.6	3,497.9	1,140.5
Less: cash and cash equivalents	(376.5)	(429.3)	(792.5)
Net funded debt	2,747.1	3,068.6	348.0
Total shareholders' equity, net of non-controlling interest	5,872.1	5,700.5	3,957.7
Net total capital	\$ 8,619.2	\$ 8,769.1	\$ 4,305.7

(\$ in millions)	Nov. 1, 2014	May 3, 2014	Nov. 2, 2013
Funded debt	\$ 3,123.6	\$ 3,497.9	\$ 1,140.5
Total shareholders' equity, net of non-controlling interest	5,872.1	5,700.5	3,957.7
Total capital	\$ 8,995.7	\$ 9,198.4	\$ 5,098.2

- Funded debt to EBITDA ratio is funded debt divided by trailing four-quarter EBITDA. Management uses this ratio to partially assess the financial condition of the Company. An increasing ratio would indicate that the Company is utilizing more debt per dollar of EBITDA generated.

- EBITDA to interest expense ratio is trailing four-quarter EBITDA divided by trailing four-quarter interest expense. Management uses this ratio to partially assess the coverage of its interest expense on financial obligations. An increasing ratio would indicate that the Company is generating more EBITDA per dollar of interest expense, resulting in greater interest coverage.
- Book value per common share is shareholders' equity, net of non-controlling interest, divided by total common shares outstanding. The following table shows the calculation of Empire's book value per common share as at November 1, 2014, May 3, 2014 and November 2, 2013.

(\$ in millions, except per share information)	Nov. 1, 2014	May 3, 2014	Nov. 2, 2013
Shareholders' equity, net of minority interest	\$ 5,872.1	\$ 5,700.5	\$ 3,957.7
Shares outstanding (basic)	92.331	92.310	67.971
Book value per common share	\$ 63.60	\$ 61.75	\$ 58.23

- Free cash flow is calculated as cash flows from operating activities, plus proceeds on disposal of property, equipment and investment property, less property, equipment and investment property purchases. Management uses free cash flow as a measure to assess the amount of cash available for debt repayment, dividend payments and other investing and financing activities. Free cash flow is reconciled to GAAP measures as reported on the consolidated statements of cash flows in the "Free Cash Flow" section of this MD&A.

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

Dated: December 12, 2014  
Stellarton, Nova Scotia, Canada