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**EMPIRE COMPANY LIMITED**

First Quarter Report | 13 Weeks Ended August 2, 2008

# QUARTERLY REPORT TO SHAREHOLDERS

Empire Company Limited ("Empire or the Company") is a Canadian company headquartered in Stellarton, Nova Scotia. Empire's key businesses include food retailing, real estate, and investments and other operations. Food retailing is carried out through wholly-owned Sobeys Inc. ("Sobeys"). The real estate business is carried out through a wholly-owned operating subsidiary: ECL Properties Limited ("ECL"), which includes a 100.0 percent ownership interest in ECL Developments Limited ("ECL Developments"), as well as a 35.7 percent ownership interest in Genstar Development Partnership and a 43.3 percent interest in Genstar Development Partnership II (collectively referred to as "Genstar") and a 47.9 percent ownership interest in Crombie Real Estate Investment Trust ("Crombie REIT"). The results of Sobey Leased Properties Limited ("SLP") until April 22, 2008 were consolidated under the real estate business; results after April 22, 2008 are reported under Sobeys. Corporate investment activities and other operations includes wholly-owned ETL Canada Holdings Limited ("Empire Theatres"); Kepec Resources Limited ("Kepec"), a joint venture with APL Oil and Gas Limited which has ownership interests in various oil and gas properties in Alberta; and a 27.6 percent ownership position in Wajax Income Fund ("Wajax"). With over $14 billion in annual revenue and approximately $5.7 billion in assets, Empire employs approximately 42,000 people directly and through its subsidiaries.

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Copies of this report are available on the Company's website (www.empireco.ca) or by contacting the Vice-President, Treasury and Investor Relations at (902) 755-4440. A copy has also been filed on SEDAR.

The Company provided additional details concerning its first quarter results on a conference call held on Thursday, September 11, 2008. Replay of the call is available on the Company's website (www.empireco.ca).

## Forward-looking Statements

*This quarterly report contains forward-looking statements which reflect management's expectations regarding the Company's objectives, plans, goals, strategies, future growth, results of operations, performance and business prospects and opportunities. Forward-looking statements are typically identified by words or phrases such as "anticipates", "expects", "believes", "estimates", "intends" and other similar expressions. These statements are based on management's assumptions and beliefs in light of the information currently available to them. These forward-looking statements are subject to inherent uncertainties, risks and other factors that could cause actual results to differ materially from such statements. These uncertainties and risks are discussed in the Company's materials filed with the Canadian securities regulatory authorities from time to time, including those in the Risk Management section of the annual MD&A included in the Company's 2008 Annual Report. When relying on forward-looking statements to make decisions, the Company cautions readers not to place undue reliance on these statements, as a number of important factors could cause actual results to differ materially from any estimates or intentions expressed in such forward-looking statements. 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 Canadian security regulations.*

# LETTER TO SHAREHOLDERS

Empire Company Limited (TSX: EMP.A) announced earnings before capital gains, net of tax, for its first quarter ended August 2, 2008 of $70.3 million ($1.07 per share) as compared to $60.4 million ($0.92 per share) in the first quarter last year, a $9.9 million or 16.4 percent increase.

## First Quarter Highlights (versus the first quarter last year)

- *Revenue of $3.78 billion, up $258.8 million or 7.4 percent.*
- *Sobeys' same-store sales increased 3.0 percent.*
- *Earnings before capital gains, net of tax, of $70.3 million, up $9.9 million or 16.4 percent.*
- *Earnings per share, before capital gains, net of tax, of $1.07 versus $0.92 per share last year.*
- *Capital gains, net of tax, of $4.8 million versus $81.9 million last year.*
- *Net earnings of $75.1 million ($1.14 per share).*
- *Funded debt to total capital of 38.5 percent, down from 39.8 percent at the end of the last fiscal year and 43.1 percent at the end of Q1 last year.*

## Financial Overview

Consolidated revenue for the first quarter equalled $3.78 billion compared to $3.52 billion last year, an increase of $258.8 million or 7.4 percent. Sobeys' revenue equalled $3.71 billion, an increase of $270.5 million or 7.9 percent compared to the first quarter last year. First quarter same-store sales increased 3.0 percent. Sobeys' retail sales growth resulted from the continued implementation of sales and merchandising initiatives across the country, coupled with an increase in retail selling square footage from new stores, store enlargements and the acquisition of Thrifty Foods on September 12, 2007. Thrifty Foods sales in the first quarter were $157.3 million. Adjusting for the impact of the Thrifty Foods acquisition, first quarter sales growth for Sobeys and Empire consolidated would have been 3.3 percent and 2.9 percent, respectively.

Real estate division revenue (net of inter-segment transactions) in the first quarter was $24.6 million, a decrease of $10.8 million from the $35.4 million recorded in the first quarter last year. Commercial property revenue declined by $5.6 million while residential property revenue declined by $5.2 million from the first quarter last year. The decline in commercial property revenue was primarily due to the sale of 61 properties to Crombie REIT in the fourth quarter of last fiscal year. The decline in residential property revenue was the result of an expected slowdown in lot sales activity in Western Canada.

Investments and other operations generated revenue of $42.1 million in the first quarter versus $43.0 million in the first quarter last year.

Consolidated operating income in the first quarter was $127.5 million, unchanged from last year. The $10.3 million increase in food retailing division operating income was offset by a decline in real estate division operating income of $9.4 million and a decline in operating income from investments and other operations, net of corporate expenses, of $0.9 million.

Sobeys' operating income contribution to Empire in the first quarter totalled $105.5 million, an increase of $10.3 million or 10.8 percent from the $95.2 million recorded in the first quarter last year. Sobeys' first quarter operating margin, which is operating income divided by revenue, was 2.84 percent compared to 2.77 percent in the first quarter last year. Included in Sobeys first quarter fiscal 2009 operating income was an $11.9 million increase in depreciation and amortization expense, reflecting Sobeys continued capital investments. Also impacting operating income in the first quarter of fiscal 2009 were pre-tax costs totalling $5.6 million in connection with rationalization and severance costs, as compared to pre-tax costs totalling $5.0 million in the first quarter last year which were associated with rationalization costs and business process and system initiative costs.

First quarter real estate division operating income was $19.5 million versus $28.9 million in the same quarter last year. The $9.4 million decline in real estate division operating income is attributed to a $7.8 million decrease in commercial property operating income and a $2.3 million reduction in residential property operating income, partially offset by a $0.7 million increase in equity accounted earnings from our 47.9 percent interest in Crombie REIT. The decrease in commercial property operating income is primarily attributed to the sale of 61 properties to Crombie REIT. The decline in residential operating income was the result of lower residential lot sales activity in Western Canada as mentioned.

Investments and other operations' operating income, net of corporate expenses, was $2.5 million compared to $3.4 million in the first quarter last year. Equity accounted earnings generated from the Company's 27.6 percent interest in Wajax Income Fund amounted to $5.5 million in the first quarter versus $4.2 million last year. Operating income generated from other operations, net of corporate expenses, declined to ($3.0) million from ($0.8) million in the first quarter last year, with the most significant factor being reduced dividend income.

Interest expense in the first quarter amounted to $21.1 million compared to $20.8 million in the first quarter last year.

The effective consolidated income tax rate for the first quarter of fiscal 2009 was 30.1 percent compared to 32.4 percent last year. The decline in the effective income tax rate in fiscal 2009 is largely attributed to a reduction in the general federal corporate income tax rate as approved by the Canadian Government during the third quarter of fiscal 2008.

In the first quarter of fiscal 2009, Empire recorded minority interest expense of $4.1 million compared to minority interest expense of $11.7 million in the first quarter last year. The decrease in minority interest expense is primarily the result of Empire increasing its ownership position in Sobeys to 100.0 percent on June 15, 2007. Empire's weighted average ownership position in Sobeys in the first quarter last year was 87.6 percent.

For the 13 weeks ended August 2, 2008, Empire recorded earnings before capital gains, net of tax, of $70.3 million ($1.07 per share) versus $60.4 million ($0.92 per share) last year, a $9.9 million or 16.4 percent increase. The increase in earnings before capital gains, net of tax, reflects a $7.6 million decline in minority interest and a $2.0 million decline in income taxes, partially offset by a $0.3 million increase in interest expense.

The Company reported capital gains, net of tax, of $4.8 million ($0.07 per share) in the first quarter as compared to capital gains, net of tax, of $81.9 million ($1.24 per share) in the same quarter last year. Capital gains in the first quarter of fiscal 2009 were the result of the sale of non-core property. First quarter fiscal 2008 capital gains were primarily the result of the sale of liquid portfolio investments to support the funding of Sobeys privatization.

Consolidated net earnings in the first quarter equalled $75.1 million ($1.14 per share) as compared to $142.3 million ($2.16 per share) last year.

## Consolidated Financial Condition

Consolidated funded debt declined $57.6 million to $1,515.9 million at the end of the first quarter of fiscal 2009 as compared to $1,573.5 million at the end of fiscal 2008. The ratio of funded debt to capital declined to 38.5 percent from 39.8 percent at the end of fiscal 2008 and 43.1 percent at the end of the first quarter last year.

During the quarter, in July 2008, both Dominion Bond Rating Service and Standard & Poor's Ratings Services revised their outlook on Sobeys Inc. to stable from negative.

At the end of the first quarter, August 2, 2008, Empire's investment portfolio, including its 27.6 percent interest in Wajax Income Fund (TSX: WJX.UN) and its 47.9 percent interest in Crombie REIT (TSX: CRR.UN), carried a market value of $423.4 million on a cost base of $44.8 million, resulting in an unrealized gain of $378.6 million. This compares to an unrealized gain of $388.2 million at the end of fiscal 2008 and $278.5 million at the end of the first quarter last year.

The purchase of property and equipment in the first quarter equalled $116.6 million as compared to $109.8 million in the same quarter last year. Investment in food retailing division property and equipment accounted for $102.3 million of the total capital investment in the first quarter. Capital expenditures for the real estate division in the first quarter equalled $13.0 million and for investments and other operations equalled $1.3 million.

During the first quarter, Sobeys opened, acquired or relocated 11 corporate and franchised stores compared to 13 corporate and franchised stores opened, acquired or relocated during the first quarter of last year. An additional four stores were expanded during the first quarter compared to 10 stores expanded during the first quarter last year. A total of 10 stores were closed during the quarter compared to 16 stores closed in the first quarter last year. There were five stores rebannered in the first quarter of fiscal 2009 compared to 35 stores rebannered in the first quarter of last year.

At the end of the first quarter Sobeys' square footage totalled 27.3 million, a 3.0 percent increase over last year.

## Dividend Declaration

The Board of Directors declared a quarterly dividend of $0.175 per share on both the Non-Voting Class A shares and the Class B common shares that will be payable on October 31, 2008 to shareholders of record on October 15, 2008. The Board also declared regular dividends on the Company's outstanding preferred shares. The dividends are eligible dividends as defined for the purposes of the Income Tax Act (Canada) and applicable provincial legislation and, therefore, qualify for the favourable tax treatment applicable to such dividends.

## Closing Remarks

We are pleased with our strong revenue growth and operating earnings performance in the first quarter. Empire's earnings benefited from having 100 percent ownership of Sobeys and the significant increase in year-over-year earnings contribution from Sobeys which more than offset an expected lower earnings contribution from our real estate division.

We will continue to grow the long-term sustainable value of Empire by focusing our efforts and capital on our core food retail and related real estate businesses driven by our commitment to operational excellence, innovation and disciplined growth.

Paul D. Sobey
President & Chief Executive Officer

September 11, 2008

**EMPIRE COMPANY LIMITED**
**CONSOLIDATED BALANCE SHEETS**
(in millions)

| | August 2 2008 Unaudited | May 3 2008 Audited |
|---|---|---|
| **ASSETS** | | |
| Current | | |
| Cash and cash equivalents | **$ 170.4** | $ 191.4 |
| Receivables | **316.0** | 316.3 |
| Mortgages, loans and other receivables | **17.3** | 18.7 |
| Inventories | **815.6** | 820.2 |
| Prepaid expenses | **69.9** | 62.0 |
| | **1,389.2** | 1,408.6 |
| Investments (realizable value $1.6; May 3, 2008 $1.6) | **1.6** | 1.6 |
| Investments, at equity (realizable value $421.8; May 3, 2008 $429.6) (Note 3) | **43.2** | 41.4 |
| Mortgages, loans and other receivables | **60.9** | 56.3 |
| Other assets (Note 4) | **148.4** | 175.5 |
| Property and equipment | **2,512.8** | 2,457.3 |
| Assets held for sale | **45.7** | 60.3 |
| Intangibles (less accumulated amortization of $24.2; May 3, 2008 $21.3) | **346.5** | 346.8 |
| Goodwill | **1,159.9** | 1,159.1 |
| | **$ 5,708.2** | $ 5,706.9 |
| **LIABILITIES** | | |
| Current | | |
| Bank indebtedness | **$ 53.5** | $ 92.1 |
| Accounts payable and accrued liabilities | **1,347.6** | 1,322.4 |
| Income taxes payable | **9.2** | 15.5 |
| Future income taxes | **35.5** | 32.9 |
| Long-term debt due within one year | **55.5** | 60.4 |
| Liabilities relating to assets held for sale | **6.3** | 6.4 |
| | **1,507.6** | 1,529.7 |
| Long-term debt (Note 5) | **1,400.6** | 1,414.6 |
| Employee future benefits obligation | **112.3** | 110.7 |
| Future income taxes | **118.7** | 125.5 |
| Other long-term liabilities | **106.4** | 106.5 |
| Minority interest | **37.6** | 37.6 |
| | **3,283.2** | 3,324.6 |
| **SHAREHOLDERS' EQUITY** | | |
| Capital stock | **194.4** | 195.7 |
| Contributed surplus | **1.1** | 0.5 |
| Retained earnings | **2,249.6** | 2,207.6 |
| Accumulated other comprehensive loss | **(20.1)** | (21.5) |
| | **2,425.0** | 2,382.3 |
| | **$ 5,708.2** | $ 5,706.9 |

Contingent liabilities (Note 14)

*See accompanying notes to the unaudited interim period consolidated financial statements.*

**EMPIRE COMPANY LIMITED**
**CONSOLIDATED STATEMENTS OF RETAINED EARNINGS**
**13 WEEKS ENDED**
(Unaudited, in millions)

| | August 2 2008 | August 4 2007 |
|---|---|---|
| Balance, beginning of period as previously reported | **$ 2,207.6** | $ 1,939.6 |
| Adjustment due to implementation of new accounting standard (Note 1) | **(21.5)** | - |
| Adjustment due to change in accounting policy | **-** | (4.3) |
| Balance, beginning of period as restated | **2,186.1** | 1,935.3 |
| Net earnings | **75.1** | 142.3 |
| Dividends | | |
| Preferred shares | **(0.1)** | (0.1) |
| Common shares | **(11.5)** | (10.7) |
| Balance, end of period | **$ 2,249.6** | $ 2,066.8 |

**EMPIRE COMPANY LIMITED**
**CONSOLIDATED STATEMENTS OF ACCUMULATED OTHER COMPREHENSIVE LOSS**
**13 WEEKS ENDED**
(Unaudited, in millions)

| | August 2 2008 | August 4 2007 |
|---|---|---|
| Balance, beginning of period | **$ (21.5)** | $ (0.6) |
| Transition adjustment as of May 6, 2007 | **-** | 77.2 |
| Adjusted balance, beginning of period | **(21.5)** | 76.6 |
| Acquired comprehensive loss from purchase of minority interest in Sobeys Inc. | **-** | (0.6) |
| Other comprehensive income (loss) for the period | **1.4** | (79.3) |
| Balance, end of period | **$ (20.1)** | $ (3.3) |

*See accompanying notes to the unaudited interim period consolidated financial statements.*

**EMPIRE COMPANY LIMITED**
**CONSOLIDATED STATEMENTS OF EARNINGS**
**13 WEEKS ENDED**
(Unaudited, in millions, except per share amounts)

| | **August 2 2008** | August 4 2007 |
|---|---|---|
| Revenue | **$ 3,778.2** | $ 3,519.4 |
| Operating expenses | | |
| Cost of sales, selling and administrative expenses | **3,580.8** | 3,331.1 |
| Depreciation and amortization | **80.0** | 69.8 |
| | **117.4** | 118.5 |
| Investment income (Note 7) | **10.1** | 9.0 |
| Operating income | **127.5** | 127.5 |
| Interest expense | | |
| Long-term debt | **20.1** | 19.8 |
| Short-term debt | **1.0** | 1.0 |
| | **21.1** | 20.8 |
| | **106.4** | 106.7 |
| Capital gains and other items (Note 8) | **6.1** | 100.9 |
| Earnings before income taxes and minority interest | **112.5** | 207.6 |
| Income taxes | | |
| Current | **35.7** | 52.8 |
| Future | **(2.4)** | 0.8 |
| | **33.3** | 53.6 |
| Earnings before minority interest | **79.2** | 154.0 |
| Minority interest | **4.1** | 11.7 |
| Net earnings | **$ 75.1** | $ 142.3 |
| | | |
| Earnings per share (Note 2) | | |
| Basic | **$ 1.14** | $ 2.17 |
| Diluted | **$ 1.14** | $ 2.16 |
| | | |
| Weighted average number of common shares outstanding, in millions | | |
| Basic | **65.6** | 65.6 |
| Diluted | **65.7** | 65.7 |

*See accompanying notes to the unaudited interim period consolidated financial statements.*

**EMPIRE COMPANY LIMITED**
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**
**13 WEEKS ENDED**
(Unaudited, in millions)

| | **August 2 2008** | August 4 2007 |
|---|---|---|
| Net earnings | **$ 75.1** | $ 142.3 |
| Other comprehensive income, net of income taxes | | |
| Reclassification of gains on available-for-sale financial assets to earnings | **-** | (78.7) |
| Unrealized losses on derivatives designated as cash flow hedges | **(0.1)** | (0.3) |
| Reclassification of loss on derivative instruments designated as cash flow hedges to earnings | **0.6** | - |
| Share of comprehensive income (loss) of entities accounted using the equity method | **0.9** | (0.3) |
| | **1.4** | (79.3) |
| Comprehensive income | **$ 76.5** | $ 63.0 |

*See accompanying notes to the unaudited interim period consolidated financial statements.*

**EMPIRE COMPANY LIMITED**
**CONSOLIDATED STATEMENTS OF CASH FLOWS**
**13 WEEKS ENDED**
(Unaudited, in millions)

| | **August 2 2008** | August 4 2007 |
|---|---|---|
| **Operating Activities** | | |
| Net earnings | **$ 75.1** | $ 142.3 |
| Items not affecting cash (Note 9) | **86.5** | 91.0 |
| Preferred dividends | **(0.1)** | (0.1) |
| | **161.5** | 233.2 |
| Net change in non-cash working capital | **(11.9)** | (30.0) |
| Cash flows from operating activities | **149.6** | 203.2 |
| **Investing Activities** | | |
| Net decrease in investments | **-** | 189.3 |
| Purchase of shares in subsidiary, Sobeys Inc. | **-** | (1,065.7) |
| Purchase of property and equipment | **(116.6)** | (109.8) |
| Proceeds on disposal of property and equipment | **29.0** | 5.7 |
| Mortgages, loans and other receivables | **(3.2)** | 3.0 |
| Decrease (Increase) in other assets | **1.1** | (2.6) |
| Business acquisitions (Note 13) | **(6.4)** | (0.7) |
| Cash flows used in investing activities | **(96.1)** | (980.8) |
| **Financing Activities** | | |
| Decrease in bank indebtedness | **(38.6)** | (2.0) |
| Decrease in construction loans | **-** | (1.1) |
| Issue of long-term debt | **5.4** | 813.6 |
| Repayment of long-term debt | **(25.0)** | (15.2) |
| Minority interest | **(3.4)** | 19.7 |
| Repurchase of preferred shares | **(1.4)** | - |
| Issue of Non-Voting Class A shares | **-** | 0.4 |
| Common dividends | **(11.5)** | (10.7) |
| Cash flows (used in) from financing activities | **(74.5)** | 804.7 |
| (Decrease) increase in cash and cash equivalents | **(21.0)** | 27.1 |
| Cash and cash equivalents, beginning of period | **191.4** | 294.9 |
| Cash and cash equivalents, end of period | **$ 170.4** | $ 322.0 |

*See accompanying notes to the unaudited interim period consolidated financial statements.*

## 1. Summary of Significant Accounting Policies

### Interim financial statements

The unaudited interim period consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). These interim consolidated financial statements do not include all of the disclosures included in the Company's annual consolidated financial statements. Accordingly, these interim consolidated financial statements should be read in conjunction with the consolidated financial statements for the year ended May 3, 2008, as set out in the 2008 Annual Report.

### Generally accepted accounting principles

The accounting standards and policies used in the preparation of these interim consolidated financial statements conform with those used in the Company's 2008 annual consolidated financial statements except as noted below:

### Adopted during fiscal 2009

#### *Inventories*

During the first quarter of fiscal 2009, the Company implemented Canadian Institute of Chartered Accountants ("CICA") Section 3031, "Inventories", which was issued in June 2007 and has replaced existing Section 3030 with the same title. The new section establishes that inventories should be measured at the lower of cost and net realizable value, with guidance on the determination of cost, including allocation of overheads and other costs incurred in bringing the inventories to their present location and condition. Costs such as storage costs are specifically excluded from the cost of inventories and are expensed in the period incurred. The standard also requires the use of either first in, first out or weighted average cost formula to measure the cost of inventories of similar nature and use. Techniques, such as the retail method, used to measure the cost of inventory may be used if the results approximate cost. This standard is effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008. The Company applied the standard to the opening inventory for the period and adjusted retained earnings by the difference in the measurement of cost in opening inventory of a similar nature and use (prior periods were not restated).

Following adoption of Section 3031, warehouse inventories are valued at the lower of cost and net realizable value with cost being determined on a weighted average cost basis. Retail inventories are valued at the lower of cost and net realizable value. Cost is determined using a weighted average cost using either the standard cost method or a retail method. The retail method uses the anticipated selling price less normal profit margins, on a weighted average cost basis. Real estate inventory of residential properties is valued at the lower of cost and net realizable value.

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

The initial impact of measuring inventories under the new standard is a decrease to the carrying amount of opening inventories as at May 3, 2008 of $27.9 and a decrease in income taxes payable of $6.4. Opening retained earnings has been adjusted by $21.5, equal to the change in opening inventories net of tax.

The cost of inventory recognized as an expense during the first quarter of fiscal 2009 was $2,839.0. The cost of inventories recognized as an expense during the first quarter of 2009 includes $10.9 year to date for the write-down of inventories below cost to net realizable value. There were no reversals of inventories written down previously that are no longer estimated to sell below cost.

**EMPIRE COMPANY LIMITED**
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**
**AUGUST 2, 2008**
(Unaudited, in millions, except per share amounts)

## 1. Summary of Significant Accounting Policies (continued)

### *Capital disclosures*

In October 2006, the CICA issued Section 1535, “Capital Disclosures”. This section establishes standards for disclosing information about an entity’s capital and how it is managed. The standard is effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007 and is applicable for the Company’s first quarter of fiscal 2009 (see Note 6). The adoption of Section 1535 did not have an impact on the Company's  financial results or position.

### *Financial instruments - disclosure and financial instruments - presentation*

Section 3862, “Financial Instruments - Disclosure”, and Section 3863, “Financial Instruments - Presentation”, replace Section 3861, “Financial Instruments - Disclosure and Presentation”. These standards are effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007 and are applicable for the Company’s first quarter of fiscal 2009 (see Note 11). Section 3862 requires increased disclosures regarding the risks associated with financial instruments such as credit risk, liquidity risk and market risk and the techniques used to identify, monitor and manage these risks. In accordance with the transitional provision of Section 3862, comparative information about the nature and extent of risks arising from financial instruments is not required in the year of adoption. Section 3863 carries forward standards for presentation of financial instruments and non-financial derivatives and provides additional guidance for the classification of financial instruments between liabilities and equity and has no significant impact on the Company’s financial statements.

## Future changes in accounting policies

### *Goodwill and intangible assets*

In February 2008, the CICA issued Section 3064, "Goodwill and Intangible Assets", which replaced existing Section 3062, "Goodwill and Other Intangible Assets", and Section 3450, "Research and Development'. The new standard provides guidance on the recognition, measurement, presentation and disclosure of goodwill and intangible assets. This standard is effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2008 and is applicable for the Company's first quarter of fiscal 2010. The Company is currently evaluating the impact of this new standard.

## 2. Earnings Per Share

Earnings applicable to common shares is comprised of the following:

| | **2008 (13 weeks)** | 2007 (13 weeks) |
|---|---|---|
| Operating earnings | **$ 70.3** | $ 60.4 |
| Capital gains and other items, net of income taxes of $1.3; (2007 - $19.0) | **4.8** | 81.9 |
| Net earnings | **75.1** | 142.3 |
| Preferred share dividends | **(0.1)** | (0.1) |
| Earnings applicable to common shares | **$ 75.0** | $ 142.2 |
| | | |
| Earnings per share is comprised of the following: | | |
| Operating earnings | **$ 1.07** | $ 0.92 |
| Net capital gains and other items | **0.07** | 1.25 |
| Basic earnings per share | **$ 1.14** | $ 2.17 |
| | | |
| Operating earnings | **$ 1.07** | $ 0.92 |
| Net capital gains and other items | **0.07** | 1.24 |
| Diluted earnings per share | **$ 1.14** | $ 2.16 |

(Unaudited, in millions)

### 3. Investments, at Equity

| | August 2 2008 | May 3 2008 |
|---|---|---|
| Wajax Income Fund (27.6% interest) | $ 32.4 | $ 31.6 |
| Crombie REIT (47.9% interest) | 10.5 | 9.5 |
| U.S. residential real estate partnerships | 0.3 | 0.3 |
| | $ 43.2 | $ 41.4 |

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

| | August 2 2008 |
|---|---|
| Balance, beginning of period | $ 31.6 |
| Equity earnings | 5.5 |
| Share of comprehensive income | - |
| Distributions received | (4.7) |
| Balance, end of period | $ 32.4 |

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

| | August 2 2008 |
|---|---|
| Balance, beginning of period | $ 9.5 |
| Equity earnings | 4.6 |
| Share of comprehensive income | 1.4 |
| Distributions received | (5.0) |
| Balance, end of period | $ 10.5 |

### 4. Other Assets

**Asset-backed commercial paper**

As of August 2, 2008, the Company held third-party asset-backed commercial paper (“ABCP”) with an original cost of $30.0 that was in default. The ABCP was rated by the Dominion Bond Rating Service (“DBRS”) as R-1 (high), the highest credit rating for commercial paper since the ABCP are backed by AAA (high) rated assets. The $30.0 of ABCP held by the Company is entirely made up of collateralized debt obligations. Collateralized debt obligations are a type of asset-backed security that is created by a portfolio of fixed-income assets which may include pools of bonds, credit card debt, commercial mortgage-backed securities and other loans.

In the second quarter of fiscal 2008, a global disruption in the market for such commercial paper resulted in a constraint on the liquidity of ABCP. DBRS placed certain of the ABCP “under Review with Developing Implications” following an announcement on August 16, 2007 that a consortium representing banks, asset providers and major investors had agreed in principle to a long-term proposal and interim agreement regarding the ABCP (commonly referred to as “the Montreal Proposal”). On September 6, 2007 a pan-Canadian committee ("the Committee") consisting of major investors was formed to oversee the proposed restructuring process of the ABCP. As of August 2, 2008, all of the ABCP held by the Company were part of the Montreal Proposal. Under this proposal, the affected ABCP would be converted into term floating rate notes maturing no earlier than the scheduled termination dates of the underlying assets. The Montreal Proposal called for the investors to continue to roll their ABCP during the standstill period.

On December 23, 2007, a formal restructuring proposal was established to address the global disruption experienced with third-party ABCP. On April 25, 2008, note holders voted in favour of the restructuring proposal, which will provide

(Unaudited, in millions)

**4. Other Assets (continued)**

investors with new long-term notes that will more closely match the maturity dates of the underlying assets and the cash flows they are expected to generate and was approved on June 5, 2008 by the Ontario Superior Court of Justice.

On March 20, 2008, the Committee issued an Information Statement containing details about the proposed restructuring. Based on this and other public information it is estimated that the $30.0 of ABCP in which the Company has invested in is represented by a combination of leveraged collateralized debt, synthetic assets and traditional securitized assets and the Company will, on restructuring, receive replacement senior Class A-1 and Class A-2 and subordinate Class B and Class C long-term floating rate notes with maturities of approximately eight years and nine months.

The Company expects to receive replacement notes with par values as follows:

| | |
|---|---|
| Class A-1 | $ 8.2 |
| Class A-2 | 17.8 |
| Class B | 3.1 |
| Class C | 0.9 |
| | $ 30.0 |

The replacement senior notes are expected to obtain an AA rating while the replacement subordinate notes are likely to be unrated.

The valuation technique used by the Company to estimate the fair value of its investment in ABCP at August 2, 2008, incorporates probability weighted discounted cash flows considering the best available public information regarding market conditions, prevailing yields, credit spreads and other factors that a market participant would consider for such investments. The assumptions used in determining the estimated fair value reflect the details included in the Information Statement issued by the Committee and the risks associated with the long-term floating rate notes.

Interest rates and credit losses vary by each of the different replacement long-term floating rate notes to be issued as each has different credit ratings and risks. Interest rates and credit losses also vary by the different probable cash flow scenarios that have been modeled.

Discount rates vary dependent upon the credit rating of the replacement long-term floating rate notes. Discount rates have been estimated using Government of Canada benchmark rates plus expected spreads for similarly rated instruments with similar maturities and structure. An increase in the estimated discount rates of 1 percent would reduce the estimated fair value of the Company's investment in ABCP by approximately $2.0.

Maturities vary by different replacement long-term floating rate notes as a result of the expected maturity of the underlying assets.

These investments were initially and continue to be classified as held-to-maturity instruments by the Company and are carried at amortized cost. Due to the lack of liquidity and a yield on these instruments, a pre-tax impairment loss of $7.5 (25 percent of the original cost) was recorded during fiscal 2008 and remains unchanged at the first quarter of fiscal 2009. It is possible that the amount ultimately recovered may differ from the estimate. The Company continues to investigate the implications of the default and the remedies available. In addition, these investments have been reclassified as long-term other assets due to the uncertainty as to the timing of collection.

Continuing uncertainties regarding the value of assets which underlie the ABCP, the amount and timing of cash flows and the outcome of the restructuring process could give rise to a further material change in the value of the Company's investment in ABCP which could impact the Company's future earnings.

The Company believes it has sufficient credit facilities to satisfy its financial obligations as they come due and does not expect there will be a material adverse impact on its business as a result of this current third-party ABCP liquidity issue.

(Unaudited, in millions)

### 5. Long-Term Debt

During the first quarter of the previous fiscal year, in relation to the privatization of Sobeys Inc. (Sobeys), the Company entered into new credit facilities (the "Credit Facilities") consisting of a $950.0 unsecured revolving term credit maturing June 8, 2010 (subject to annual one-year extensions at the request of the Company) and a $50.0 unsecured non-revolving credit that matured on June 30, 2007. The Credit Facilities are subject to certain financial covenants. Interest on the debt varies based on the designation of the loan (bankers' acceptances ("BA") rate loans, Canadian prime rate loans, U.S. base rate loans or LIBOR loans), fluctuations in the underlying rates, and in the case of the BA rate loans or LIBOR loans, the margin applicable to the financial covenants. On June 18, 2007, the Company entered into two delayed fixed rate interest swaps. The first swap, in an amount of $200.0, is for a period of three years at a fixed interest rate of 5.00%. The second swap, in an amount of $200.0, is for a period of five years at a fixed interest rate of 5.05%. Both swaps became effective on July 23, 2007.

On June 27, 2007, pursuant to the terms of the Credit Facilities, the Company and Sobeys filed notice with the lenders requesting the establishment of a new $300.0 five-year credit in favour of Sobeys at the same interest rate and substantially on the same terms and conditions as the Credit Facilities. At July 23, 2007, Sobeys drew down $300.0 from its new credit facility, the proceeds of which were used to pay a dividend to the Company. The Company used the proceeds from the dividend to reduce its indebtedness under the Credit Facilities and the Credit Facilities were reduced to $650.0 accordingly. On that date, the Company also transferred the second swap to Sobeys. At August 2, 2008, $385.0 (May 3, 2008 - $395.0) of the Credit Facilities have been drawn down.

On July 30, 2007, Sobeys exercised an option under its new credit facility to increase the size of the credit from $300.0 to $600.0. At the same time, Sobeys terminated its previously existing $300.0 operating credit which would have expired on December 20, 2010. At August 2, 2008, $250.0 (May 3, 2008 - $250.0) of this facility has been drawn down and classified as long-term debt and $0.0 (May 3, 2008 - $25.0) has been classified as bank indebtedness. Sobeys has also issued $41.9 in letters of credit against the facility at August 2, 2008 (May 3, 2008 - $41.7).

On November 8, 2007, Sobeys established and drew down on a new unsecured revolving credit facility of $75.0. The maturity date is November 8, 2010. The interest rate is floating and may be tied to the bankers' acceptance rate, Canadian prime rate or LIBOR.

### 6. Capital Management

The Company's objectives when managing capital are: i) ensure sufficient liquidity to support its financial obligations and execute its operating and strategic plans, ii) to minimize the cost of capital while taking into consideration current and future industry, market and economic risks and conditions, iii) to maintain an optimal capital structure that provides necessary financial flexibility while also ensuring compliance with any financial covenants, and; iv) to maintain an investment grade credit rating with each rating agency that assesses the credit worthiness of the Company.

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

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

| | **August 2 2008** | May 3 2008 |
|---|---|---|
| Bank indebtedness | **$ 53.5** | $ 92.1 |
| Long-term debt due within one year | **55.5** | 60.4 |
| Liabilities relating to assets held for sale | **6.3** | 6.4 |
| Long-term debt | **1,400.6** | 1,414.6 |
| Funded debt | **1,515.9** | 1,573.5 |
| Less: cash and cash equivalents | **(170.4)** | (191.4) |
| Net funded debt | **1,345.5** | 1,382.1 |
| Shareholders' equity | **2,425.0** | 2,382.3 |
| Capital under management | **$ 3,770.5** | $ 3,764.4 |

(Unaudited, in millions, except key ratios)

### 6. Capital Management (continued)

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

The primary investments undertaken by the Company include additions to the selling square footage of its store network via the construction of new, relocated and expanded stores, including related leasehold improvements and features and the purchase of land bank sites for future store construction. The Company makes capital investments in information technology and its distribution capabilities to support an expanding store network. In addition, the Company makes capital expenditures in support of its real estate and other operations. The Company largely relies on its cash flow from operations to fund its capital investment program and dividend distributions to its shareholders. This cash flow is supplemented, when necessary, through the borrowing of additional debt. No changes were made to these objectives in the current period.

Management monitors certain key ratios to effectively manage capital:

| | **August 2 2008** | May 3 2008 |
|---|---|---|
| Funded debt to total capital(1) | **38.5%** | 39.8% |
| Funded debt to EBITDA(2) | **1.93x** | 2.02x |
| EBITDA to interest expense | **7.42x** | 7.35x |

*(1) Total capital is funded debt plus shareholders' equity.*
*(2) EBITDA is comprised of EBITDA for each of the 52 week periods then ended. EBITDA (operating income plus depreciation and amortization) is a non-GAAP financial measure. Non-GAAP financial measures do not have standardized meanings prescribed by GAAP and therefore may not be comparable to similar measures presented by other reporting issuers.*

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

The Company was in compliance with these covenants during the period.

### 7. Investment Income

| | **2008 *(13 weeks)*** | 2007 *(13 weeks)* |
|---|---|---|
| Dividend and interest income | **$ -** | $ 0.9 |
| Share of earnings of entities accounted using the equity method | **10.1** | 8.1 |
| | **$ 10.1** | $ 9.0 |

### 8. Capital Gains and Other Items

| | **2008 *(13 weeks)*** | 2007 *(13 weeks)* |
|---|---|---|
| Gain on sale of investments | **$ -** | $ 100.9 |
| Gain on sale of property | **6.1** | - |
| | **$ 6.1** | $ 100.9 |

(Unaudited, in millions)

## 9. Supplementary Cash Flow Information

| | 2008 (13 weeks) | 2007 (13 weeks) |
|---|---|---|
| ***a) Items not affecting cash*** | | |
| Depreciation and amortization | **$ 80.0** | $ 69.8 |
| Future income taxes | **(2.4)** | 0.8 |
| (Gain) loss on disposal of assets | **(4.4)** | 0.7 |
| Amortization of other assets | **1.1** | 2.6 |
| Equity in earnings of other entities, net of dividends received | **(0.4)** | - |
| Minority interest | **4.1** | 11.7 |
| Stock-based compensation | **0.6** | 2.2 |
| Long-term lease obligation | **1.6** | 1.4 |
| Employee future benefits obligation | **1.6** | 1.2 |
| Rationalization costs (Note 16) | **4.7** | 0.6 |
| | **$ 86.5** | $ 91.0 |
| ***b) Other cash flow information*** | | |
| Net interest paid | **$ 12.0** | $ 15.1 |
| Net income taxes paid | **$ 37.2** | $ 44.1 |

## 10. Segmented Information

| | 2008 (13 weeks) | 2007 (13 weeks) |
|---|---|---|
| **Segmented revenue** | | |
| Food retailing | **$ 3,711.5** | $ 3,441.0 |
| Real estate | | |
| Commercial | **4.6** | 10.2 |
| Inter-segment | **0.3** | 8.0 |
| Residential | **20.0** | 25.2 |
| | **24.9** | 43.4 |
| Investment and other operations | **42.1** | 43.0 |
| | **3,778.5** | 3,527.4 |
| Elimination | **(0.3)** | (8.0) |
| | **$ 3,778.2** | $ 3,519.4 |

| | 2008 (13 weeks) | 2007 (13 weeks) |
|---|---|---|
| **Segmented operating income** | | |
| Food retailing | **$ 105.5** | $ 95.2 |
| Real estate | | |
| Commercial | **1.2** | 9.0 |
| Equity accounted earnings | **4.6** | 3.9 |
| Residential | **13.7** | 16.0 |
| Investment and other operations | | |
| Equity accounted earnings | **5.5** | 4.2 |
| Other operations, net of corporate expenses | **(3.0)** | (0.8) |
| | **$ 127.5** | $ 127.5 |

(Unaudited, in millions)

**10. Segmented Information (continued)**

| | August 2 2008 | May 3 2008 |
|---|---|---|
| **Identifiable assets** | | |
| Food retailing | **$ 4,057.7** | $ 4,026.7 |
| Goodwill | **1,119.8** | 1,119.0 |
| | **5,177.5** | 5,145.7 |
| Real estate | **269.6** | 282.0 |
| Investment and other operations (including goodwill of $40.1; May 3, 2008 $40.1) | **261.1** | 279.2 |
| | **$ 5,708.2** | $ 5,706.9 |

| | 2008 (13 weeks) | 2007 (13 weeks) |
|---|---|---|
| **Depreciation and amortization** | | |
| Food retailing | **$ 73.7** | $ 61.8 |
| Real estate | **-** | 1.7 |
| Investment and other operations | **6.3** | 6.3 |
| | **$ 80.0** | $ 69.8 |

| | 2008 (13 weeks) | 2007 (13 weeks) |
|---|---|---|
| **Capital expenditures** | | |
| Food retailing | **$ 102.3** | $ 76.3 |
| Real estate | **13.0** | 21.5 |
| Investment and other operations | **1.3** | 12.0 |
| | **$ 116.6** | $ 109.8 |

**11. Financial Instruments**

**Credit risk**

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

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

The Company mitigates credit risk associated with its trade accounts receivable, mortgages and loans receivable through an established credit approval and monitoring process. The Company generally considers the credit quality of its financial assets that are neither past due or impaired to be solid. The Company regularly monitors collection performance and pledged security for all of its accounts receivable, mortgages and loans receivable to ensure adequate payments are being received and adequate security is available. The Company only enters into derivative contracts with Canadian chartered banks to minimize credit risk.

**Liquidity risk**

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

(Unaudited, in millions)

**11. Financial Instruments (continued)**

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

The following table summarizes the carrying amount and the contractual maturities of both the interest and principal portion of significant financial liabilities as at August 2, 2008:

| | 2009 | 2010 | 2011 | 2012 | 2013 | Thereafter | Total |
|---|---|---|---|---|---|---|---|
| Accounts payable | $ 1,347.6 | $ - | $ - | $ - | $ - | $ - | $ 1,347.6 |
| Bank indebtedness | 53.5 | - | - | - | - | - | 53.5 |
| Interest rate swaps payable(1) | 15.7 | 20.9 | 13.4 | 10.7 | 2.5 | - | 63.2 |
| Long-term debt | 119.7 | 117.1 | 595.3 | 78.3 | 307.1 | 1,108.3 | 2,325.8 |

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

**Fair value of financial instruments**

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

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

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

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

| August 2, 2008 | Held for Trading (Required) | Held for Trading (Designated) | Available for Sale | Loans and Receivables | Other Financial Liabilities | Total Carrying Amount | Fair Value |
|---|---|---|---|---|---|---|---|
| Financial Assets | | | | | | | |
| Cash and cash equivalents | $ - | $ 170.4 | $ - | $ - | $ - | $ 170.4 | $ 170.4 |
| Receivables | - | - | - | 316.0 | - | 316.0 | 316.0 |
| Mortgages, loans and other receivables | - | - | - | 78.2 | - | 78.2 | 78.2 |
| Investments | - | - | 1.6 | - | - | 1.6 | 1.6 |
| Other assets(1) | 2.3 | 26.3 | - | - | - | 28.6 | 28.6 |
| Total financial assets | $ 2.3 | $ 196.7 | $ 1.6 | $ 394.2 | $ - | $ 594.8 | $ 594.8 |
| Financial Liabilities | | | | | | | |
| Bank indebtedness | $ - | $ - | $ - | $ - | $ 53.5 | $ 53.5 | $ 53.5 |
| Accounts payable and accrued liabilities | - | - | - | - | 1,347.6 | 1,347.6 | 1,347.6 |
| Long-term debt | - | - | - | - | 1,462.4 | 1,462.4 | 1,375.1 |
| Other long-term liabilities(2) | 20.8 | - | - | - | - | 20.8 | 20.8 |
| Total financial liabilities | $ 20.8 | $ - | $ - | $ - | $ 2,863.5 | $ 2,884.3 | $ 2,797.0 |

*(1) The total carrying value of financial assets included in other assets is $28.6.*
*(2) Only the derivative liability portion is presented here.*

(Unaudited, in millions)

**11. Financial Instruments (continued)**

| May 3, 2008 | Held for Trading (Required) | Held for Trading (Designated) | Available for Sale | Loans and Receivables | Other Financial Liabilities | Total Carrying Amount | Fair Value |
|---|---|---|---|---|---|---|---|
| Financial Assets | | | | | | | |
| Cash and cash equivalents | $ - | $ 191.4 | $ - | $ - | $ - | $ 191.4 | $ 191.4 |
| Receivables | - | - | - | 316.3 | - | 316.3 | 316.3 |
| Mortgages, loans and other receivables | - | - | - | 75.0 | - | 75.0 | 75.0 |
| Investments | - | - | 1.6 | - | - | 1.6 | 1.6 |
| Other assets(1) | 2.3 | 26.4 | - | - | - | 26.4 | 26.4 |
| Total financial assets | $ 2.3 | $ 217.8 | $ 1.6 | $ 391.3 | $ - | $ 613.0 | $ 613.0 |
| Financial Liabilities | | | | | | | |
| Bank indebtedness | $ - | $ - | $ - | $ - | $ 92.1 | $ 92.1 | $ 92.1 |
| Accounts payable and accrued liabilities | - | - | - | - | 1,322.4 | 1,322.4 | 1,322.4 |
| Long-term debt | - | - | - | - | 1,481.4 | 1,481.4 | 1,415.5 |
| Other long-term liabilities(2) | 21.7 | - | - | - | - | 21.7 | 21.7 |
| Total financial liabilities | $ 21.7 | $ - | $ - | $ - | $2,895.9 | $2,917.6 | $2,851.7 |

*(1) The total carrying value of financial assets included in other assets is $28.7.*
*(2) Only the derivative liability portion is presented here.*

**Derivative financial instruments**

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

**Interest rate risk**

Interest rate risk is the potential for financial loss arising from changes in interest rates. Financial instruments that potentially subject the Company to interest rate risk include financial liabilities with floating interest rates. The majority of the Company's long-term debt is at a fixed interest rate or hedged with interest rate swaps. Bank indebtedness and approximately 30 percent of the Company's long-term debt is exposed to interest rate risk due to floating rates.

During the current period, only the interest rate swaps resulted in an earnings impact. A loss in value of $0.9 was recorded in interest expense.

Net earnings is sensitive to the impact of a change in interest rates on the average balance of interest bearing financial liabilities during the period. For the three month period ending August 2, 2008, the Company's average floating-rate indebtedness was $820.2 of which $420.0 has been hedged with interst rate swaps. Accordingly, a difference of 0.25 percent in the applicable interest rate would have impacted net earnings by $0.2 and other comprehensive income by $1.9.

**Foreign currency exchange risk**

The Company conducts the vast majority of its business in Canadian dollars. The Company's foreign currency exchange risk principally relates to purchases made in U.S. dollars. In addition, the Company also uses forward

(Unaudited, in millions)

### 11. Financial Instruments (continued)

contracts to fix the exchange rate on some of its expected requirements for Euros and U.S. dollars. Amounts received or paid related to instruments used to hedge foreign exchange, including any gains and losses, are recognized in the cost of purchases. The Company does not consider its exposure to foreign currency exchange risk to be material.

**Commodity price risk**

Commodity price risk is the risk that the fair value of certain financial instruments or the Company's future cash flows will fluctuate as a result of changes in the market price of commodities. The Company has attempted to mitigate commodity price risk to electricity prices through the use of financial derivative swap contracts while closely monitoring other commodity prices to determine the appropriate course of action. The Company estimates that a 10% increase (decrease) in applicable commodity prices would have impacted net earnings by $1.5 and other comprehensive income by $0.4.

### 12. Employee Future Benefits

During the Company's first quarter, the net employee future benefit expense was $8.1 (2007 - $5.8). The expense included costs for the Company's defined contribution pension plans, defined benefit pension plans, post-retirement benefit plans and post-employment benefit plans.

### 13. Business Acquisitions

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

| | **2008 (13 weeks)** | 2007 (13 weeks) |
|---|---|---|
| Franchisees | | |
| Inventory | **$ 1.7** | $ 0.5 |
| Property and equipment | **1.1** | 0.2 |
| Intangibles | **2.4** | - |
| Goodwill | **0.9** | - |
| Other assets | **0.3** | - |
| Cash consideration | **$ 6.4** | $ 0.7 |

### 14. Contingent Liabilities

**Contingencies**

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.

The Company and a subsidiary have been reassessed in respect to the tax treatment of gains realized on the sale of shares in Hannaford Bros. Co. ("Hannaford') in fiscal 2001. In the event that the tax authorities are successful in respect of the Hannaford transaction, which the Company believes is unlikely, the maximum potential exposure in excess of provisions taken is approximately $23.3. The Company has appealed the reassessments in respect of the sale of Hannaford shares. The Company expects that it will be substantially successful on its appeals of each of these reassessments. The Company also believes that the ultimate resolution of these matters will not, in any event, have a material impact on earnings because it has made adequate provisions for each of these matters. Should the ultimate outcome materially differ from the provisions established, the effective tax rate and earnings of the Company could be materially affected, negatively or positively, in the period in which the matters are resolved.

(Unaudited, in millions)

### 14. Contingent Liabilities (continued)

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.

### 15. Stock-Based Compensation

#### Deferred share units

Members of the Board of Directors may elect to receive all or any portion of their fees in Deferred Share Units ("DSUs") in lieu of cash. The number of DSUs received is determined by the market value of the Company's Non-Voting Class A shares on each director's fee payment date. Additional DSUs are received as dividend equivalents. DSUs cannot be redeemed for cash until the holder is no longer a director of the Company. The redemption value of a DSU equals the market value of an Empire Company Limited Non-Voting Class A share at the time of the redemption. On an ongoing basis, the Company values the DSU obligation at the current market value of a corresponding number of Non-Voting Class A shares and records any increase in the DSU obligation as an operating expense. At August 2, 2008, there were 69,626 (May 3, 2008 – 64,877) DSUs outstanding. During the first quarter, the compensation expense was $0.7 (2007 - $0.7).

#### Stock option plan

During the first quarter of fiscal 2009, the Company granted an additional 189,967 options under the Stock Option plan for employees of the Company whereby options are granted to purchase Non-Voting Class A Shares. These options allow holders to purchase Non-Voting Class A Shares at $40.26 per share and expire in July 2016. The options vest over 4 years with 50 percent of the options vesting only if certain financial targets are attained in a given fiscal year. These options have been treated as stock-based compensation.

The compensation cost relating to the period was determined to be $0.6 (2007 - $0.0) with amortization of the cost over the vesting period. The total increase in contributed surplus in relation to the Stock Option compensation cost was $0.6. The compensation cost was calculated using the Black-Scholes model with the following assumptions:

| | |
|---|---|
| Expected life | 8 years |
| Risk-free | 3.50% |
| Expected volatility | 20.1% |
| Dividend yield | 1.75% |

#### Phantom performance option plan

In June 2007, the Board of Directors approved a Phantom Performance Option Plan for eligible employees of Sobeys. Under the plan, units are granted at the discretion of the Board based on a notional equity value of Sobeys tied to a specified formula. The units have a three-year vesting period with a third of the units vesting each year. As the notional fair value of Sobeys changes, the employees are entitled to the incremental increase in the notional equity value over a five-year period. The Company recognizes a compensation expense equal to the change in notional value over the original grant value on a straight-line basis over the vesting period. After the vesting period, any change in incremental notional equity value is recognized as a compensation expense immediately. This is recorded as a liability until settlement and is re-measured at each interim and annual reporting period of the Company. At the end of the first quarter of fiscal 2009, 1,027,729 units were outstanding and the Company recognized $0.7 (2007 - $0.1) of compensation expense associated with this Plan during the period.

### 16. Business Rationalization Costs

During the first quarter of fiscal 2009 severance costs of approximately $5.6 have been incurred and recognized. Additional rationalization costs are anticipated and will be quantified and disclosed throughout fiscal 2009 as they are available. The costs associated with the organizational change are recorded as incurred as cost of sales, selling and

**16. Business Rationalization Costs (continued)**

administrative expenses in the statement of earnings. The liability as of May 3, 2008 was $5.9 and is $10.6 as of August 2, 2008. Costs incurred and anticipated as of May 3, 2008 were $22.6, which includes those incurred in the 13 weeks ended August 2, 2008. The total combined incurred and anticipated amount at August 2, 2008 is $22.6.

**17. Subsequent Events**

On November 15, 2007, Sobeys established and utilized a new unsecured non-revolving credit facility of $30.0 which matured on May 15, 2008 and subsequently extended to August 15, 2008. Subsequent to August 2, 2008 the credit facility was extended to October 14, 2008. The interest rate is floating and may be tied to the bankers' acceptance rate, Canadian prime rate or LIBOR. This balance has been classified as bank indebtedness.

**18. Comparative Figures**

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

# MANAGEMENT'S DISCUSSION AND ANALYSIS

# Management's Discussion and Analysis

The following is Management's Discussion and Analysis ("MD&A") of the consolidated financial results of Empire Company Limited ("Empire" or the "Company") for the 13 weeks ended August 2, 2008, as compared to the 13 weeks ended August 4, 2007. This discussion and analysis should be read in conjunction with the Company's unaudited interim period consolidated financial statements and accompanying notes for the 13 weeks ended August 2, 2008, the audited annual consolidated financial statements and accompanying notes for the 52 weeks ended May 3, 2008 and the related annual MD&A as contained on pages 27 through 68 of Empire's 2008 Annual Report. Information about the Company, including the Annual Report and Annual Information Form, can be found on SEDAR at www.sedar.com.

The consolidated financial statements and the accompanying notes have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") and are reported in Canadian Dollars.

These consolidated financial statements include the accounts of Empire and its subsidiaries and variable interest entities ("VIEs") which the Company is required to consolidate. Included in the Company's 2008 Annual Report, on page 106, is a glossary of terms used throughout this MD&A. The information contained in this MD&A is current to September 11, 2008, unless otherwise noted.

## Forward-Looking Information

This discussion contains forward-looking statements which reflect management's expectations regarding the Company's objectives, plans, goals, strategies, future growth, results of operations, performance and business prospects and opportunities. These forward-looking statements include the following items:

- Sobeys' expectation that there will not be a material adverse impact on its business as a result of global disruption in the market for third-party asset-backed commercial paper ("ABCP") liquidity, and its belief that it has sufficient credit facilities to satisfy its financial obligations in respect of ABCPs as they come due;

- Sobeys' expectations that administrative and business rationalization activities as well as system process initiatives in prior years and upcoming quarters will have a cost impact as expected and will provide thereafter annualized cost reductions, both of which could be impacted by the final scope and scale of these activities;

- Sobeys' expectations that the new distribution centre announced in Ontario, which is expected to open in the first quarter of fiscal 2010, will reduce overall distribution costs, which could be impacted by the number of positions eliminated at other distribution centres in Ontario;

- Management's belief that the growth rate in residential lot sales will continue to be impacted by general economic conditions, particularly in the Western Canada housing market, with lot sales likely to slow moderately from the level experienced in fiscal 2008;

- The Company's expectations on future capital spending for its real estate and food retailing divisions, which could be impacted by the availability of labour, capital resource allocation decisions, as well as general economic and market conditions;

- The Company's expectation that certain real estate property held by ECL Properties can be successfully redeveloped or leased up to the point where such property can be offered for sale to Crombie REIT and if refused by Crombie REIT, then offered to a third party;

- The Company's expectations regarding the purchase of 102,100 Series 2 Preferred Shares for cancellation by the end of calendar 2008 could be impacted by market conditions and availability of sellers;

- Management's expectations that funded debt to capital ratio will decline in fiscal 2009;

- The Company's expectations that its capital resources and liquidity position will meet its capital and liquidity requirements over the next year; and

- The Company's expectations relating to pending tax matters with Canada Revenue Agency ("CRA") and provincial tax authorities, which could be determined differently by CRA. This could cause the Company's effective tax rate and its earnings to be affected positively or negatively in the period the matter is resolved.

Forward-looking statements are typically identified by words or phrases such as “anticipates”, “expects”, “believes”, “estimates”, “intends” and other similar expressions. These statements are based on management’s assumptions and beliefs in light of the information currently available to them. These forward-looking statements are subject to inherent uncertainties, risks and other factors that could cause actual results to differ materially from such statements. These uncertainties and risks are discussed in the Company’s materials filed with the Canadian securities regulatory authorities from time to time, including those discussed in the Risk Management section of this MD&A.

When relying on forward-looking statements to make decisions, the Company cautions readers not to place undue reliance on these statements, as a number of important factors could cause actual results to differ materially from any estimates or intentions expressed in such forward-looking statements. 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 Canadian security regulations.

## Non-GAAP Financial Measures

There are measures included in this MD&A that do not have a standardized meaning under Canadian GAAP. Management includes these measures because it believes certain investors use these measures as a means of assessing relative financial performance. Additional information relating to non-GAAP financial measures is provided at the end of this document.

## Overview of the Business

Empire’s key businesses include food retailing, real estate, and investments and other operations. Food retailing is carried out through wholly-owned Sobeys Inc. (“Sobeys”). The real estate business is carried out through a wholly-owned operating subsidiary ECL Properties Limited (“ECL”), which includes a 100.0 percent ownership interest in ECL Developments Limited (“ECL Developments”), as well as a 35.7 percent ownership interest in Genstar Development Partnership and a 43.3 percent interest in Genstar Development Partnership II (collectively referred to as “Genstar”) and a 47.9 percent ownership interest in Crombie REIT. The results of Sobey Leased Properties Limited (“SLP”) until April 22, 2008 were consolidated under the real estate business; results after April 22, 2008 are reported under Sobeys. Corporate investment activities and other operations includes wholly-owned ETL Canada Holdings Limited (“Empire Theatres”); Kepec Resources Limited (“Kepec”), a joint venture with APL Oil and Gas Limited which has ownership interests in various oil and gas properties in Alberta; and a 27.6 percent ownership position in Wajax Income Fund (“Wajax”). With over $14 billion in annual revenue and approximately $5.7 billion in assets, Empire employs approximately 42,000 people directly and through its subsidiaries.

## Sobeys Privatization

On April 26, 2007, Empire and Sobeys jointly announced that they had entered into an arrangement agreement (the "Arrangement") pursuant to which Empire would acquire all of the outstanding common shares of Sobeys that it did not then own at a price of $58.00 per share. The transaction valued the Sobeys shares not then owned by Empire at approximately $1.06 billion.

The Arrangement required various approvals to comply with applicable corporate and securities laws. Sobeys’ shareholders approved the Arrangement at a Special Shareholders’ Meeting held on June 9, 2007 by the requisite majority; the Supreme Court of Nova Scotia gave its sanction to the Arrangement on June 13, 2007; the Arrangement became effective upon registration of the final Court order with the Nova Scotia Registry of Joint Stock Companies at the close of business on June 15, 2007, at which time Empire acquired all of the outstanding shares of Sobeys that it did not previously own. Subsequently, the Sobeys common shares ceased trading on the Toronto Stock Exchange, and were de-listed at the close of business on June 18, 2007.

The acquisition was accounted for using the purchase method with operating results being included in the consolidated financial statements since the acquisition date. The final purchase price allocation and a description of the acquisition financing is outlined in Note 2 of the audited annual consolidated financial statements of the Company for fiscal 2008.

## Acquisition of Thrifty Foods

On September 12, 2007, Sobeys acquired all the assets and assumed certain liabilities of Thrifty Foods for $253.6 million. The assets acquired consisted of 20 full-service supermarkets, a main distribution centre and a wholesale division on Vancouver Island and the lower mainland of British Columbia. The acquisition was accounted for using the purchase method with the results of Thrifty Foods being consolidated as of the acquisition date.

The measurement and allocation of finite and infinite intangible assets, and goodwill (approximately $174.0 million of which is deductible for tax) was completed during the fourth quarter of fiscal 2008 and is outlined in Note 25 of the audited annual consolidated financial statements of the Company for fiscal 2008.

## Sale Of 61 Properties To Crombie REIT

On April 22, 2008, the Company's real estate division sold 61 properties to Crombie REIT. Included in the proceeds were additional Class B Units of Crombie Limited Partnership (which are convertible on a one for one basis into Units of Crombie REIT). The investment in Class B Units maintained the Company's interest in Crombie REIT at approximately 48 percent after Crombie REIT issued additional units as a result of the underwriting banks exercising their over-allotment option. The Company's investment in Crombie REIT is accounted using the equity method. Details of the sale are outlined in Note 3 of the audited annual consolidated financial statements of the Company for fiscal 2008.

As part of the transaction, Sobeys entered into new lease agreements (the "Sobeys Leases") with respect to their occupancy in a portion of the 61 commercial properties. The Sobeys Leases have terms of between 17 and 23 years (except for three leases which have an outside date of 12 years) (the "Outside Date"). Each Sobeys Lease is based on an initial term of two years and thereafter alternating between successive periods of three years and two years until the applicable Outside Date. The Outside Date may be extended at Sobeys' option by up to four consecutive further periods of five years each. The minimum rents under the Sobeys Leases will range from $8 per square foot to $14 per square foot with rental increases every five years.

## Consolidated Operating Results

The consolidated financial overview provided below reports on the financial performance in the first quarter of fiscal 2009 relative to the first quarter last year.

| | 13 Weeks Ended | | | |
|---|---|---|---|---|
| | **August 2, 2008** | | August 4, 2007 | |
| ($ in millions, except per share information) | **$** | **% of Revenue** | $ | % of Revenue |
| Revenue | **$ 3,778.2** | **100.00%** | $ 3,519.4 | 100.00% |
| Operating income | **127.5** | **3.37%** | 127.5 | 3.62% |
| Operating earnings | **70.3** | **1.86%** | 60.4 | 1.72% |
| Capital gains and other items, net of tax | **4.8** | **0.13%** | 81.9 | 2.32% |
| Net earnings | **$ 75.1** | **1.99%** | $ 142.3 | 4.04% |
| **Basic earnings per share** | | | | |
| Operating earnings | **$ 1.07** | | $ 0.92 | |
| Capital gains and other items, net of tax | **0.07** | | 1.25 | |
| Net earnings | **$ 1.14** | | $ 2.17 | |
| Basic weighted average number of shares outstanding (in millions) | **65.6** | | 65.6 | |
| **Diluted earnings per share** | | | | |
| Operating earnings | **$ 1.07** | | $ 0.92 | |
| Capital gains and other items, net of tax | **0.07** | | 1.24 | |
| Net earnings | **$ 1.14** | | $ 2.16 | |
| Diluted weighted average number of shares outstanding (in millions) | **65.7** | | 65.7 | |
| Dividends per share | **$ 0.175** | | $ 0.165 | |

## Management's Explanation of Consolidated Results

The following is a review of Empire's consolidated financial performance for the 13-week period ended August 2, 2008 compared to the 13-week period ended August 4, 2007.

**Revenue**

Consolidated revenue for the first quarter of fiscal 2009 was $3.78 billion compared to $3.52 billion for the same quarter last year, an increase of $258.8 million or 7.4 percent.

For the first quarter ended August 2, 2008, the food retailing division contributed revenue of $3.71 billion versus $3.44 billion in the first quarter last year, an increase of $270.5 million or 7.9 percent. Sobeys' revenues for the first quarter of fiscal 2009 were positively impacted by the acquisition of Thrifty Foods on September 12, 2007 as mentioned. Thrifty Foods' sales in the first quarter were $157.3 million. Adjusting for the impact of the Thrifty Foods acquisition, first quarter sales growth for Sobeys and Empire consolidated would have been 3.3 percent and 2.9 percent, respectively. During the first quarter of fiscal 2009, the food retailing division's same-store sales growth (sales from stores in the same locations in both reporting periods) increased 3.0 percent.

Real estate revenue (net of inter-segment transactions) of $24.6 million declined $10.8 million or 30.5 percent in the first quarter of fiscal 2009 primarily as a result of a decrease in revenue from commercial operations due to the sale of 61 properties to Crombie REIT as discussed, along with lower residential property revenues due to weaker lot sales.

Investments and other operations reported revenues of $42.1 million in the first quarter of fiscal 2009 compared to $43.0 million in the first quarter of last year, a decrease of $0.9 million or 2.1 percent.

The change in revenue for each division is explained in the section which follows, entitled "Operating Performance by Division".

**Operating Income**

Consolidated operating income in the first quarter of fiscal 2009 totalled $127.5 million, unchanged from the first quarter last year. The $10.3 million or 10.8 percent increase in the food retailing division's operating income was offset by a decline in real estate division operating income of $9.4 million or 32.5 percent and a decline in operating income from investments and other operations, net of corporate expenses, of $0.9 million or 26.5 percent.

The change in operating income for each division is explained in the section which follows, entitled "Operating Performance by Division".

**Interest Expense**

Interest expense in the first quarter amounted to $21.1 million, relatively unchanged from the $20.8 million recorded in the first quarter last year. Consolidated funded debt was $1,515.9 million at the end of the first quarter of fiscal 2009 compared to $1,709.2 million at the end of the first quarter last year, a $193.3 million or 11.3 percent decrease.

**Income Tax Expense**

The effective income tax rate for the first quarter was 30.1 percent versus 32.4 percent in the first quarter of fiscal 2008. The reduction in the effective income tax rate in fiscal 2009 relates to general federal corporate income tax rate reductions ranging from 1.0 to 3.5 percent, by January 2012, approved by the Canadian Government during the third quarter of fiscal 2008.

**Minority Interest**

In the first quarter of fiscal 2009, Empire recorded minority interest expense of $4.1 million compared to $11.7 million in the first quarter last year. The decrease in minority interest expense is primarily the result of Empire privatizing Sobeys on June 15, 2007, resulting in a weighted average ownership position in the first quarter of fiscal 2009 of 100.0 percent compared to a weighted average ownership position in the first quarter of last fiscal year of 87.6 percent.

### Earnings Before Capital Gains and Other Items

Empire recorded earnings before capital gains and other items, net of tax, for the first quarter of fiscal 2009 of $70.3 million compared to $60.4 million recorded in the first quarter last year. The $9.9 million or 16.4 percent improvement in earnings before capital gains and other items, net of tax, over the prior year was the result of the $7.6 million decrease in minority interest and a $2.6 million decrease in income taxes, partially offset by the $0.3 million increase in interest expense.

### Capital Gains and Other Items

There were capital gains and other items, net of tax, of $4.8 million generated in the first quarter of fiscal 2009 compared to $81.9 million generated during the first quarter last year. Capital gains and other items in the first quarter of fiscal 2009 were the result of the sale of non-core property. First quarter fiscal 2008 capital gains and other items were primarily the result of the sale of the liquid portfolio investments to assist in the funding of privatizing Sobeys.

### Net Earnings

Consolidated net earnings in the first quarter equalled $75.1 million compared to $142.3 million in the first quarter last year. The decrease in net earnings of $67.2 million compared to the first quarter of last year is attributed to the $77.1 million decrease in realized capital gains and other items, net of tax, partially offset by the $9.9 million increase in earnings before capital gains and other items, as discussed.

## Quarterly Results of Operations

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

| | **Fiscal 2009** | Fiscal 2008 | | | | Fiscal 2007(1) | | |
|---|---|---|---|---|---|---|---|---|
| | **Q1** | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 |
| ($ in millions, except per share information) | **(13 weeks) Aug. 2/08** | (13 weeks) May 3/08 | (13 weeks) Feb. 2/08 | (13 weeks) Nov. 3/07 | (13 weeks) Aug. 4/07 | (13 weeks) May 5/07 | (13 weeks) Feb. 3/07 | (13 weeks) Nov. 4/06 |
| Revenue | **$3,778.2** | $3,557.8 | $3,503.0 | $3,484.8 | $3,519.4 | $3,350.4 | $3,281.9 | $3,353.5 |
| Operating income | **127.5** | 136.2 | 90.7 | 118.2 | 127.5 | 124.0 | 72.9 | 113.0 |
| Operating earnings(2) | **70.3** | 73.6 | 48.9 | 59.9 | 60.4 | 64.1 | 32.9 | 49.8 |
| Capital gains (losses) and other items, net of tax | **4.8** | (7.1) | (0.3) | (1.5) | 81.9 | 0.7 | (1.0) | 6.0 |
| Net earnings | **$ 75.1** | $ 66.5 | $ 48.6 | $ 58.4 | $ 142.3 | $ 64.8 | $ 31.9 | $ 55.8 |
| **Per share information, diluted** | | | | | | | | |
| Operating earnings | **$ 1.07** | $ 1.12 | $ 0.73 | $ 0.91 | $ 0.92 | $ 0.98 | $ 0.49 | $ 0.76 |
| Capital gains (losses) and other items, net of tax | **0.07** | (0.11) | 0.01 | (0.02) | 1.24 | 0.01 | (0.01) | 0.09 |
| Net earnings | **$ 1.14** | $ 1.01 | $ 0.74 | $ 0.89 | $ 2.16 | $ 0.99 | $ 0.48 | $ 0.85 |
| Diluted weighted average number of shares outstanding (in millions) | **65.7** | 65.7 | 65.7 | 65.7 | 65.7 | 65.7 | 65.7 | 65.7 |

*(1) Amounts have been restated as a result of a reclassification and change with respect to deferred charges. Please see the sections entitled "Deferred Charges" in the annual MD&A as contained in Empire's 2008 Annual Report.*

*(2) Operating earnings is earnings before capital gains (losses) and other items, net of tax.*

Sales and operating earnings growth have been influenced by the Company's investing activities, the competitive environment, general industry trends and by other risk factors as outlined in the fiscal 2008 annual MD&A, as contained on pages 27 - 68 of the Company's 2008 Annual Report.

## Operating Performance by Division

### Food Retailing

Empire's food retailing division is carried out through its wholly-owned subsidiary, Sobeys.

Sobeys conducts business through more than 1,300 retail grocery stores (corporately owned and franchised) which operate in every province across Canada under retail banners that include Sobeys, IGA, IGA extra, Foodland, Price Chopper and Thrifty Foods, as well as Lawtons Drug Stores.

Sobeys' financial contribution to Empire reflects Empire's weighted average ownership of 100.0 percent and 87.6 percent for the quarters ended August 2, 2008 and August 4, 2007, respectively. The table below presents Sobeys' contribution to Empire's consolidated sales, operating income and net earnings:

| | 13 Weeks Ended | | Year over Year | |
|---|---|---|---|---|
| ($ in millions) | **Aug. 2, 2008** | Aug. 4, 2007 | ($) Change | (%) Change |
| Sales | **$ 3,711.5** | $ 3,441.0 | $ 270.5 | 7.9% |
| Operating income (1) | **105.5** | 95.2 | 10.3 | 10.8% |
| Net earnings (1) | **57.6** | 44.9 | 12.7 | 28.3% |

*(1) Adjusted for the impact of the amortization and depreciation of various items related to the privatization of Sobeys.*

**Sales**

Food retailing division sales for the first quarter of fiscal 2009 were $3.71 billion compared to $3.44 billion for the same quarter last year, an increase of $270.5 million or 7.9 percent. During the first quarter of fiscal 2009 Sobeys' same-store sales (sales from stores in the same locations in both reporting periods) increased by 3.0 percent.

Retail sales growth in the first quarter of fiscal 2009 was a direct result of the increased selling square footage from new stores, enlargements and the acquisition of Thrifty Foods on September 12, 2007, coupled with the continued implementation of sales and merchandising initiatives across the country.

As shown in the table below, excluding the impact of the Thrifty Foods acquisition, sales for the food retailing division would have grown by 3.3 percent over the first quarter last year.

| | 13 Weeks Ended | | | |
|---|---|---|---|---|
| ($ in millions) | **Aug. 2, 2008 ($)** | Aug. 4, 2007 ($) | ($) Change | (%) Change |
| Sobeys' financially reported sales | **$ 3,711.5** | $ 3,441.0 | $ 270.5 | 7.9% |
| Add (deduct) impact of: | | | | |
| Thrifty acquistion | | | (157.3) | |
| | | | $ 113.2 | 3.3% |

**Business Process and Information System Transformation and Rationalization Costs**

In fiscal 2006, Sobeys began its business process and information systems transformation plan by focusing on the significant opportunity to upgrade information processing and decision support capabilities. The system processes that were implemented were developed over several years and were focused on standardizing and streamlining the "back shop" in support of Sobeys' food focused strategy. These changes allow Sobeys to leverage technology investments, improve efficiencies and are expected to lower costs over the long-term.

Sobeys completed the implementation of this system in Ontario during the third quarter of fiscal 2007 and in Western Canada during the second quarter of fiscal 2008. The business process and system initiative costs primarily included labour, implementation and training costs associated with these initiatives. During the first quarter of fiscal 2009 there were no pre-tax costs related to these initiatives incurred compared to $3.8 million of pre-tax costs incurred in the first quarter of fiscal 2008.

The systems implementations support all aspects of the business including operations, merchandising, distribution and finance. It is an important enabler of further initiatives such as a new distribution facility in Ontario that was announced on November 21, 2006.

When opened in the first quarter of fiscal 2010, the new distribution centre, located in Vaughan, Ontario, will utilize automation technology and is expected to significantly increase Sobeys' warehouse and distribution capacity while reducing overall distribution costs and improving service to its store network and customers. During the third quarter of fiscal 2007 and the first quarter of fiscal 2009, Sobeys recognized $5.3 million and $4.6 million respectively of severance costs related to the development of this automated facility. The new distribution centre is expected to provide annual distribution savings in excess of these costs and any additional business rationalization or restructuring costs incurred leading up to its opening.

During the first quarter of fiscal 2008, Sobeys also performed a rationalization of administrative functions in its National departments. An additional $1.0 million of pre-tax rationalization costs were incurred in the first quarter of fiscal 2009 ($1.2 million in the first quarter of fiscal 2008).

Sobeys expects to incur additional administrative rationalization costs in the remainder of fiscal 2009, enabled by its continuing business process and systems initiative. The dollar value of these additional costs will be quantified and disclosed throughout fiscal 2009.

**Operating Income**

Sobeys reported operating income of $106.8 million during the first quarter of fiscal 2009, an $11.0 million or 11.5 percent increase from the first quarter last year. Operating income margin in the first quarter equalled 2.88 percent compared to 2.78 percent in the first quarter of fiscal 2008. This increase is primarily due to the realization of benefits in the current period from the rationalization and business process initiative of previous periods and cost management initiatives as mentioned.

Sobeys operating income contribution to Empire in the first quarter of fiscal 2009 was $105.5 million (first quarter of fiscal 2008 - $95.2 million) after adjusting for the impact of the amortization and depreciation of various items related to the privatization as discussed. Sobeys' operating income margin in the first quarter after adjusting for above items equalled 2.84 percent compared to 2.77 percent in the first quarter of fiscal 2008.

**Net Earnings**

Sobeys' first quarter fiscal 2009 net earnings equalled $58.5 million, an increase of 12.9 percent compared to the $51.8 million recorded in the first quarter of fiscal 2008.

Adjusting for the impact of the depreciation and amortization related to the privatization and the related tax impact, as well as for the change in Empire's weighted average of ownership position in Sobeys (100.0 percent in the first quarter of fiscal 2009 compared to 87.6 percent in the first quarter of last fiscal year), Sobeys contributed net earnings of $57.6 million to Empire for the first quarter of fiscal 2009, an increase of $12.7 million over the $44.9 million recorded last year.

## Real Estate

Empire's real estate operations are focused on the development of food-anchored shopping plazas, ownership of retail and office properties through a 47.9 percent ownership interest in Crombie REIT and residential land development through its ownership interest in Genstar.

Commercial real estate operations are conducted through ECL and its wholly-owned subsidiary, ECL Developments, while residential land development is primarily conducted through Genstar, which operates principally in high growth communities in Ontario and Western Canada.

The table below presents revenue, operating income, net earnings and funds from operations for the real estate division's commercial operations and residential operations.

| | 13 Weeks Ended | | | |
|---|---|---|---|---|
| ($ in millions) | **Aug. 2, 2008** | Aug. 4, 2007 | $ Change | % Change |
| Revenue | | | | |
| Commercial | **$ 4.9** | $ 18.2 | $ (13.3) | (73.1%) |
| Residential | **20.0** | 25.2 | (5.2) | (20.6%) |
| | **24.9** | 43.4 | (18.5) | (42.6%) |
| Inter-segment | **(0.3)** | (8.0) | 7.7 | (96.3%) |
| | **$ 24.6** | $ 35.4 | $ (10.8) | (30.5%) |
| Operating income | | | | |
| Commercial | **$ 1.2** | $ 9.0 | $ (7.8) | (86.7%) |
| Equity accounted earnings [(1)] | **4.6** | 3.9 | 0.7 | 17.9% |
| Residential | **13.7** | 16.0 | (2.3) | (14.4%) |
| | **$ 19.5** | $ 28.9 | $ (9.4) | (32.5%) |
| Net earnings | | | | |
| Commercial | **$ 7.5** | $ 6.0 | $ 1.5 | 25.0% |
| Residential | **9.6** | 10.7 | (1.1) | (10.3%) |
| | **$ 17.1** | $ 16.7 | $ 0.4 | 2.4% |
| Funds from operations [(2)] | | | | |
| Commercial | **$ 3.5** | $ 7.5 | $ (4.0) | (53.3%) |
| Residential | **9.6** | 10.9 | (1.3) | (11.9%) |
| | **$ 13.1** | $ 18.4 | $ (5.3) | (28.8%) |

*(1) Equity accounted earnings in 47.9% owned Crombie REIT.*

*(2) Operating earnings plus depreciation.*

**Revenue**

Real estate division revenue (net of inter-segment transactions) amounted to $24.6 million for the first quarter ended August 2, 2008, a $10.8 million or 30.5 percent decrease from the first quarter last year. The decline is primarily attributed to lower revenues from commercial operations due to the sale of 61 properties to Crombie REIT as discussed, along with lower residential property revenues from Genstar related to weaker lot sales, particularly in the Calgary and Edmonton, Alberta markets.

**Operating Income**

First quarter real estate division operating income was $19.5 million versus $28.9 million in the same quarter last year. The $9.4 million decline in real estate division operating income is largely as a result of a $7.8 million decrease in commercial property operating income. The decrease in commercial property operating income is primarily attributed to the sale of 61 properties to Crombie REIT. Residential property operating income declined by $2.3 million as a result of lower residential lot sales activity in Western Canada as mentioned. Equity accounted earnings from Empire's 47.9 percent interest in Crombie REIT increased $0.7 million.

**Capital Gains**

Capital gains, net of tax, for the real estate division amounted to $4.0 million in the first quarter of fiscal 2009 as a result of the sale of one commercial property that was deemed non-core. There were no capital gains in the first quarter last year for the real estate division.

**Net Earnings**

Real estate division net earnings contribution in the first quarter amounted to $17.1 million compared to $16.7 million last year, a $0.4 million or 2.4 percent increase. The earnings increase largely reflects a $3.3 million reduction in interest expense, a $4.0 million increase in net capital gains and a decrease in income taxes of $2.5 million, partially offset by a $9.4 million decrease in operating income, as discussed.

### Funds from Operations

Funds from operations in the first quarter of $13.1 million decreased $5.3 million or 28.8 percent compared to funds from operations in the first quarter of last year as a result of lower operating earnings. Trailing (last four quarters) funds from operations for the real estate division was $59.1 million, a decrease of 8.2 percent from the trailing (last four quarters) funds from operations of $64.4 million reported on May 3, 2008.

## Investments and Other Operations

The third component of Empire's business is its investments and other operations, consisting primarily of a 27.6 percent ownership interest in Wajax, wholly-owned Empire Theatres (the second largest movie exhibitor in Canada) and Kepec.

### Investment Value

At the end of the first quarter, Empire's total investments, excluding its investment in Genstar U.S. investments and in Crombie REIT, carried a market value of $132.7 million on a cost base of $34.0 million, resulting in an unrealized pre-tax gain of $98.7 million.

The table below presents a reconciliation of the consolidated balance sheet investments, both equity and cost:

| | **Aug. 2, 2008** | | | May 3, 2008 | | | Aug. 4, 2007 | | |
|---|---|---|---|---|---|---|---|---|---|
| (in millions) | **Market Value** | **Cost Value** | **Unrealized Gain** | Market Value | Cost Value | Unrealized Gain | Market Value | Cost Value | Unrealized Gain |
| Investments, at cost | **$ 1.6** | **$ 1.6** | **$ -** | $ 1.6 | $ 1.6 | $ - | $ 1.6 | $ 1.6 | $ - |
| Investments, at equity | **421.8** | **43.2** | **378.6** | 429.6 | 41.4 | 388.2 | 419.7 | 141.2 | 278.5 |
| Total Investments | **423.4** | **44.8** | **378.6** | 431.2 | 43.0 | 388.2 | 421.3 | 142.8 | 278.5 |
| Less: Crombie REIT | **290.4** | **10.5** | **279.9** | 275.9 | 9.5 | 266.4 | 262.0 | 108.5 | 153.5 |
| Less: Genstar U.S. (1) | **0.3** | **0.3** | **-** | 0.3 | 0.3 | - | 0.6 | 0.6 | - |
| | **$ 132.7** | **$ 34.0** | **$ 98.7** | $ 155.0 | $ 33.2 | $ 121.8 | $ 158.7 | $ 33.7 | $ 125.0 |

*(1) Assumes market value equals book value.*

There were realized pre-tax capital gains in the first quarter of fiscal 2009 of $1.0 million related to the sale of a Theatre location compared to realized pre-tax capital gains during the first quarter of fiscal 2008 of $100.9 million related to the sale of the majority of the investments, at cost.

### Portfolio Composition

At August 2, 2008, Empire's investment portfolio (excluding cash) consisted of:

| | | | | Unrealized Gain | | |
|---|---|---|---|---|---|---|
| ($ in millions Cdn.) | **Market Value** | **% of Total** | **Cost** | **Aug. 2, 2008** | May 3, 2008 | Aug. 4, 2007 |
| Wajax | **$ 131.1** | **98.8%** | **$ 32.4** | **$ 98.7** | $ 121.8 | $ 125.0 |
| Preferred shares & other | **1.6** | **1.2%** | **1.6** | **-** | - | - |
| Total | **$ 132.7** | **100.0%** | **$ 34.0** | **$ 98.7** | $ 121.8 | $ 125.0 |

The table below presents investments and other operation's financial highlights for the 13 weeks ended August 2, 2008 compared to the same period last year:

| | 13 Weeks Ended | | Year over Year | |
|---|---|---|---|---|
| ($ in millions) | **Aug. 2, 2008** | Aug. 4, 2007 | ($) Change | (%) Change |
| Revenue | **$ 42.1** | $ 43.0 | $ (0.9) | (2.1%) |
| Operating Income | | | | |
| Equity accounted earnings | **$ 5.5** | $ 4.2 | $ 1.3 | 31.0% |
| Other operations, net of corporate expenses | **(3.0)** | (0.8) | (2.2) | 275.0% |
| Total operating income | **2.5** | 3.4 | (0.9) | (26.5%) |
| Operating earnings | **(0.4)** | (1.2) | 0.8 | 66.7% |
| Capital gains and other items, net of tax | **0.8** | 81.9 | (81.1) | - |
| Net earnings | **$ 0.4** | $ 80.7 | $ (80.3) | (99.5%) |

**Revenue**

Investments and other operations' revenue, primarily generated by Empire Theatres, equalled $42.1 million in the first quarter ended August 2, 2008 versus $43.0 million in the first quarter last year. The decrease primarily reflects a reduction in revenue for Empire Theatres.

**Operating Income**

Investments and other operations' operating income, net of corporate expenses, was $2.5 million compared to $3.4 million in the first quarter last year. Equity accounted earnings generated from the Company's 27.6 percent interest in Wajax Income Fund amounted to $5.5 million in the first quarter versus $4.2 million last year, a 31.0 percent increase. Operating income generated from other operations, net of corporate expenses, declined to ($3.0) million from ($0.8) million in the first quarter last year, with the most significant factor being reduced dividend income.

**Operating Earnings**

Investments, net of corporate expenses, and other operations' operating earnings equalled ($0.4) million in the first quarter of fiscal 2009 compared to ($1.2) million in the same quarter last year, an increase of $0.8 million. This increase was largely the result of lower interest expense due to the reduced funded debt outstanding in the first quarter of fiscal 2009 compared to the same quarter last year.

Corporate expenses, including depreciation, amounted to $3.5 million in the first quarter, compared to $3.2 million in the same quarter last year.

**Capital Gains**

During the first quarter of fiscal 2009, there were capital gains, net of tax of $0.8 million related to the sale of a non-core Theatre location realized compared to capital gains, net of tax, of $81.9 million related to the sale of the majority of the liquid investment portfolio realized during the first quarter of fiscal 2008.

**Net Earnings**

Investments, net of corporate expenses, and other operations contributed $0.4 million to Empire's consolidated first quarter fiscal 2009 net earnings. This compares to an $80.7 million net earnings contribution in the first quarter last year. The decrease is primarily the result of the capital gains, net of tax, realized in the first quarter of last year related to the sale of the majority of the liquid investment portfolio.

## Financial Condition

### Capital Structure and Key Financial Condition Measures

The Company's financial condition at the end of the first quarter remained healthy as indicated by the capital structure and key financial condition measures in the table below.

| ($ in millions, except per share and ratio calculations) | | **Aug. 2, 2008** | | May 3, 2008 | | Aug. 4, 2007 |
|---|---|---|---|---|---|---|
| Shareholders' equity | **$** | **2,425.0** | $ | 2,382.3 | $ | 2,260.4 |
| Book value per share | **$** | **36.81** | $ | 36.14 | $ | 34.27 |
| Minority interest | **$** | **37.6** | $ | 37.6 | $ | 45.1 |
| Bank indebtedness | **$** | **53.5** | $ | 92.1 | $ | 28.1 |
| Long-term debt, including current portion (1) | **$** | **1,462.4** | $ | 1,481.4 | $ | 1,681.1 |
| Funded debt to total capital | | **38.5%** | | 39.8% | | 43.1% |
| Net debt to capital ratio (2) | | **35.7%** | | 36.7% | | 38.0% |
| Debt to EBITDA (3) | | **1.93x** | | 2.02x | | 2.40x |
| EBITDA to Interest Expense (3) | | **7.42x** | | 7.35x | | 10.71x |
| Total assets | **$** | **5,708.2** | $ | 5,706.9 | $ | 5,606.6 |

*(1) Includes liabilities related to assets held for sale.*

*(2) Net debt to total capital reduces funded debt by cash and cash equivalents.*

*(3) Calculation uses trailing 12-month EBITDA and interest expense, if applicable.*

### Shareholders' Equity

The Company's share capital on August 2, 2008 consisted of:

| | **Authorized Number of Shares** | **Issued and Outstanding Number of Shares** | **$ Millions** |
|---|---|---|---|
| Preferred shares, par value $25 each, issuable in series. | 2,716,200 | 202,100 | 5.1 |
| 2002 Preferred shares par value $25 each, issuable in series | 992,000,000 | - | - |
| Non-Voting Class A shares, without par value | 259,107,435 | 31,484,498 | 185.1 |
| Class B common shares, without par value, voting | 40,800,000 | 34,260,763 | 7.6 |
| | | | 197.8 |
| Employees' Share Plan | | | (3.4) |
| | | | 194.4 |

Total Non-Voting Class A plus Class B common shares outstanding at August 2, 2008 equalled 65,745,261, unchanged from the previous fiscal year-end and August 4, 2007. There were 31,484,498 Non-Voting Class A and 34,260,763 Class B common shares outstanding at August 2, 2008. During fiscal 2008, 300,000 Class B common shares were exchanged for 300,000 Non-Voting Class A shares of Empire.

At August 2, 2008, Empire had 282,733 options outstanding compared to no options outstanding at August 4, 2007.

During the first quarter of last year, 10,461 Non-Voting Class A shares were issued under Empire's share purchase plan to certain officers and employees for $0.4 million. There were no Empire Non-Voting Class A shares purchased in the first quarter of fiscal 2009 or in the first quarter of the prior fiscal year.

During the first quarter of fiscal 2009, the Company purchased for cancellation 56,100 Series 2 Preferred shares for $1.4 million compared to no Series 2 Preferred shares purchased in the first quarter of last year. The Company plans to purchase on a best efforts basis an additional 102,100 Series 2 Preferred shares by the end of calendar 2008.

As at September 11, 2008, the Company had Non-Voting Class A and Class B common shares outstanding of 31,484,498 and 34,260,763, respectively.

Dividends paid to common shareholders amounted to $11.5 million in the first quarter ($0.175 per share) versus $10.7 million ($0.165 per share) in the first quarter last fiscal year.

**Liabilities**

Historically, Empire has financed a significant portion of its assets through the use of long-term debt. Longer-term assets are generally financed with fixed rate, long-term debt, thereby reducing both interest rate and refinancing risk. Total long-term debt (including the current portion of long-term debt) at August 2, 2008 was $1,462.4 million, representing 96.5 percent of Empire's total funded debt of $1,515.9 million. Funded debt has decreased $57.6 million since the end of the fiscal year, May 3, 2008 ($1,573.5 million) and $193.3 million since the first quarter last year ($1,709.2 million). The significant decrease over the first quarter last fiscal year is primarily the result of repaying debt with proceeds from the sale of 61 properties to Crombie REIT in the fourth quarter of fiscal 2008. The funded debt associated with the 61 properties was effectively transferred to Crombie REIT's balance sheet. Since Crombie REIT is an equity accounted investment, this debt is no longer reported on Empire's balance sheet. Since the first quarter last year, the consolidated funded debt to total capital ratio has decreased 4.6 percentage points to 38.5 percent as a result of the repayment of debt as discussed. Management expects the funded debt to capital ratio to decline in fiscal 2009.

The majority of Empire's funded debt is long-term in nature. The long-term debt is segmented by division as follows:

| Long-term debt (including current portion)<br>($ in millions) | **Aug. 2,<br>2008** | May 3,<br>2008 | Aug. 4,<br>2007 |
|---|---|---|---|
| Food retailing | **$ 1,006.0** | $ 1,010.2 | $ 912.1 |
| Real estate | **47.6** | 50.7 | 223.0 |
| Investments and other operations | **408.8** | 420.5 | 546.0 |
| Total | **$ 1,462.4** | $ 1,481.4 | $ 1,681.1 |

For additional disclosure on Empire's bank indebtedness and long-term debt, see Notes 11 and 12 to the Company's annual audited financial statements for fiscal 2008 as detailed on pages 87 and 88 of the Company's Fiscal 2008 Annual Report.

DBRS and S&P placed Sobeys' credit ratings under review when the privatization of Sobeys was announced. On July 20, 2007, DBRS downgraded their rating on Sobeys' Medium Term Notes from BBB (high) to BBB (low). The trend remained negative. On July 31, 2007, S&P also downgraded Sobeys' credit ratings from BBB (low) to BB (high). S&P also kept a negative trend in place. During the first quarter of fiscal 2009, both agencies changed their trends from negative to stable.

Empire's EBITDA to interest expense ratio in the first quarter was 7.4 times, relatively unchanged from fiscal year-end and down from the 10.7 times recorded for the first quarter last fiscal year. The decline over the same quarter last year is due to the higher interest expense primarily related to the debt incurred to privatize Sobeys and acquire Thrifty Foods, as discussed.

Empire and its subsidiaries have provided covenants to its lenders in support of various financing facilities. All covenants were complied with for the 13 weeks ended August 2, 2008 and for fiscal 2008.

**Financial Instruments**

Empire utilizes interest rate instruments from time to time to prudently manage its exposure to interest rate volatility and also to fix future long-term debt maturities that are expected to be refinanced. At August 2, 2008, there were four interest rate hedges in place with Empire or one of its operating companies. On June 18, 2007, Empire entered into two delayed fixed rate interest swaps. The first swap in an amount of $200.0 million is three years in duration and carries a fixed interest rate of 4.998 percent. The second swap in an amount of $200.0 million is for a period of five years at a fixed interest rate of 5.051 percent. Both swaps became effective on July 23, 2007. Empire later transferred the second swap to Sobeys. Empire Theatres entered into two interest rate swaps on December 27, 2006, which fixed the interest rate on $20.0 million of the floating rate debt at 4.28 percent, plus a stamping fee for a five-year term. The fair value of these four interest rate swaps at August 2, 2008 was negative $18.5 million.

The Company also uses forward contracts to fix the exchange rate on some of its expected requirements for Euros and U.S. dollars. As of August 2, 2008, due to a devaluation of the Euro relative the CAD, Sobeys had recognized an asset of $2.3 million representing the fair value of three Euro denominated forward currency contracts. There were no outstanding U.S. dollar forward contracts.

In July 2008, Sobeys entered into a floating-for-floating currency swap with a fixed rate of $1.015 CAD/USD to mitigate the currency risk associated with a U.S. Dollar denominated variable rate lease. The terms of the swap match the lease terms. As of August 2, 2008, Sobeys recognized a liability of $0.6 million relating to this instrument.

Empire and its subsidiaries utilize hedging instruments as deemed appropriate to mitigate risk exposure, not for speculative purposes.

## Liquidity and Capital Resources

The Company maintains the following sources of liquidity:

• Cash and cash equivalents on hand;
• Availability of long-term debt financing;
• Unutilized bank credit facilities; and
• Cash generated from operating activities.

The Company anticipates that these sources of liquidity will be sufficient to meet expected cash outflows over the next year.

At August 2, 2008, cash and cash equivalents were $170.4 million versus $322.0 million at August 4, 2007 and $191.4 million at fiscal year-end, May 3, 2008.

At the end of the first quarter of fiscal 2009, on a non-consolidated basis, Empire maintained authorized bank lines for operating, general and corporate purposes of $650.0 million, of which $389.1 million or approximately 59.9 percent were utilized. On a consolidated basis, Empire's authorized bank credit facilities exceeded borrowings by approximately $733.7 million at August 2, 2008, versus $690.8 million at May 3, 2008.

The table below highlights major cash flow components for the 13 weeks ended August 2, 2008 compared to the 13 weeks ended August 4, 2007.

**Major Cash Flow Components:**

| | 13 Weeks Ended | |
|---|---|---|
| ($ in millions) | **Aug. 2, 2008** | Aug. 4, 2007 |
| Earnings for common shareholders | **$ 75.0** | $ 142.2 |
| Items not affecting cash | **86.5** | 91.0 |
| | **161.5** | 233.2 |
| Net change in non-cash working capital | **(11.9)** | (30.0) |
| Cash flows from operating activities | **149.6** | 203.2 |
| Cash flows used investing activities | **(96.1)** | (980.8) |
| Cash flows (used in) from financing activities | **(74.5)** | (804.7) |
| (Decrease) increase in cash and cash equivalents | **$ (21.0)** | $ 27.1 |

**Operating Activities**

First quarter cash flows from operating activities equalled $149.6 million compared to $203.2 million in the comparable period last year. The decrease of $53.6 million is largely attributed to decreased net earnings available for common shareholders of $67.2 million as discussed and a decrease in items not affecting cash of $4.5 million, partially offset by a decrease in the net change in non-cash working capital of $18.1 million. Net earnings to common shareholders in the first quarter last year benefited from a net after tax gain on the sale of investments of $81.9 million.

The following tables present non-cash working capital changes compared to the fourth quarter of fiscal 2008 and the first quarter of fiscal 2008 ended August 4, 2007.

| **Non-Cash Working Capital (Quarter-Over-Quarter)** ($ in millions) | **Aug. 2, 2008** | May 3, 2008 | Q1 Fiscal 2009 Increase (Decrease) in Cash Flows | Q1 Fiscal 2008 Increase (Decrease) in Cash Flows |
|---|---|---|---|---|
| Receivables | **$ 316.0** | $ 316.3 | $ 0.3 | $ (3.4) |
| Inventories | **815.6** | 820.2 | 4.6 | 1.4 |
| Prepaid expenses | **69.9** | 62.0 | (7.9) | (22.7) |
| Accounts payable and accrued liabilities | **(1,347.6)** | (1,322.4) | 25.2 | (13.7) |
| Income taxes payable | **(9.2)** | (15.5) | (6.3) | 8.5 |
| Impact of reclassifications on working capital(1) | **27.8** | - | (27.8) | (0.1) |
| Total | **$ (127.5)** | $ (139.4) | $ (11.9) | $ (30.0) |

| **Non-Cash Working Capital (Year-Over-Year)** ($ in millions) | **Aug. 2, 2008** | Aug. 4, 2007 | Year-Over-Year Increase (Decrease) in Cash Flows |
|---|---|---|---|
| Receivables | **$ 316.0** | $ 315.7 | $ (0.3) |
| Inventories | **815.6** | 756.1 | (59.5) |
| Prepaid expenses | **69.9** | 74.1 | 4.2 |
| Accounts payable and accrued liabilities | **(1,347.6)** | (1,246.6) | 101.0 |
| Income taxes payable | **(9.2)** | (4.9) | 4.3 |
| Impact of reclassifications on working capital(1) | **57.7** | - | (57.7) |
| Total | **$ (97.6)** | $ (105.6) | $ (8.0) |

*(1) Reclassifications primarily relate to business acquistions and rationalization costs and the adoption of the new inventory policy further explained on page 38.*

The net change in non-cash working capital of negative $11.9 million in the first quarter was largely due to the impact of reclassifications on working capital totalling $27.8 million, a prepaid expense increase of $7.9 million and an income taxes payable decrease of $6.3 million, partially offset by a $25.2 million increase in accounts payable and accrued liabilities and an inventory decrease of $4.6 million. The increase in accounts payable and accrued liabilities is mainly related to a $33.2 million increase at Sobeys which reflects increased inventory levels at Sobeys as well as increased operations. The decrease in inventories is primarily related to a decrease of $3.5 million at Sobeys which reflects the higher inventory requirements during the summer selling season offset by the adoption of the new inventory policy as explained in the “Accounting Policy Changes” section of this MD&A. The impact of this new policy on cash flow is reflected in the impact of reclassifications on working capital. The increase in prepaid expenses is primarily related to Sobeys and is a result of a growth in operations.

Compared to the first quarter of fiscal 2008, inventories increased $59.5 million while accounts payable and accrued liabilities increased by $101.0 million, income taxes payable increased by $4.3 million and prepaid expenses decreased $4.2 million. The increase in inventory and related accounts payable and accrued liabilities reflects higher inventory requirements due to Sobeys’ higher sales volume and increased square footage in its expanded store network.

**Investing Activities**

Cash used in investing activities of $96.1 million in the first quarter was $884.7 million lower than in the first quarter of last fiscal year. The decrease in cash used in investing activities was largely the result of the privatization of Sobeys for $1,065.7 million and the related sale of the liquid investment portfolio for net proceeds of $189.3 million, both occurring in the first quarter of last year.

Consolidated purchases of property and equipment totalled $116.6 million in the first quarter of fiscal 2009 compared to $109.8 million in the first quarter last year. This increase is partially due to current construction of the new distribution centre in Ontario. Proceeds on disposal of property and equipment increased $23.3 million over the first quarter last year to $29.0 million in the first quarter as a result of the disposal of properties that were deemed non-core.

The table below outlines the number of stores Sobeys invested in during the first quarter of fiscal 2009 compared to fiscal 2008:

**Sobeys' Corporate and Franchised Store Construction Activity**

| | 13 Weeks Ended | |
|---|---|---|
| # of Stores | **Aug. 2, 2008** | Aug. 4, 2007 |
| Opened/Acquired/Relocated | **11** | 13 |
| Expanded | **4** | 10 |
| Rebannered/Redeveloped | **5** | 35 |
| Closed | **10** | 16 |

The following table shows Sobeys' square footage changes for the 13 and 52 weeks ended August 2, 2008 by type:

**Sobeys' Square Footage Changes**
**(in thousands)**

| Square Feet | Q3 F09 vs. Q4 F08 | Q1 F09 vs. Q1 F08 |
|---|---|---|
| Opened | 156 | 536 |
| Relocated | - | 265 |
| Acquired | - | 562 |
| Expanded | 46 | 147 |
| Closed | (142) | (703) |
| Net Change | 60 | 807 |

At August 2, 2008, Sobeys' square footage totalled 27.3 million square feet, a 3.0 percent increase over the 26.5 million square feet operated at the end of the first quarter last year.

**Financing Activities**

Financing activities during the first quarter of fiscal 2009 used $74.5 million of cash compared to $804.7 million of cash generated from financing activities in the same quarter last year. The decrease of $879.2 million in cash flows from financing activities when compared to the same quarter last year is primarily the result of: (i) a decrease in long-term debt issuance of $808.2 million; (ii) a decrease in bank indebtedness of $38.6 million during the first quarter of fiscal 2009 compared to a decrease in bank indebtedness of $2.0 million last year; and (iii) an increase in repayment of long-term debt of $9.8 million. The Sobeys privatization was completed in the first quarter of last year and required significant issuance of long-term debt to finance the transaction.

## Accounting Policy Changes

Accounting standards adopted during fiscal 2009:

**Inventories**

During the first quarter of fiscal 2009 the Company implemented Canadian Institute of Chartered Accountants ("CICA") Section 3031, "Inventories" which was issued in June 2007 and has replaced existing Section 3030 with the same title. The new section establishes that inventories should be measured at the lower of cost and net realizable value, with guidance on the determination of cost, including allocation of overheads and other costs incurred in bringing the inventories to their present location and condition. Costs such as storage costs are specifically excluded from the cost of inventories and are expensed in the period incurred. The standard also requires the use of either first in, first out or weighted average cost formula to measure the cost of inventories of similar nature and use. Techniques, such as the retail method, used to measure the cost of inventory may be used if the results approximate cost. This standard is effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008. The Company applied the standard to the opening inventory for the period and adjusted retained earnings by the difference in the measurement of cost in opening inventory of a similar nature and use (prior periods were not restated).

Following adoption of Section 3031, warehouse inventories are valued at the lower of cost and net realizable value with cost being determined on a weighted average cost basis. Retail inventories are valued at the lower of cost and net realizable value. Cost is determined using a weighted average cost using either the standard cost method or a retail method. The retail method uses the anticipated selling price less normal profit margins, on a weighted average cost basis. Real estate inventory of residential properties is valued at the lower of cost and net realizable value.

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

The initial impact of measuring inventories under the new standard is a decrease to the carrying amount of opening inventories as at May 3, 2008 of $27.9 million and a decrease in income taxes payable of $6.4 million. Opening retained earnings has been adjusted by $21.5 million, equal to the change in opening inventories net of tax.

The cost of inventory recognized as an expense during the first quarter of fiscal 2009 was $2,839.0 million. The cost of inventories recognized as an expense during the first quarter of fiscal 2009 includes $10.9 million year-to-date for the write-down of inventories below cost to net realizable value. There were no reversals of inventories written down previously that are no longer estimated to sell below cost.

**Capital Disclosures**

In October 2006, the CICA issued Section 1535, “Capital Disclosures”. This section establishes standards for disclosing information about an entity’s capital and how it is managed. The standard is effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007 and is applicable for the Company’s first quarter of fiscal 2009. The adoption of Section 1535 did not have an impact on the Company’s financial results or position (see Note 6 to the unaudited interim consolidated first quarter fiscal 2009 financial statements).

**Financial Instruments - Disclosure and Financial Instruments - Presentation**

Section 3862, “Financial Instruments - Disclosure” and Section 3863, “Financial Instruments - Presentation” replace Section 3861, “Financial Instruments - Disclosure and Presentation”. These standards are effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007 and are applicable for the Company’s first quarter of fiscal 2009 (see Note 11 to the unaudited interim consolidated first quarter fiscal 2009 financial statements). Section 3862 requires increased disclosures regarding the risks associated with financial instruments such as credit risk, liquidity risk and market risk and the techniques used to identify, monitor and manage these risks. In accordance with the transitional provision of Section 3862, comparative information about the nature and extent of risks arising from financial instruments is not required in the year of adoption. Section 3863 carries forward standards for presentation of financial instruments and non-financial derivatives and provides additional guidance for the classification of financial instruments between liabilities and equity and has no significant impact on the Company’s financial statements.

**Future Changes in Accounting Policies**

**Goodwill and intangible assets**

In February 2008, the CICA issued Section 3064, “Goodwill and Intangible Assets”, which replaced existing Section 3062, “Goodwill and Other Intangible Assets”, as well as Section 3450, “Research and Development”. The new standard provides guidance on the recognition, measurement, presentation and disclosure of goodwill and intangible assets. This standard is effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2008 and is applicable for the Company’s first quarter of fiscal 2010. The Company is currently evaluating the impact of this new standard.

**International financial reporting standards**

On February 13 2008, the Accounting Standards Board of Canada announced that Canadian generally accepted accounting principles (“GAAP”) for publicly accountable enterprises will be replaced by International Financial Reporting Standards (“IFRS”). IFRS must be adopted for interim and annual financial statements related to fiscal years beginning on or after January 1, 2011, with restatement of comparative periods. Accordingly, the conversion from Canadian GAAP to IFRS will be applicable to the Company’s reporting for the first quarter of fiscal 2012 for which the current and comparative information will be prepared under IFRS. The Company expects the transition to IFRS to impact financial reporting, business processes and information systems. The Company will assess the impact of the transition to IFRS and will continue to invest in training and resources throughout the transition period to facilitate a timely conversion.

## Critical Accounting Estimates

Critical accounting estimates used by the Company's management are discussed in detail in the "Management's Discussion and Analysis" section of the 2008 Annual Report from pages 58 to 60.

## Internal Controls Over Financial Reporting

Empire's management, with the participation of the CEO and CFO have designed internal controls over financial reporting (as that term is defined in MI 52-109) to provide reasonable assurance regarding the reliability of the Company's financial reporting and its preparation of financial statements for external purposes in accordance with Canadian GAAP. There have been no changes in the Company's internal controls over financial reporting during the 13 weeks ended August 2, 2008 that have materially affected, or are reasonably likely to materially affect, internal controls over financial reporting.

## Related Party Transactions

The Company rents premises from Crombie REIT. In addition, Crombie REIT provides administrative and management services to the Company. The rental payments are at fair value and the charges incurred for administrative and management services are on a cost recovery basis. The Company has non-interest bearing notes payable to Crombie REIT in the amount of $16.6 million.

On April 22, 2008, the Company sold 61 commercial properties to Crombie REIT for cash proceeds of $373.5 million plus additional Class B Units in Crombie Limited Partnership totalling $55.0 million, which was fair market value. In accordance with GAAP, the gain on this transaction of $144.3 million has been accounted for as a reduction in the carrying value of Crombie REIT because the purchaser is a related party. See Note 3 to the Company's annual audited financial statements for fiscal 2008 as detailed on page 82 of the Company's Fiscal 2008 Annual Report for more information.

## Designation of Eligible Dividends

The new dividend regime for the favourable tax treatment of "eligible dividends" has been brought into effect by Bill C-28, which came into effect on February 21, 2007. Passage of this bill has important implications for corporations paying eligible dividends. To be eligible dividends, dividends paid on or after February 21, 2007 must be designated as such at the time of payment.

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

## Contingent Liabilities

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 tax authorities.

On June 21, 2005, Sobeys received a notice of reassessment from the CRA for the fiscal years 1999 and 2000 related to the Goods and Services Tax ("GST"). CRA asserts that Sobeys was obliged to collect GST on the sales of tobacco products to Status Indians. The total tax, interest and penalties in the reassessment were $13.6 million. Sobeys has reviewed this matter, has received legal advice, and believes it was not required to collect GST. During the second quarter of fiscal 2006, Sobeys filed a Notice of Objection with CRA. Accordingly, Sobeys has not recorded in its statement of earnings any of the tax, interest or penalties set-out in the notice of reassessment. Sobeys has deposited with CRA funds to cover the total tax, interest and penalties in the reassessment and has recorded this amount as a long-term receivable from CRA pending resolution of the matter.

The Company and a subsidiary have been reassessed in respect to the tax treatment of gains realized on the sale of shares in Hannaford Bros. Co. ("Hannaford") in fiscal 2001. In the event that the tax authorities are successful in respect of the Hannaford transaction, which the Company believes is unlikely; the maximum potential exposure in excess of provisions taken is approximately $23.3 million. The Company has appealed the reassessments in respect of the sale of Hannaford shares. The Company expects that it will be substantially successful on its appeal of this reassessment. The Company also believes that the ultimate resolution of this matter will not, in any event, have a material impact on earnings because it has made adequate provisions for each of these matters. Should the ultimate outcome materially differ from the provision established, the effective tax rate and earnings of the Company could be materially affected, negatively or positively, in the period in which this matter is resolved.

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.

## Other Matters

**Asset-Backed Commercial Paper**

As of August 2, 2008, the Company held third-party ABCP with an original cost of $30.0 million that was in default. The ABCP was rated by the Dominion Bond Rating Service ("DBRS") as R-1 (high), the highest credit rating for commercial paper since the ABCP are backed by AAA (high) rated assets. The $30.0 million of ABCP held by the Company is entirely made up of collateralized debt obligations. Collateralized debt obligations are a type of asset-backed security that is created by a portfolio of fixed-income assets which may include pools of bonds, credit card debt, commercial mortgage-backed securities and other loans.

In the second quarter of fiscal 2008, a global disruption in the market for such commercial paper resulted in a constraint on the liquidity of ABCP. DBRS placed certain of the ABCP "Under Review with Developing Implications" following an announcement on August 16, 2007 that a consortium representing banks, asset providers and major investors had agreed in principle to a long-term proposal and interim agreement regarding the ABCP (commonly referred to as "the Montreal Proposal"). On September 6, 2007 a pan-Canadian committee ("the Committee") consisting of major investors was formed to oversee the proposed restructuring process of the ABCP. As of August 2, 2008, all of the ABCP held by the Company were part of the Montreal Proposal. Under this proposal, the affected ABCP would be converted into term floating rate notes maturing no earlier than the scheduled termination dates of the underlying assets. The Montreal Proposal called for the investors to continue to roll their ABCP during the standstill period.

See Note 4 to the Company's unaudited interim consolidated first quarter fiscal 2009 financial for more information.

## Risk Management

Risk and uncertainties related to economic and industry factors and the Company's management of this risk are discussed in detail in the "Management's Discussion and Analysis" section of the Company's fiscal 2008 annual report on pages 63 to 67.

## 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 publicly traded companies. The Company includes these measures because it believes certain investors use these measures as a means of assessing financial performance. Empire's definition of the non-GAAP terms are as follows:

- Operating income or earnings before interest and taxes ("EBIT") is calculated as operating earnings before minority interest, interest expense and income taxes.
- Earnings before interest, taxes, depreciation and amortization ("EBITDA") is calculated as EBIT plus depreciation and amortization.
- Operating earnings is calculated as net earnings before capital gains and other items, net of tax.
- Funds from operations is calculated as operating earnings plus depreciation and amortization.
- Funded debt is all interest bearing debt, which includes bank loans, bankers' acceptances, long-term debt and debt related to assets held for sale.
- Total capital is calculated as funded debt plus equity.
- Same-store sales are sales from stores in the same locations in both reporting periods.

The following table reconciles Empire's funded debt and total capital to GAAP measures reported in the unaudited interim period balance sheets as at August 2, 2008, May 3, 2008 and August 4, 2007, respectively:

| ($ in millions) | **Aug. 2, 2008** | May 3, 2008 | Aug. 4, 2007 |
|---|---|---|---|
| Bank indebtedness | **$ 53.5** | $ 92.1 | $ 28.1 |
| Long-term debt due within one year | **55.5** | 60.4 | 80.6 |
| Liabilities relating to assets held for sale | **6.3** | 6.4 | 6.7 |
| Long-term debt | **1,400.6** | 1,414.6 | 1,593.8 |
| Funded debt | **1,515.9** | 1,573.5 | 1,709.2 |
| Less: cash and cash equivalents | **(170.4)** | (191.4) | (322.0) |
| Net funded debt | **1,345.5** | 1,382.1 | 1,387.2 |
| Total shareholders' equity | **2,425.0** | 2,382.3 | 2,260.4 |
| Total capital under management | **$ 3,770.5** | $ 3,764.4 | $ 3,647.6 |

Additional financial information relating to Empire, including the Company's Annual Information Form, can be found on the Company's web site or on the SEDAR web site for Canadian regulatory filings at www.sedar.com.

Dated: September 11, 2008
Stellarton, Nova Scotia, Canada

# SHAREHOLDER AND INVESTOR INFORMATION

**EMPIRE COMPANY LIMITED**
Head Office:
115 King St.
Stellarton, Nova Scotia
B0K 1S0
Telephone: (902) 755-4440
Fax: (902) 755-6477
Website: www.empireco.ca

**INVESTOR RELATIONS AND INQUIRIES**
Shareholders, analysts, and investors should direct their financial inquiries or requests to:
Stewart H. Mahoney, CFA
Vice President, Treasury and Investor Relations
E-mail: investor.relations@empireco.ca

Communication regarding investor records including changes of address or ownership, lost certificates or tax forms, should be directed to the Company's transfer agent and registrar, CIBC Mellon Trust Company.

**AFFILIATED COMPANY WEB ADDRESSES**
www.sobeys.com
www.empiretheatres.com

**STOCK EXCHANGE LISTING**
The Toronto Stock Exchange

**STOCK SYMBOLS**
Non-Voting Class A shares – EMP.A
Preferred shares: Series 2 – EMP.PR.B

**AVERAGE DAILY TRADING VOLUME (TSX:EMP.A)**
63,580

**DIVIDEND RECORD AND PAYMENT DATES FOR FISCAL 2009**

| Record Date | Payment Date |
|---|---|
| July 15, 2008 | July 31, 2008 |
| October 15, 2008 | October 31, 2008 |
| January 15, 2009* | January 30, 2009* |
| April 15, 2009* | April 30, 2009* |

* Subject to the approval by Board of Directors

**OUTSTANDING SHARES**

| As of September 11, 2008 | |
|---|---|
| Non-Voting Class A shares | 31,484,498 |
| Class B common shares, voting | 34,260,763 |

**TRANSFER AGENT**
CIBC Mellon Trust Company
Investor Correspondence
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**BANKERS**
Bank of Montreal
Bank of Nova Scotia
Bank of Tokyo-Mitsubishi
Canadian Imperial Bank of Commerce
National Bank of Canada
Rabobank
Royal Bank of Canada
TD Canada Trust

**SOLICITORS**
Stewart McKelvey
Halifax, Nova Scotia

**AUDITORS**
Grant Thornton, LLP
New Glasgow, NS

**MULTIPLE MAILINGS**
If you have more than one account, you may receive a separate mailing for each. If this occurs, please contact CIBC Mellon Trust Company at (800) 387-0825 to eliminate the multiple mailings.

EMPIRE

COMPANY LIMITED

www.empireco.ca