



# CLEARLY FOCUSED ON OUR STRENGTHS

**EMPIRE COMPANY LIMITED**

First Quarter Report | 13 Weeks Ended August 1, 2009

## 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 47.4 percent ownership interest in Crombie Real Estate Investment Trust (“Crombie REIT”). Corporate investment activities and other operations includes wholly-owned ETL Canada Holdings Limited (“Empire Theatres”); Kepec Resources Limited (“Kepec”), a party to 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 \$15 billion in annual revenue and approximately \$6.0 billion in assets, Empire and its related companies, including its franchisees and affiliates, employ over 90,000 people.

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Copies of this report are available on the Company’s website ([www.empireco.ca](http://www.empireco.ca)) or by contacting the Vice-President, Treasury & 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 Friday, September 11, 2009. Replay of the call is available on the Company’s website ([www.empireco.ca](http://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, financial condition, results of operations, cash flows, performance, business prospects and opportunities. All statements other than statements of historical facts included in this quarterly report, including statements regarding the Company’s objectives, plans, goals, strategies, future growth, financial condition, results of operations, cash flows, performance, business prospects and opportunities may constitute forward-looking information. Forward-looking information and statements are identified by words or phrases such as “anticipates”, “expects”, “believes”, “estimates”, “intends”, “could”, “may”, “plans”, “predicts”, “projects”, “will”, “would”, “foresees”, “remain confident that” and other similar expressions or the negative of these terms. These statements are based on Empire management’s reasonable assumptions and beliefs in light of the information currently available to them. The forward-looking information contained in this quarterly report is presented for the purpose of assisting the Company’s security holders in understanding its financial position and results of operation as at and for the periods ended on the dates presented and the Company’s strategic priorities and objectives and may not be appropriate for other purposes. By its very nature, forward-looking information requires the Company to make assumptions and is subject to inherent risks and uncertainties, which give rise to the possibility that the Company’s predictions, forecasts, expectations or conclusions will not prove to be accurate, that the Company’s assumptions may not be correct and that the Company’s objectives, strategic goals and priorities will not be achieved. Although the Company believes that the predictions, forecasts, expectations or conclusions reflected in the forward-looking information are reasonable, it can give no assurance that such matters will prove to have been correct. Such forward-looking information is not fact but only reflections of management’s estimates and expectations. These forward-looking statements are subject to uncertainties and other factors that could cause actual results to differ materially from such statements. These factors include but are not limited to: changes in general industry, market and economic conditions, competition from existing and new competitors, energy prices, supply issues, inventory management, changes in demand due to seasonality of the business, interest rates, changes in laws and regulations, operating efficiencies and cost saving initiatives. In addition, these uncertainties and risks are discussed in the Company’s materials filed with the Canadian securities regulatory authorities from time to time, including the Risk Management section of the MD&A in this quarterly report.*

*Empire cautions that the list of important factors is not exhaustive and other factors could also adversely affect our results. Readers are urged to consider the risks, uncertainties and assumptions carefully in evaluating the forward-looking information and are cautioned not to place undue reliance on such forward-looking information. Forward-looking statements may not take into account the effect on the Company’s business of transactions occurring after such statements have been made. For example, dispositions, acquisitions, asset write-downs or other changes announced or occurring after such statements are made may not be reflected in forward-looking statements. The forward-looking information in this quarterly report reflect the Company’s expectations as of September 11, 2009, and is subject to change after this date.*

## LETTER TO SHAREHOLDERS

Empire Company Limited (TSX: EMP.A) announced financial results for its first quarter ended August 1, 2009. For the first quarter, the Company recorded earnings before capital gains and other items of \$72.2 million (\$1.05 per share) as compared to \$70.9 million (\$1.08 per share) in the first quarter last year, a \$1.3 million increase.

As a result of the equity issue completed on April 24, 2009, Empire had a diluted weighted average number of shares outstanding of 68.5 million in the first quarter ended August 1, 2009, as compared to 65.7 million in the first quarter last year.

### First Quarter Highlights

- Revenue of \$3.97 billion, up \$190.3 million or 5.0 percent.
- Sobeys Inc. ("Sobeys") same-store sales increased 4.0 percent.
- Earnings before capital gains and other items of \$72.2 million (\$1.05 per share) as compared to \$70.9 million (\$1.08 per share) last year.
- Capital gains and other items, net of tax, of \$17.5 million versus \$4.8 million last year.
- Net earnings of \$89.7 million (\$1.31 per share) as compared to \$75.7 million (\$1.15 per share) last year.
- Net funded debt to total capital of 26.3 percent, down from 28.6 percent at the end of the last fiscal year and 35.7 percent at the end of Q1 last year.

### Dividend Declaration

The Board of Directors declared a quarterly dividend of 18.5 cents per share on both the Non-Voting Class A shares and the Class B common shares that will be payable on October 30, 2009 to shareholders of record on October 15, 2009. 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.

### Consolidated Financial Overview

Consolidated revenue for the first quarter equalled \$3.97 billion compared to \$3.78 billion last year, an increase of \$190.3 million or 5.0 percent. Sobeys' revenue equalled \$3.91 billion, an increase of \$195.2 million or 5.3 percent compared to the first quarter last year. Sobeys' first quarter same-store sales increased 4.0 percent.

Real estate division revenue (net of elimination) in the first quarter was \$14.5 million, a decrease of \$10.1 million from the \$24.6 million recorded in the first quarter last year. Commercial property revenue declined by \$1.5 million while residential property revenue decreased by \$8.6 million from the first quarter last year. The decline in residential property revenue was expected, reflecting a marked reduction of residential lot sales in Western Canada.

Investments and other operations recorded revenue of \$47.3 million in the first quarter versus \$42.1 million in the first quarter last year, an increase of \$5.2 million or 12.4 percent.

Consolidated operating income (earnings before capital gains and other items, minority interest, interest expense and income tax) in the first quarter was \$130.2 million, an increase of \$1.9 million or 1.5 percent from the \$128.3 million recorded in the first quarter last year.

The contributors to the change in consolidated operating income from the first quarter last year were as follows:

- (i) Sobeys' operating income contribution to Empire in the first quarter totalled \$121.6 million, an increase of \$15.3 million or 14.4 percent from the \$106.3 million recorded in the first quarter last year.
- (ii) Residential property operating income contribution in the first quarter was \$5.1 million, a decrease of \$8.6 million from the \$13.7 million recorded in the first quarter last year as a result of lower residential lot sales activity in Western Canada.
- (iii) Commercial property operating income for the quarter was \$4.6 million as compared to \$5.8 million in the first quarter last fiscal year, a decline of \$1.2 million. Crombie REIT contributed \$4.9 million to operating income in the first quarter versus a \$4.6 million contribution in the first quarter last year.

(iv) Investments and other operations (net of corporate expenses) contributed operating income of negative \$1.1 million in the first quarter compared to a positive \$2.5 million in the first quarter last year. Equity accounted earnings generated from the Company's 27.6 percent interest in Wajax amounted to \$2.7 million in the first quarter versus \$5.5 million in the first quarter last year. Operating income generated from other operations (net of corporate expenses) amounted to negative \$3.8 million as compared to negative \$3.0 million in the first quarter last year.

Interest expense in the first quarter amounted to \$18.2 million, a decrease of \$2.9 million or 13.7 percent from the \$21.1 million recorded in the same quarter last year. The decline in interest expense largely reflects lower funded debt levels which are principally related to repaying debt with the net proceeds of \$129.1 million from the equity issue completed on April 24, 2009, as well as with free cash flow generated by Sobeys.

Consolidated funded debt was \$1,287.6 million at the end of the first quarter of fiscal 2010 compared to \$1,515.9 million at the end of the first quarter last year, a \$228.3 million or 15.1 percent decrease.

Included in income taxes for the first quarter of fiscal 2010 was an income tax recovery of \$17.0 million related to the settlement negotiated with Canada Revenue Agency relating to the tax treatment of gains realized on the sale of shares in Hannaford Bros. Co. in fiscal 2001.

Excluding the impact of the Hannaford Bros. Co. tax settlement, the effective income tax rate for the first quarter of fiscal 2010 was 31.1 percent versus 30.0 percent in the first quarter last year.

For the 13 weeks ended August 1, 2009, Empire recorded earnings before capital gains and other items of \$72.2 million (\$1.05 per share) versus \$70.9 million (\$1.08 per share) last year, a \$1.3 million or 1.8 percent increase. The increase in earnings before capital gains and other items is the result of a \$1.9 million increase in operating income and a \$2.9 million reduction in interest expense, partially offset by an increase in income taxes of \$2.6 million and an increase in minority interest expense of \$0.9 million.

Empire's per share earnings were impacted by an increase in the weighted average number of shares outstanding, to 68.5 million on a diluted basis from 65.7 million last year, as a result of an equity issue completed April 24, 2009.

The table below presents Empire's segmented earnings before capital gains by division for the 13 weeks ended August 1, 2009 as compared to the 13 weeks ended August 2, 2008.

(\$ in millions)	13 Weeks Ended		
	August 1, 2009	August 2, 2008 <sup>(1)</sup>	(\$) Change
Food retailing <sup>(2)</sup>	\$ 69.2	\$ 58.2	\$ 11.0
Real estate	6.1	13.1	(7.0)
Investments & other operations	(3.1)	(0.4)	(2.7)
Consolidated	\$ 72.2	\$ 70.9	\$ 1.3

(1) Amounts have been restated as a result of a change in accounting policy and a reclassification with respect to goodwill and intangible assets. Please refer to note 1 of the unaudited consolidated financial statements for the first quarter ended August 1, 2009.

(2) Adjusted for the impact of depreciation and amortization related to the privatization of Sobeys in June 2007.

Excluding the impact of the Hannaford Bros. Co. tax settlement, the Company recorded capital gains and other items, net of tax, of \$0.5 million in the first quarter as compared to \$4.8 million in the first quarter last year. Capital gains and other items, net of tax, in the first quarter last year were the result of the sale of non-core properties.

The table below presents capital gains and other items, net of tax, including the impact of the tax recovery related to the sale of the shares in Hannaford Bros. Co. as discussed.

(\$ in millions)	13 Weeks Ended		
	August 1, 2009	August 2, 2008	(\$) Change
Gain on sale of properties, net of tax	\$ 0.2	\$ 4.8	\$ (4.6)
Other items, net of tax	0.3	-	0.3
Tax recovery related to sale of shares in Hannaford Bros. Co.	17.0	-	17.0
	<b>\$ 17.5</b>	<b>\$ 4.8</b>	<b>\$ 12.7</b>

Consolidated net earnings in the first quarter equalled \$89.7 million (\$1.31 per share) as compared to \$75.7 million (\$1.15 per share) last year. The increase of \$14.0 million compared to the first quarter last year is attributed to the \$12.7 million increase in capital gains and other items, net of tax and the \$1.3 million increase in earnings before capital gains and other items, as discussed.

Consolidated sales and operating earnings growth have been influenced by the Company's investing activities, the competitive and economic environment, general industry trends and by other risk factors as outlined in the fiscal 2009 annual MD&A, as contained on pages 23 - 60 of the Company's 2009 Annual Report.

## Consolidated Financial Condition

The Company's financial condition has improved since the start of the fiscal year.

Funded debt has decreased \$15.3 million since the end of the fiscal year, May 2, 2009 (\$1,302.9 million) and \$228.3 million since the first quarter last year (\$1,515.9 million). The significant decrease over the first quarter last fiscal year is primarily the result of repaying debt with net proceeds of \$129.1 million from the equity issue completed on April 24, 2009 and free cash flow generation by Sobeys. The ratio of funded debt to total capital has declined by 6.7 percentage points since the first quarter last year to 31.8 percent as a result of the repayment of debt as discussed.

## Liquidity and Capital Resources

The Company maintains the following sources of liquidity: (i) cash and cash equivalents on hand; (ii) unutilized bank credit facilities; and (iii) 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 1, 2009, consolidated cash and cash equivalents were \$300.6 million versus \$170.4 million at August 2, 2008 and \$231.6 million at fiscal year-end, May 2, 2009.

At the end of the first quarter of fiscal 2010, on a non-consolidated basis, Empire directly maintained authorized bank lines for operating, general and corporate purposes of \$650 million, of which approximately \$281 million or 43 percent were utilized. Empire's non-consolidated credit facility of \$650 million matures on June 8, 2010. It is Empire's intention to renew or replace this credit facility prior to its maturity. To that end, management has held preliminary discussions with the financial institutions providing the credit facility and has developed a timeline for its renegotiation to ensure that new credit facilities are in place prior to the maturity of the existing credit facilities. However, given the current credit environment, the terms of the renewed or replacement credit facility may not be as favorable as those of the in-place credit facility.

On a consolidated basis, Empire's authorized bank credit facilities exceeded borrowings by approximately \$958 million at August 1, 2009, versus \$930 million at May 2, 2009 and \$734 million at August 2, 2008. The Company anticipates that the above mentioned in-place sources of liquidity will adequately meet its short-term and long-term financial requirements. The Company mitigates potential liquidity risk by ensuring its various sources of funds are diversified by term to maturity and source of credit.

Cash used in investing activities of \$102.6 million in the first quarter consisted primarily of purchases of property and equipment of \$101.7 million compared to purchases of property and equipment of \$121.6 million in the first quarter last year. Proceeds on disposal of property and equipment increased \$28.6 million over the first quarter last year to \$57.6 million in the first quarter of the current year. Included in disposals for the first quarter of fiscal 2010 was the sale-leaseback of a distribution centre by Sobeys.

Cash used in investing activities for the first quarter of fiscal 2010 included an additional investment of \$30.0 million in Crombie REIT Class B units which coincided with the closing of Crombie REIT's public offering of units on June 25, 2009. As a result of the public offering, Empire's equity ownership interest was reduced modestly to 47.4 percent from 47.9 percent.

At August 1, 2009, Sobeys' square footage totalled 27.7 million square feet, a 1.5 percent increase over the 27.3 million square feet operated at the end of the first quarter last year.

## Outlook

Going forward, our key priorities have not changed. First, we intend to remain focused on our core strengths in food retailing and real estate.

Sobeys has been able to continue to grow sales and profitability in a competitive market but we are not complacent. We will continue to support Sobeys as it innovates, executes and grows in a manner that is consistent with being widely recognized as the best food retailer in the country.

Second, we intend to remain committed to the development of free-standing grocery stores and food anchored shopping plazas as ECL Developments continues to build on the synergies between Sobeys and Crombie REIT.

Our corporate success and sustainability has been made possible by the skill and dedication of our management teams and the contributions of more than 90,000 employees at Empire and its related companies, including its franchises and affiliates. They have been instrumental in creating a successful and exciting organization and that success has in turn created a winning environment.



Paul D. Sobey  
President & Chief Executive Officer

September 11, 2009

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

	August 1 2009 Unaudited	May 2 2009 Audited <i>Restated (Note 1)</i>	August 2 2008 Unaudited <i>Restated (Note 1)</i>
<b>ASSETS</b>			
Current			
Cash and cash equivalents	\$ 300.6	\$ 231.6	\$ 170.4
Receivables	319.3	318.7	292.0
Loans and other receivables	79.6	55.8	66.4
Income taxes receivable	28.8	4.9	-
Inventories (Note 2)	854.7	842.8	815.6
Prepaid expenses	68.0	63.9	65.7
	<u>1,651.0</u>	<u>1,517.7</u>	<u>1,410.1</u>
Investments, at realizable value	1.2	1.1	1.6
Investments, at equity (realizable value \$363.8; May 2, 2009 - \$254.4; August 2, 2008 - \$421.8) (Note 4)	61.7	18.8	43.2
Loans and other receivables	78.6	75.3	60.9
Other assets	82.8	89.0	89.1
Property and equipment	2,539.6	2,567.8	2,485.4
Assets held for sale	7.4	8.5	45.7
Intangibles	442.8	441.5	433.2
Goodwill	1,171.6	1,171.4	1,159.9
	<u>\$ 6,036.7</u>	<u>\$ 5,891.1</u>	<u>\$ 5,729.1</u>
<b>LIABILITIES</b>			
Current			
Bank indebtedness	\$ 69.8	\$ 45.9	\$ 53.5
Accounts payable and accrued liabilities	1,556.1	1,487.1	1,372.7
Income taxes payable	-	-	9.2
Future income taxes	46.2	40.5	34.2
Long-term debt due within one year (Note 5)	364.9	133.0	55.5
Liabilities relating to assets held for sale	-	-	6.3
	<u>2,037.0</u>	<u>1,706.5</u>	<u>1,531.4</u>
Long-term debt (Note 5)	852.9	1,124.0	1,400.6
Employee future benefits obligation (Note 11)	119.9	118.4	112.3
Future income taxes	86.1	89.5	118.7
Other long-term liabilities	135.9	135.0	106.4
Minority interest	40.2	38.9	37.6
	<u>3,272.0</u>	<u>3,212.3</u>	<u>3,307.0</u>
<b>SHAREHOLDERS' EQUITY</b>			
Capital stock	324.5	324.5	194.4
Contributed surplus	2.1	1.7	1.1
Retained earnings	2,478.1	2,401.1	2,246.7
Accumulated other comprehensive loss	(40.0)	(48.5)	(20.1)
	<u>2,764.7</u>	<u>2,678.8</u>	<u>2,422.1</u>
	<u>\$ 6,036.7</u>	<u>\$ 5,891.1</u>	<u>\$ 5,729.1</u>
Contingent liabilities (Note 13)			

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)

	<b>August 1 2009</b>	August 2 2008 <i>Restated (Note 1)</i>
	<u>                    </u>	<u>                    </u>
Balance, beginning of period as previously reported	\$ 2,405.8	\$ 2,207.6
Adjustment due to implementation of new accounting standard (Note 1)	<u>(4.7)</u>	<u>(25.0)</u>
Balance, beginning of period as restated	2,401.1	2,182.6
Net earnings	89.7	75.7
Dividends		
Preferred shares	-	(0.1)
Common shares	<u>(12.7)</u>	<u>(11.5)</u>
Balance, end of period	<u>\$ 2,478.1</u>	<u>\$ 2,246.7</u>

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

	<b>August 1 2009</b>	August 2 2008
	<u>                    </u>	<u>                    </u>
Balance, beginning of period	\$ (48.5)	\$ (21.5)
Other comprehensive income for the period	<u>8.5</u>	<u>1.4</u>
Balance, end of period	<u>\$ (40.0)</u>	<u>\$ (20.1)</u>

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)

	<b>August 1 2009</b>	August 2 2008 <i>Restated (Note 1)</i>
Revenue	<b>\$ 3,968.5</b>	\$ 3,778.2
Operating expenses		
Cost of sales, selling and administrative expenses	<b>3,763.9</b>	3,577.4
Depreciation and amortization	<b>82.0</b>	82.6
	<b>122.6</b>	118.2
Investment income (Note 6)	<b>7.6</b>	10.1
Operating income	<b>130.2</b>	128.3
Interest expense		
Long-term debt	<b>17.4</b>	20.1
Short-term debt	<b>0.8</b>	1.0
	<b>18.2</b>	21.1
	<b>112.0</b>	107.2
Capital gains and other items (Note 7)	<b>0.6</b>	6.1
Earnings before income taxes and minority interest	<b>112.6</b>	113.3
Income taxes (Note 8)		
Current	<b>18.9</b>	37.2
Future	<b>(1.0)</b>	(3.7)
	<b>17.9</b>	33.5
Earnings before minority interest	<b>94.7</b>	79.8
Minority interest	<b>5.0</b>	4.1
Net earnings	<b>\$ 89.7</b>	\$ 75.7
Earnings per share (Note 3)		
Basic	<b>\$ 1.31</b>	\$ 1.15
Diluted	<b>\$ 1.31</b>	\$ 1.15
Weighted average number of common shares outstanding, in millions		
Basic	<b>68.4</b>	65.6
Diluted	<b>68.5</b>	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)

	<b>August 1 2009</b>	August 2 2008 <i>Restated (Note 1)</i>
Net earnings	<b>\$ 89.7</b>	<b>\$ 75.7</b>
Other comprehensive income, net of income taxes		
Unrealized gains on available-for-sale financial assets, net of income taxes of \$nil (2008 - \$nil)	<b>0.1</b>	-
Unrealized gains (losses) on derivatives designated as cash flow hedges, net of income taxes of \$1.2 (2008 - \$nil)	<b>2.0</b>	(0.1)
Reclassification of loss on derivative instruments designated as cash flow hedges to earnings, net of income taxes of \$0.8 (2008 - \$0.3)	<b>1.5</b>	0.6
Share of comprehensive income of entities accounted using the equity method, net of income taxes of \$3.1 (2008 - \$0.5)	<b>5.5</b>	0.9
Foreign currency translation adjustment	<b>(0.6)</b>	-
Comprehensive income	<b>\$ 98.2</b>	<b>\$ 77.1</b>

*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)

	<b>August 1 2009</b>	August 2 2008 <i>Restated (Note 1)</i>
<b>Operating Activities</b>		
Net earnings	\$ 89.7	\$ 75.7
Items not affecting cash (Note 9)	89.4	85.2
Preferred dividends	-	(0.1)
	179.1	160.8
Net change in non-cash working capital	27.9	(11.1)
Cash flows from operating activities	<b>207.0</b>	149.7
<b>Investing Activities</b>		
Net increase in investments	(35.6)	-
Purchase of property and equipment	(101.7)	(121.6)
Proceeds on disposal of property and equipment	57.6	29.0
Loans and other receivables	(27.1)	(1.1)
Decrease in other assets	7.3	3.9
Business acquisitions (Note 12)	(3.1)	(6.4)
Cash flows used in investing activities	<b>(102.6)</b>	(96.2)
<b>Financing Activities</b>		
Increase (decrease) in bank indebtedness	23.9	(38.6)
Issue of long-term debt	44.6	5.4
Repayment of long-term debt	(87.5)	(25.0)
Minority interest	(3.7)	(3.4)
Repurchase of preferred shares	-	(1.4)
Common dividends	(12.7)	(11.5)
Cash flows used in financing activities	<b>(35.4)</b>	(74.5)
Increase (decrease) in cash and cash equivalents	69.0	(21.0)
Cash and cash equivalents, beginning of period	231.6	191.4
Cash and cash equivalents, end of period	<b>\$ 300.6</b>	\$ 170.4

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

**EMPIRE COMPANY LIMITED**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**AUGUST 1, 2009**  
(Unaudited, in millions)

**1. Summary of Significant Accounting Policies**

The unaudited interim period consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and include the accounts of Empire Company Limited (the "Company"), all subsidiary companies, including 100% owned Sobeys Inc. ("Sobeys") and its subsidiaries and variable interest entities ("VIEs") which the Company is required to consolidate.

**Interim consolidated financial statements**

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 2, 2009, as set out in the 2009 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 2009 annual consolidated financial statements except as noted below:

**Adopted during fiscal 2010**

***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. As a result of adopting Section 3064, Emerging Issues Committee Abstract 27, "Revenues and Expenditures During the Pre-operating Period", no longer applies. The Company has implemented these requirements effective for the first quarter of fiscal 2010 retroactively with restatement of the comparative period. The initial impact under the new standard as at May 2, 2009 was a decrease to prepaid expenses of \$6.9, a decrease to other assets of \$62.4, a decrease in property and equipment of \$33.7, an increase to intangibles of \$96.1, a decrease of future tax liabilities of \$2.2 as well as a reduction of retained earnings of \$4.7. The impact of implementation on the balance sheet as at August 2, 2008 was a decrease of prepaid expenses of \$4.2, a decrease to other assets of \$59.3, a decrease in property and equipment of \$27.4, an increase to intangibles of \$86.7, a decrease in future tax liabilities of \$1.3 and an opening retained earnings reduction of \$3.5. For the 13 weeks ended August 2, 2008, cost of sales, selling and administrative expenses decreased \$3.4, depreciation and amortization expense increased \$2.6 and income taxes increased \$0.2.

**Adopted during fiscal 2009**

***Inventories***

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

**Future changes in accounting policies**

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

In January 2009, the CICA issued three new accounting standards which are based on the International Accounting Standards Board's International Financial Reporting Standard 3, "Business Combinations". Section 1582, "Business Combinations", which replaces Section 1581 with the same title, aims to improve the relevance, reliability and comparability of the information provided in financial statements about business combinations. This

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

section is to be applied prospectively to business combinations for which the acquisition date is on or after January 1, 2011 and assets and liabilities that arose from business combinations that preceded the adoption of this standard should not be adjusted upon adoption. Section 1601, "Consolidated Financial Statements", and Section 1602, "Non-controlling Interests", replace Section 1600, "Consolidated Financial Statements", and establish standards for the preparation of consolidated financial statements and for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards apply to interim and annual consolidated financial statements beginning on or after January 1, 2011. Earlier adoption of all three standards is permitted as of the beginning of a fiscal year, however if an entity chooses to early adopt, all three standards must be adopted concurrently. The Company is currently evaluating the impact of these new standards.

**Financial Instruments - Disclosures**

In June 2009, the CICA issued amendments to the existing Section 3862, "Financial Instruments - Disclosures", to more closely align the section with those required under IFRS. The amendments include enhanced disclosure requirements relating to fair value measurements of financial instruments and liquidity risks. These amendments apply for annual financial statements with fiscal years ending after September 30, 2009. The adoption of the amendments to Section 3862 are not expected to have a material impact on the disclosures of the Company.

**2. Inventories**

The cost of inventories recognized as an expense during the 13 weeks ended August 1, 2009 was \$2,981.2 (August 2, 2008 - \$2,839.0). The cost of inventories recognized as an expense during the quarter includes \$13.1 (August 2, 2008 - \$10.9) for the write-down of inventories below cost to net realizable value. There were no reversals of inventories written down previously.

**3. Earnings Per Share**

Earnings applicable to common shares is comprised of the following:

	<b>2009</b> <b>(13 weeks)</b>	2008 <i>(13 weeks)</i> <i>Restated (Note 1)</i>
Operating earnings	<b>\$ 72.2</b>	\$ 70.9
Capital gains and other items, net of income taxes of \$(16.9); (2008 - \$1.3)	<b>17.5</b>	4.8
Net earnings	<b>89.7</b>	75.7
Preferred share dividends	-	(0.1)
Earnings applicable to common shares	<b>\$ 89.7</b>	\$ 75.6

Included in income taxes of \$(16.9) for the 13 weeks ended August 1, 2009 is an income tax recovery of \$17.0 (see Note 8).

Earnings per share is comprised of the following:

Operating earnings	<b>\$ 1.05</b>	\$ 1.08
Net capital gains and other items	<b>0.26</b>	0.07
Basic earnings per share	<b>\$ 1.31</b>	\$ 1.15
Operating earnings	<b>\$ 1.05</b>	\$ 1.08
Net capital gains and other items	<b>0.26</b>	0.07
Diluted earnings per share	<b>\$ 1.31</b>	\$ 1.15

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**4. Investments, at Equity**

	<b>August 1</b>	May 2	August 2
	<b>2009</b>	2009	2008
Wajax Income Fund (27.6% interest)	\$ 30.9	\$ 31.0	\$ 32.4
Crombie REIT (47.4% interest)	18.3	(19.7)	10.5
U.S. residential real estate partnerships	12.5	7.5	0.3
	<u>\$ 61.7</u>	<u>\$ 18.8</u>	<u>\$ 43.2</u>

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

	<b>August 1</b>	August 2
	<b>2009</b>	2008
Balance, beginning of period	\$ 31.0	\$ 31.6
Equity earnings	2.7	5.5
Share of comprehensive loss	(0.1)	-
Distributions received	(2.7)	(4.7)
Balance, end of period	<u>\$ 30.9</u>	<u>\$ 32.4</u>

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

	<b>August 1</b>	August 2
	<b>2009</b>	2008
Balance, beginning of period	\$ (19.7)	\$ 9.5
Equity earnings	4.9	4.6
Share of comprehensive income	8.7	1.4
Distributions received	(5.6)	(5.0)
Interest acquired in Crombie REIT	30.0	-
Balance, end of period	<u>\$ 18.3</u>	<u>\$ 10.5</u>

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

**5. Long-Term Debt**

During the quarter, the Company's credit facility (\$277.0 as of August 1, 2009) has been classified as current as it matures on June 8, 2010.

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

**6. Investment Income**

	<b>2009</b>	2008
	<b>(13 weeks)</b>	<b>(13 weeks)</b>
Share of earnings of entities accounted using the equity method	<u>\$ 7.6</u>	<u>\$ 10.1</u>

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**7. Capital Gains and Other Items**

	<b>2009</b> <b>(13 weeks)</b>	2008 <b>(13 weeks)</b>
Gain on sale of property	\$ 0.2	\$ 6.1
Other items	0.4	-
	<u>\$ 0.6</u>	<u>\$ 6.1</u>

**8. Income Taxes**

The effective tax rate for the quarter ended August 1, 2009 of 15.9% differs from the combined statutory rate of 31.1% due to the settlement negotiated with Canada Revenue Agency relating to the tax treatment of gains realized on the sale of shares in Hannaford Bros. Co. in fiscal 2001. Income tax expense was reduced by \$17.0 as a result of this settlement.

**9. Supplementary Cash Flow Information**

	<b>2009</b> <b>(13 weeks)</b>	2008 <b>(13 weeks)</b> <i>Restated (Note 1)</i>
<b>a) Items not affecting cash</b>		
Depreciation and amortization	\$ 82.0	\$ 82.6
Future income taxes	(1.0)	(3.7)
Loss (gain) on disposal of assets	0.2	(4.4)
Amortization of other assets	(2.2)	(1.5)
Equity in earnings of other entities, net of dividends received	0.7	(0.4)
Minority interest	5.0	4.1
Stock-based compensation	0.4	0.6
Long-term lease obligation	2.8	1.6
Employee future benefits obligation	1.5	1.6
Rationalization costs (Note 15)	-	4.7
	<u>\$ 89.4</u>	<u>\$ 85.2</u>
<b>b) Other cash flow information</b>		
Net interest paid	\$ 12.3	\$ 12.0
Net income taxes paid	\$ 45.4	\$ 37.2

**10. Segmented Information**

	<b>2009</b> <b>(13 weeks)</b>	2008 <b>(13 weeks)</b>
<b>Segmented revenue</b>		
Food retailing	\$ 3,906.7	\$ 3,711.5
Real estate		
Residential	11.4	20.0
Other Commercial	3.1	4.6
Inter-segment	0.6	0.3
	<u>15.1</u>	<u>24.9</u>
Investment and other operations	47.3	42.1
	<u>3,969.1</u>	<u>3,778.5</u>
Elimination	(0.6)	(0.3)
	<u>\$ 3,968.5</u>	<u>\$ 3,778.2</u>

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**10. Segmented Information (continued)**

	<b>2009</b>	2008
	<b>(13 weeks)</b>	<b>(13 weeks)</b>
		<i>Restated (Note 1)</i>
<b>Segmented operating income</b>		
Food retailing	\$ 121.6	\$ 106.3
Real estate		
Residential	5.1	13.7
Crombie REIT	4.9	4.6
Other Commercial	(0.3)	1.2
Investment and other operations		
Wajax Income Fund	2.7	5.5
Other operations, net of corporate expenses	(3.8)	(3.0)
	<u>\$ 130.2</u>	<u>\$ 128.3</u>
	<b>August 1</b>	May 2
	<b>2009</b>	2009
		August 2
		2008
		<i>Restated (Note 1)</i>
<b>Identifiable assets</b>		
Food retailing	\$ 4,332.0	\$ 4,272.1
Goodwill	1,130.8	1,130.6
	<u>5,462.8</u>	<u>5,402.7</u>
Real estate	293.9	223.1
Investment and other operations (including goodwill of \$40.8; May 2, 2009 - \$40.8; August 2, 2008 - \$40.1)	280.0	265.3
	<u>\$ 6,036.7</u>	<u>\$ 5,891.1</u>
	<b>2009</b>	2008
	<b>(13 weeks)</b>	<b>(13 weeks)</b>
		<i>Restated (Note 1)</i>
<b>Depreciation and amortization</b>		
Food retailing	\$ 76.7	\$ 76.3
Real estate	0.5	-
Investment and other operations	4.8	6.3
	<u>\$ 82.0</u>	<u>\$ 82.6</u>
	<b>2009</b>	2008
	<b>(13 weeks)</b>	<b>(13 weeks)</b>
		<i>Restated (Note 1)</i>
<b>Capital expenditures</b>		
Food retailing	\$ 79.8	\$ 105.1
Real estate	17.5	13.0
Investment and other operations	4.4	3.5
	<u>\$ 101.7</u>	<u>\$ 121.6</u>

**11. Employee Future Benefits**

During the quarter ended August 1, 2009, the net employee future benefit expense was \$10.2 (2008 - \$8.1). 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.

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**12. Business Acquisitions**

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

	<b>2009</b> <u>(13 weeks)</u>	2008 <u>(13 weeks)</u>
<u>Franchisees</u>		
Inventory	\$ 1.0	\$ 1.7
Property and equipment	1.7	1.1
Intangibles	-	2.4
Goodwill	0.2	0.9
Other assets	0.2	0.3
Cash consideration	<u>\$ 3.1</u>	<u>\$ 6.4</u>

**13. 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 the tax authorities.

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.

**14. 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 1, 2009, there were 89,565 (May 2, 2009 - 84,195) DSUs outstanding. During the quarter, the compensation expense was \$nil (2008 - \$0.7).

**Stock option plan**

During the quarter ended August 1, 2009, the Company granted an additional 162,399 options under the stock option plan for employees of the Company whereby options are granted to purchase Non-Voting Class A Shares. These options allow holders to purchase Non-Voting Class A Shares at \$46.04 per share and expire in June 2017. The options vest over four years with 50 percent of the options vesting only if certain financial targets are attained in a given fiscal year. These options have been treated as stock-based compensation.

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**14. Stock-Based Compensation (continued)**

The compensation cost relating to the period was determined to be \$0.4 (2008 - \$0.6) with amortization of the cost over the vesting period. The total increase in contributed surplus in relation to the stock option compensation cost was \$0.4. The compensation cost was calculated using the Black-Scholes model with the following assumptions:

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

**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. Upon implementation, the units had a three year vesting period with 33.3 percent of the units vesting each year. Subsequent issuances have a four year vesting period with 25.0 percent of the units vesting each year. As the notional fair value of Sobeys changes, the employees are entitled to the incremental increase in the notional equity value over a five year period. The Company recognizes a compensation expense equal to the change in notional value over the original grant value on a straight-line basis over the vesting period. After the vesting period, any change in incremental notional equity value is recognized as a compensation expense immediately. This is recorded as an accrued liability until settlement and is remeasured at each interim and annual reporting period of the Company. As at August 1, 2009, 1,436,323 units (May 2, 2009 - 1,069,413) were outstanding and for the quarter the Company recognized \$2.1 (2008 - \$0.7) of compensation expense associated with this plan.

**15. Business Rationalization Costs**

During the quarter ended August 1, 2009, severance costs of \$nil have been incurred and recognized (August 2, 2008 - \$5.6). The costs associated with the organizational change are recorded as incurred as cost of sales, selling and administrative expenses in the statement of earnings. The liability as of August 1, 2009 is \$12.2 (August 2, 2008 - \$10.6). Costs incurred as of August 1, 2009 were \$27.7.

**16. Comparative Figures**

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

## MANAGEMENT'S DISCUSSION AND ANALYSIS

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## MANAGEMENT'S DISCUSSION AND ANALYSIS

The following is Management's Discussion and Analysis ("MD&A") of the consolidated financial results of Empire Company Limited ("Empire" or the "Company") for the 13 weeks ended August 1, 2009, as compared to the 13 weeks ended August 2, 2008. 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 1, 2009, the audited annual consolidated financial statements and accompanying notes for the 52 weeks ended May 2, 2009 and the related annual MD&A as contained on pages 23 through 60 of Empire's 2009 Annual Report. Information about the Company, including the Annual Report and Annual Information Form, can be found on SEDAR at [www.sedar.com](http://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 unaudited 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 2009 Annual Report, on page 100, is a glossary of terms used throughout this MD&A. The information contained in this MD&A is current to September 11, 2009, 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, financial condition, results of operations, cash flows, performance, business prospects and opportunities. All statements other than statements of historical facts included in this MD&A, including statements regarding the Company's objectives, plans, goals, strategies, future growth, financial condition, results of operations, cash flows, performance, business prospects and opportunities may constitute forward-looking information. Forward-looking information and statements are identified by words or phrases such as "anticipates", "expects", "believes", "estimates", "intends", "could", "may", "plans", "predicts", "projects", "will", "would", "foresees", "remain confident that" and other similar expressions or the negative of these terms. These statements are based on Empire management's reasonable assumptions and beliefs in light of the information currently available to them. The forward-looking information contained in this MD&A is presented for the purpose of assisting the Company's security holders in understanding its financial position and results of operation as at and for the periods ended on the dates presented and the Company's strategic priorities and objectives and may not be appropriate for other purposes. By its very nature, forward-looking information requires the Company to make assumptions and is subject to inherent risks and uncertainties, which give rise to the possibility that the Company's predictions, forecasts, expectations or conclusions will not prove to be accurate, that the Company's assumptions may not be correct and that the Company's objectives, strategic goals and priorities will not be achieved. Although the Company believes that the predictions, forecasts, expectations or conclusions reflected in the forward-looking information are reasonable, it can give no assurance that such matters will prove to have been correct. Such forward-looking information is not fact but only reflections of management's estimates and expectations. These forward-looking statements are subject to uncertainties and other factors that could cause actual results to differ materially from such statements. These factors include but are not limited to: changes in general industry, market and economic conditions, competition from existing and new competitors, energy prices, supply issues, inventory management, changes in demand due to seasonality of the business, interest rates, changes in laws and regulations, operating efficiencies and cost saving initiatives. In addition, these uncertainties and risks are discussed in the Company's materials filed with the Canadian securities regulatory authorities from time to time, including the Risk Management section of this MD&A.

Empire cautions that the list of important factors is not exhaustive and other factors could also adversely affect our results. Readers are urged to consider the risks, uncertainties and assumptions carefully in evaluating the forward-looking information and are cautioned not to place undue reliance on such forward-looking information. Forward-looking statements may not take into account the effect on the Company's business of transactions occurring after such statements have been made. For example, dispositions, acquisitions, asset write-downs or other changes announced or occurring after such statements are made may not be reflected in forward-looking statements. The forward-looking information in this MD&A reflects the Company's expectations as of September 11, 2009, and is subject to change after this date.

### 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 47.4 percent ownership interest in Crombie REIT. Corporate investment activities and other operations include wholly-owned ETL Canada Holdings Limited ("Empire Theatres"); Kepec Resources Limited ("Kepec"), a party to 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 \$15 billion in annual revenue and approximately \$6.0 billion in assets, Empire and its related companies, including its franchisees and affiliates, employ over 90,000 people.

## Consolidated Operating Results

The consolidated financial overview provided below reports on the financial performance in the first quarter of fiscal 2010 relative to the first quarter last year.

### Summary Table of Consolidated Financial Results

(\$ in millions, except per share information)	13 Weeks Ended			
	August 1, 2009		August 2, 2008 <sup>(1)</sup>	
	\$	% of Revenue	\$	% of Revenue
Revenue	\$ 3,968.5	100.00%	\$ 3,778.2	100.00%
Operating income	130.2	3.28	128.3	3.40
Operating earnings	72.2	1.82	70.9	1.88
Capital gains and other items, net of tax	17.5	0.44	4.8	0.12
Net earnings	\$ 89.7	2.26%	\$ 75.7	2.00%
<b>Basic earnings per share</b>				
Operating earnings	\$ 1.05		\$ 1.08	
Capital gains and other items, net of tax	0.26		0.07	
Net earnings	\$ 1.31		\$ 1.15	
Basic weighted average number of shares outstanding (in millions)	68.4		65.6	
<b>Diluted earnings per share</b>				
Operating earnings	\$ 1.05		\$ 1.08	
Capital gains and other items, net of tax	0.26		0.07	
Net earnings	\$ 1.31		\$ 1.15	
Diluted weighted average number of shares outstanding (in millions)	68.5		65.7	
Dividends per share	\$ 0.185		\$ 0.175	

*(1) Amounts have been restated as a result of a change in accounting policy and a reclassification with respect to goodwill and intangible assets. Please see the section entitled "Accounting Policy Changes" in this MD&A.*

## Management's Explanation of Consolidated Results

The following is a review of Empire's consolidated financial performance for the 13 week period ended August 1, 2009 compared to the 13 week period ended August 2, 2008.

### Revenue

Consolidated revenue for the first quarter of fiscal 2010 was \$3.97 billion compared to \$3.78 billion for the same quarter last year, an increase of \$190.3 million or 5.0 percent.

For the first quarter ended August 1, 2009, the food retailing division contributed revenue of \$3.91 billion versus \$3.71 billion in the first quarter last year, an increase of \$195.2 million or 5.3 percent. The growth in sales was a direct result of increased retail selling square footage from new stores and enlargements, coupled with the continued implementation of sales and merchandising initiatives, improved consistency of store level execution and retail food price inflation. During the first quarter of fiscal 2010, the food retailing division's same-store sales grew by 4.0 percent.

Real estate revenue (net of elimination) in the first quarter was \$14.5 million, a decrease of \$10.1 million from the \$24.6 million recorded in the first quarter last year. Commercial property revenue declined by \$1.5 million while residential property revenue decreased by \$8.6 million from the first quarter last year. The decline in residential property revenue was expected, reflecting a marked reduction in residential lot sales in Western Canada.

Investments and other operations reported revenues of \$47.3 million in the first quarter of fiscal 2010 compared to \$42.1 million in the first quarter of last year, an increase of \$5.2 million or 12.4 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 was \$130.2 million, an increase of \$1.9 million or 1.5 percent from the \$128.3 million recorded in the first quarter last year.

The contributors to the change in consolidated operating income from the first quarter last year are as follows:

- Sobeys' operating income contribution to Empire in the first quarter totalled \$121.6 million, an increase of \$15.3 million or 14.4 percent from the \$106.3 million recorded in the first quarter last year.
- Residential property operating income contribution in the first quarter was \$5.1 million, a decrease of \$8.6 million from the \$13.7 million recorded in the first quarter last year as a result of lower residential lot sales activity in Western Canada.
- Commercial property operating income for the quarter was \$4.6 million as compared to \$5.8 million in the first quarter last fiscal year, a decline of \$1.2 million. This decline is primarily attributed to other commercial operating income declining by \$1.5 million to negative \$0.3 million in the current quarter. Equity accounted earnings from Crombie REIT of \$4.9 million for the first quarter of fiscal 2010 (2009 - \$4.6 million) benefited from a full quarter of results from the 61 properties acquired from Sobey Leased Properties part way through Crombie REIT's comparable quarter last fiscal year on April 22, 2008.
- Investments and other operations (net of corporate expenses) contributed operating income of negative \$1.1 million in the first quarter compared to a positive \$2.5 million in the first quarter last year. Equity accounted earnings generated from the Company's 27.6 percent interest in Wajax amounted to \$2.7 million in the first quarter versus \$5.5 million in the first quarter last year. Operating income generated from other operations (net of corporate expenses) amounted to negative \$3.8 million as compared to negative \$3.0 million in the first quarter last year.

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 \$18.2 million, a decrease of \$2.9 million or 13.7 percent from the \$21.1 million recorded in the first quarter last year. The decline in interest expense largely reflects lower funded debt levels which are principally related to repaying debt with the net proceeds of \$129.1 million from the equity issue completed on April 24, 2009, as well as with free cash flow generated by Sobeys.

Consolidated funded debt was \$1,287.6 million at the end of the first quarter of fiscal 2010 compared to \$1,515.9 million at the end of the first quarter last year, a \$228.3 million or 15.1 percent decrease.

## Income Taxes

Included in income taxes for the first quarter of fiscal 2010 was an income tax recovery of \$17.0 million related to the settlement negotiated with Canada Revenue Agency relating to the tax treatment of gains realized on the sale of shares in Hannaford Bros. Co. in fiscal 2001.

Excluding the impact of the Hannaford Bros. Co. tax settlement, the effective income tax rate for the first quarter of fiscal 2010 was 31.1 percent versus 30.0 percent in the first quarter last year.

## Earnings Before Capital Gains and Other Items

Empire recorded earnings before capital gains and other items for the first quarter of fiscal 2010 of \$72.2 million (\$1.05 per share) compared to \$70.9 million (\$1.08 per share) recorded in the first quarter last year. The \$1.3 million or 1.8 percent improvement in earnings before capital gains and other items over the prior year was the result of the \$2.9 million decrease in interest expense and a \$1.9 million increase in operating income, partially offset by the \$2.6 million increase in income taxes and a \$0.9 million increase in minority interest expense.

As a result of the equity issue on April 24, 2009, Empire had a diluted weighted average number of shares outstanding of 68.5 million in the first quarter ended August 1, 2009, as compared to 65.7 million in the first quarter last year.

The following table presents Empire's segmented earnings before capital gains by division for the 13 weeks ended August 1, 2009 as compared to the 13 weeks ended August 2, 2008.

(\$ in millions)	13 Weeks Ended		
	August 1, 2009	August 2, 2008 <sup>(1)</sup>	(\$) Change
Food retailing <sup>(2)</sup>	\$ 69.2	\$ 58.2	\$ 11.0
Real estate	6.1	13.1	(7.0)
Investments & other operations	(3.1)	(0.4)	(2.7)
Consolidated	\$ 72.2	\$ 70.9	\$ 1.3

*(1) Amounts have been restated as a result of a change in accounting policy and a reclassification with respect to goodwill and intangible assets. Please see the section entitled "Accounting Policy Changes" in this MD&A.*

*(2) Adjusted for the impact of depreciation and amortization related to the privatization of Sobeys in June 2007.*

## Capital Gains and Other Items

Excluding the impact of the Hannaford Bros. Co. tax settlement, the Company recorded capital gains and other items, net of tax, of \$0.5 million in the first quarter as compared to \$4.8 million in the first quarter last year. Capital gains and other items, net of tax, in the first quarter last year were the result of the sale of non-core properties.

The table below presents capital gains and other items, net of tax, including the impact of the tax recovery related to the sale of the shares in Hannaford Bros. Co. as discussed.

(\$ in millions)	13 Weeks Ended		
	August 1, 2009	August 2, 2008	(\$) Change
Gain on sale of properties, net of tax	\$ 0.2	\$ 4.8	\$ (4.6)
Other items, net of tax	0.3	-	0.3
Tax recovery related to sale of shares in Hannaford Bros. Co.	17.0	-	17.0
	<b>\$ 17.5</b>	<b>\$ 4.8</b>	<b>\$ 12.7</b>

## Net Earnings

Consolidated net earnings in the first quarter of fiscal 2010 equalled \$89.7 million (\$1.31 per share) compared to \$75.7 million (\$1.15 per share) in the first quarter last year. The increase in net earnings of \$14.0 million compared to the first quarter of last year is attributed to the \$12.7 million increase in capital gains and other items, net of tax and the \$1.3 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.

(\$ in millions, except per share information)	Fiscal 2010		Fiscal 2009 <sup>(1)</sup>				Fiscal 2008 <sup>(1)</sup>		
	Q1 (13 Weeks)	Q4 (13 Weeks)	Q3 (13 Weeks)	Q2 (13 Weeks)	Q1 (13 Weeks)	Q4 (13 Weeks)	Q3 (13 Weeks)	Q2 (13 Weeks)	
	Aug. 1/09	May 2/09	Jan. 31/09	Nov. 1/08	Aug. 2/08	May 3/08	Feb. 2/08	Nov. 3/07	
Revenue	\$ 3,968.5	\$ 3,709.0	\$ 3,800.0	\$ 3,727.9	\$ 3,778.2	\$ 3,557.8	\$ 3,503.0	\$ 3,484.8	
Operating income	130.2	109.0	115.6	113.4	128.3	136.2	90.7	118.2	
Operating earnings <sup>(2)</sup>	72.2	62.6	65.0	63.2	70.9	73.6	48.9	59.9	
Capital gains (losses) and other items, net of tax	17.5	(0.8)	(3.5)	2.5	4.8	(7.1)	(0.3)	(1.5)	
Net earnings	\$ 89.7	\$ 61.8	\$ 61.5	\$ 65.7	\$ 75.7	\$ 66.5	\$ 48.6	\$ 58.4	
<b>Per share information, diluted</b>									
Operating earnings	\$ 1.05	\$ 0.95	\$ 0.99	\$ 0.96	\$ 1.08	\$ 1.12	\$ 0.74	\$ 0.91	
Capital gains (losses) and other items, net of tax	0.26	(0.01)	(0.05)	0.04	0.07	(0.11)	-	(0.02)	
Net earnings	\$ 1.31	\$ 0.94	\$ 0.94	\$ 1.00	\$ 1.15	\$ 1.01	\$ 0.74	\$ 0.89	
Diluted weighted average number of shares out- standing (in millions)	68.5	66.0	65.7	65.7	65.7	65.7	65.7	65.7	

(1) Amounts have been restated as a result of a change in accounting policy and a reclassification with respect to goodwill and intangible assets. Please see the section entitled "Accounting Policy Changes" in this MD&A.

(2) Operating earnings is earnings before capital gains (losses) and other items.

Consolidated 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 2009 annual MD&A, as contained on pages 23 - 60 of the Company's 2009 Annual Report. There have been no material changes to the disclosures as contained in the "Critical Accounting Estimates", "Risk Management", "Employee Future Benefits Obligations" or "Outlook" sections of the Company's fiscal 2009 MD&A.

## Operating Performance by Division

### Food Retailing

Empire's food retailing division is carried out through its wholly-owned subsidiary, Sobeys, which conducts business through more than 1,300 retail grocery stores (corporately owned and franchised) which operate in every province across Canada.

Sobeys' strategy is focused on delivering the best food shopping experience to its customers in the right format, right-sized stores, supported by superior customer service. The five distinct store formats deployed by Sobeys to satisfy its customers' principal shopping requirements are the full service, fresh service, convenience service, community service and price service formats. Sobeys remains focused on improving the product, service and merchandising offerings within each format by expanding and renovating its current store base, while continuing to build new stores. Sobeys' six major banners: Sobeys, IGA *extra*, IGA, Price Chopper, Foodland and Thrifty Foods are the primary focus of these format development efforts.

During the quarter ended August 1, 2009, Sobeys opened, replaced, expanded, renovated, acquired and/or converted the banners in 22 stores (2009 – 20). During the first quarter of fiscal 2010, Sobeys continued to execute a number of initiatives in support of its food-focused strategy including product and service innovations, productivity initiatives and business process, supply chain and system upgrades.

### **Business process and information system transformation and rationalization costs**

Sobeys continues to make significant progress in the implementation of system-wide business process optimization and rationalization initiatives that are designed to reduce complexity and improve processes and efficiency throughout Sobeys.

Sobeys completed the implementation of this system in Ontario during the third quarter of fiscal 2007. A business process and information system transformation plan, similar to that deployed in Ontario, began in Western Canada during fiscal 2007 and was completed during the second quarter of fiscal 2008. The business process and information systems implementation began in Quebec in the first quarter of fiscal 2010. The business process and system initiative costs primarily included labour, implementation and training costs associated with these initiatives. For the 13 week period ended August 1, 2009, pre-tax costs of \$3.6 million related to these initiatives were incurred compared to no pre-tax costs incurred in the same period last year.

These implementations support all aspects of the business including operations, merchandising, distribution, human resources and administration. They are an important enabler of further initiatives including the new distribution facility in Ontario that was announced on November 21, 2006.

The new distribution centre, in Vaughan, Ontario, utilizes automation technology and equipment 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 first quarter of fiscal 2010, no severance costs were required related to the development of this automated facility (2009 - \$4.6 million), which, in the first quarter of fiscal 2009, included the severance costs associated with a resulting rationalization of certain administrative functions in Ontario. 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 fiscal 2008 and 2009, Sobeys also performed a rationalization of administrative functions in its National and other regional departments. No additional rationalization costs were incurred in the first quarter of fiscal 2010 (2009 - \$1.0 million).

The table below summarizes the sales, operating income and net earnings contribution to Empire by Sobeys:

	13 Weeks Ended		Year over Year	
	August 1, 2009	August 2, 2008 <sup>(1)</sup>	(\$) Change	(%) Change
(\$ in millions)				
Sales	\$ 3,906.7	\$ 3,711.5	\$ 195.2	5.3%
Operating income <sup>(2)</sup>	121.6	106.3	15.3	14.4%
Net earnings <sup>(2)</sup>	69.2	58.2	11.0	18.9%

(1) Amounts have been restated as a result of a change in accounting policy and a reclassification with respect to goodwill and intangible assets. Please see the section entitled "Accounting Policy Changes" in this MD&A.

(2) Adjusted for the impact of depreciation and amortization related to the privatization of Sobeys in June 2007.

## **Sales**

Food retailing division sales for the first quarter of fiscal 2010 were \$3.91 billion compared to \$3.71 billion for the same quarter last year, an increase of \$195.2 million or 5.3 percent. During the first quarter of fiscal 2010, Sobeys' same-store sales (sales from stores in the same locations in both reporting periods) increased by 4.0 percent. The growth in sales continues to be a direct result of the increased retail selling square footage from new stores and enlargements, coupled with the continued implementation of sales and merchandising initiatives, improved consistency of store level execution and retail food price inflation.

## **Operating Income**

Sobeys reported operating income of \$122.9 million during the first quarter of fiscal 2010, a \$15.3 million or 14.2 percent increase from the first quarter last year. Operating income margin in the first quarter equalled 3.15 percent compared to 2.90 percent in the first quarter of fiscal 2009.

After adjusting for the impact of depreciation and amortization of \$1.3 million related to the privatization, Sobeys' operating income contribution to Empire in the first quarter of fiscal 2010 was \$121.6 million (first quarter of fiscal 2009 - \$106.3 million). Sobeys' operating income margin in the first quarter after adjusting for above items equalled 3.11 percent compared to 2.86 percent in the first quarter of fiscal 2009.

## **Net Earnings**

Sobeys' first quarter fiscal 2010 net earnings equalled \$70.1 million, an increase of \$11.0 million or 18.6 percent compared to the \$59.1 million recorded in the first quarter of fiscal 2009.

Adjusting for the impact of depreciation and amortization related to the privatization and the related tax impact, Sobeys contributed net earnings of \$69.2 million to Empire for the first quarter of fiscal 2010, an increase of \$11.0 million or 18.9 percent over the \$58.2 million recorded in the same period 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 47.4 percent ownership interest in Crombie REIT and residential land development through an 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 communities in Ontario and Western Canada.

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

(\$ in millions)	13 Weeks Ended		(\$) Change
	August 1, 2009	August 2, 2008	
<b>Revenue</b>			
Residential	\$ 11.4	\$ 20.0	\$ (8.6)
Other Commercial	3.1	4.6	(1.5)
Inter-segment	0.6	0.3	0.3
	<b>15.1</b>	<b>24.9</b>	<b>(9.8)</b>
Elimination	(0.6)	(0.3)	(0.3)
	<b>\$ 14.5</b>	<b>\$ 24.6</b>	<b>\$ (10.1)</b>
<b>Operating income</b>			
Residential	\$ 5.1	\$ 13.7	\$ (8.6)
Crombie REIT <sup>(1)</sup>	4.9	4.6	0.3
Other Commercial	(0.3)	1.2	(1.5)
	<b>\$ 9.7</b>	<b>\$ 19.5</b>	<b>\$ (9.8)</b>
<b>Net earnings</b>			
Residential	\$ 3.4	\$ 9.6	\$ (6.2)
Commercial	2.7	3.5	(0.8)
Capital gains, net of tax	-	4.0	(4.0)
	<b>\$ 6.1</b>	<b>\$ 17.1</b>	<b>\$ (11.0)</b>
<b>Funds from operations<sup>(2)</sup></b>			
Residential	\$ 3.4	\$ 9.6	\$ (6.2)
Commercial	3.2	3.5	(0.3)
	<b>\$ 6.6</b>	<b>\$ 13.1</b>	<b>\$ (6.5)</b>

(1) Equity accounted earnings in Crombie REIT during the period.

(2) Operating earnings plus depreciation and amortization.

## Revenue

Real estate division revenue (net of elimination) amounted to \$14.5 million for the first quarter ended August 1, 2009, a \$10.1 million or 41.1 percent decrease from the first quarter last year. The decline is primarily attributed to lower residential property revenues from Genstar related to weaker lot sales, particularly in the Calgary and Edmonton, Alberta markets along with lower revenue from commercial operations due to the sale of several properties in the first half of last year.

## Operating Income

First quarter real estate division operating income was \$9.7 million versus \$19.5 million in the same quarter last year. The \$9.8 million decline in real estate division operating income is largely as a result of an \$8.6 million decrease in residential property operating income as a result of lower residential lot sales activity in Western Canada along with a \$1.5 million decrease in other commercial operating income primarily due to the sale of several properties in the first half of fiscal 2009. Equity accounted earnings from Empire's 47.4 percent interest in Crombie REIT which increased \$0.3 million benefited from a full quarter of results in the current year from the 61 properties acquired from Sobey Leased Properties part way through Crombie REIT's second quarter last year on April 22, 2008.

## Capital Gains

There were no capital gains or losses, net of tax, for the real estate division in the first quarter of fiscal 2010 compared to \$4.0 million of capital gains, net of tax, related to the sale of one commercial property during the first quarter last year.

## Net Earnings

Real estate division net earnings contribution in the first quarter amounted to \$6.1 million compared to \$17.1 million last year, an \$11.0 million or 64.3 percent decrease. The earnings decrease largely reflects the \$9.8 million reduction in operating income, a \$4.0 million decrease in net capital gains and an increase in interest expense of \$0.2 million, partially offset by a \$3.0 million reduction in income taxes.

## Funds from Operations

Funds from operations in the first quarter of \$6.6 million decreased \$6.5 million or 49.6 percent compared to funds from operations in the first quarter of last year largely as a result of lower operating earnings. Trailing (last four quarters) funds from operations for the real estate division was \$32.0 million, a decrease of 16.9 percent from the trailing (last four quarters) funds from operations of \$38.5 million reported on May 2, 2009.

## 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 and wholly-owned Empire Theatres (the second largest movie exhibitor in Canada).

### Portfolio Composition

At August 1, 2009, Empire's investment portfolio (including equity accounted investments in Crombie REIT and Genstar U.S.) consisted of:

(\$ in millions)	August 1, 2009			May 2, 2009			August 2, 2008		
	Market Value	Carrying Value	Unrealized Gain	Market Value	Carrying Value	Unrealized Gain	Market Value	Carrying Value	Unrealized Gain
Investment in Wajax	\$ 85.8	\$ 30.9	\$ 54.9	\$ 71.3	\$ 31.0	\$ 40.3	\$ 131.1	\$ 32.4	\$ 98.7
Investment in Crombie REIT	265.5	18.3	247.2	175.6	(19.7)	195.3	290.4	10.5	279.9
Investment in Genstar U.S. <sup>(1)</sup>	12.5	12.5	-	7.5	7.5	-	0.3	0.3	-
Other Investments	1.2	1.2	-	1.1	1.1	-	1.6	1.6	-
	<b>\$ 365.0</b>	<b>\$ 62.9</b>	<b>\$ 302.1</b>	<b>\$ 255.5</b>	<b>\$ 19.9</b>	<b>\$ 235.6</b>	<b>\$ 423.4</b>	<b>\$ 44.8</b>	<b>\$ 378.6</b>

(1) Assumes market value equals book value.

The following table presents investments and other operations' financial highlights for the 13 weeks ended August 1, 2009 compared to the same period last year:

(\$ in millions)	13 Weeks Ended		
	August 1, 2009	August 2, 2008	(\$) Change
Revenue	\$ 47.3	\$ 42.1	\$ 5.2
Operating income			
Wajax	2.7	5.5	(2.8)
Other operations, net of corporate expenses	(3.8)	(3.0)	(0.8)
Total operating income	(1.1)	2.5	(3.6)
Operating earnings	(3.1)	(0.4)	(2.7)
Capital gains and other items, net of tax <sup>(1)</sup>	17.5	0.8	16.7
Net earnings	\$ 14.4	\$ 0.4	\$ 14.0

(1) First quarter fiscal 2010 capital gains and other items, net of tax, includes \$17.0 million related to the settlement of Canada Revenue Agency tax reassessment relating to the sale of Hannaford Bros. Co. shares in fiscal 2001.

## Revenue

Investments and other operations' revenue, primarily generated by Empire Theatres, equalled \$47.3 million in the first quarter ended August 1, 2009 versus \$42.1 million in the first quarter last year, a 12.4 percent increase.

## Operating Income

Investments and other operations' operating income (net of corporate expenses) was negative \$1.1 million compared to a positive \$2.5 million in the first quarter last year. Equity accounted earnings generated from the Company's 27.6 percent interest in Wajax amounted to \$2.7 million in the first quarter versus \$5.5 million last year. Operating income generated from other operations (net of corporate expenses) declined to negative \$3.8 million from negative \$3.0 million in the first quarter last year.

## Operating Earnings

Investments and other operations (net of corporate expenses) contributed operating earnings of negative \$3.1 million in the first quarter of fiscal 2010 compared to negative \$0.4 million in the same quarter last year, a decrease of \$2.7 million. This decrease was largely the result of lower equity earnings from Wajax due to the economic slowdown in the first quarter of fiscal 2010 compared to the same quarter last year.

## Capital Gains

During the first quarter of fiscal 2010, there were capital gains and other items, net of tax, of \$17.5 million compared to capital gains, net of tax, of \$0.8 million during the first quarter of fiscal 2009. Capital gains and other items, net of tax in the current quarter are primarily related to the settlement of the tax reassessment for \$17.0 million relating to the sale of Hannaford Bros. Co. in fiscal 2001. The capital gains and other items, net of tax, in the first quarter of fiscal 2009 were primarily related to the sale of a non-core theatre location.

## Net Earnings

Investments and other operations (net of corporate expenses) contributed \$14.4 million to Empire's consolidated first quarter fiscal 2010 net earnings as compared to a \$0.4 million net earnings contribution in the first quarter last year. The increase is primarily due to the tax settlement for \$17.0 million relating to the sale of Hannaford Bros. Co. in fiscal 2001, partially offset by the \$2.7 million decline in operating earnings as discussed.

## Financial Condition

### Capital Structure and Key Financial Condition Measures

The Company's financial condition has improved since the start of the fiscal year as evidenced by the capital structure and key financial condition measures in the table below.

(\$ in millions, except per share and ratio calculations)	August 1, 2009	May 2, 2009 <sup>(1)</sup>	August 2, 2008 <sup>(1)</sup>
Shareholders' equity	\$ 2,764.7	\$ 2,678.8	\$ 2,422.1
Book value per share	\$ 40.32	\$ 39.07	\$ 36.76
Bank indebtedness	\$ 69.8	\$ 45.9	\$ 53.5
Long-term debt, including current portion <sup>(2)</sup>	\$ 1,217.8	\$ 1,257.0	\$ 1,462.4
Funded debt to total capital	31.8%	32.7%	38.5%
Net debt to capital ratio <sup>(3)</sup>	26.3%	28.6%	35.7%
Debt to EBITDA <sup>(4)</sup>	1.62x	1.64x	1.93x
EBITDA to interest expense <sup>(4)</sup>	10.22x	9.84x	7.42x
Total assets	\$ 6,036.7	\$ 5,891.1	\$ 5,729.1

(1) Amounts have been restated as a result of a change in accounting policy and a reclassification with respect to goodwill and intangible assets. Please see the section entitled "Accounting Policy Changes" in this MD&A.

(2) Includes liabilities related to assets held for sale.

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

(4) Calculation uses trailing 12-month EBITDA and interest expense.

## Shareholders' Equity

The Company's share capital on August 1, 2009 consisted of:

	Authorized Number of Shares	Issued and Outstanding Number of Shares	\$ in Millions
Preferred shares, par value \$25 each, issuable in series	2,682,100	168,000	\$ 4.2
2002 Preferred shares par value \$25 each, issuable in series	992,000,000	-	-
Non-Voting Class A shares, without par value	259,107,435	34,197,498	316.1
Class B common shares, without par value, voting	40,800,000	34,260,763	7.6
			327.9
Employees' Share Plan			(3.4)
			\$ 324.5

Total Non-Voting Class A plus Class B common shares outstanding at August 1, 2009 equalled 68,458,261, unchanged from the previous fiscal year-end and 2,713,000 shares higher than August 2, 2008. The increase over last year is due to the equity issue which closed on April 24, 2009 at a price of \$49.75 per share. There were 34,197,498 Non-Voting Class A and 34,260,763 Class B common shares outstanding at August 1, 2009.

At August 1, 2009, Empire had 445,132 options outstanding compared to 282,733 options outstanding at August 2, 2008.

During the first quarter of fiscal 2010, there were no Series 2 Preferred shares purchased for cancellation compared to 56,100 Series 2 Preferred shares purchased for \$1.4 million in the first quarter of last year. The Company plans to purchase on a best efforts basis additional Series 2 Preferred shares by the end of calendar 2009.

As at September 11, 2009, the Company had Non-Voting Class A and Class B common shares outstanding of 34,197,498 and 34,260,763, respectively, as well as 445,132 options to acquire in aggregate 445,132 Non-Voting Class A shares.

Dividends paid to common shareholders amounted to \$12.7 million in the first quarter (\$0.185 per share) versus \$11.5 million (\$0.175 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 1, 2009 was \$1,217.8 million, representing 94.6 percent of Empire's total funded debt of \$1,287.6 million.

Funded debt has decreased \$15.3 million since the end of the fiscal year, May 2, 2009 (\$1,302.9 million) and \$228.3 million since the first quarter last year (\$1,515.9 million). The significant decrease over the first quarter last fiscal year is primarily the result of repaying debt with net proceeds of \$129.1 million from the equity issue completed on April 24, 2009 along with the free cash flow generated by Sobeys. The ratio of funded debt to total capital ratio has declined by 6.7 percentage points since the first quarter last year to 31.8 percent as a result of the repayment of debt as discussed.

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) (\$ in millions)	August 1, 2009	May 2, 2009	August 2, 2008
Food retailing	\$ 881.6	\$ 954.0	\$ 1,006.0
Real estate	39.7	39.6	47.6
Investments and other operations	296.5	263.4	408.8
<b>Total</b>	<b>\$ 1,217.8</b>	<b>\$ 1,257.0</b>	<b>\$ 1,462.4</b>

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 2009 as detailed on pages 79 and 80 of the Company's Fiscal 2009 Annual Report.

On July 23, 2008, Dominion Bond Rating Service ("DBRS") changed its trend on Sobeys' credit rating from BBB (low) with a negative trend to BBB (low) with a stable trend. On July 30, 2008, Standard & Poors ("S&P") changed its trend on Sobeys' credit rating from BB+ with a negative trend to BB+ with a stable trend. On June 26, 2009, DBRS confirmed its long-term debt rating of Sobeys at BBB (low) and revised the trend to positive from stable. On July 6, 2009, S&P confirmed its long-term debt rating of Sobeys at BB+ and revised the trend to positive from stable.

Empire's EBITDA to interest expense ratio in the first quarter was 10.2 times, an increase from the 9.8 times reported at the prior fiscal year-end and up significantly from the 7.4 times recorded for the first quarter last fiscal year. The increase over the same quarter last year is primarily due to the reduction in funded debt which resulted in lower interest expense in the first quarter of fiscal 2010.

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 1, 2009 and for the fiscal year ended May 2, 2009.

## 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 1, 2009, there were four interest rate hedges in place with a fair value of negative \$28.4 million.

The Company also uses forward contracts to fix the exchange rate on some of its expected requirements for Euros and U.S. dollars ("USD"). As of August 1, 2009, due to an appreciation of the Euro relative to the Canadian dollar ("CAD"), Sobeys had recognized a nominal asset representing the fair value of one Euro denominated forward currency 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 USD denominated variable rate lease. The terms of the swap match the lease terms. As of August 1, 2009, Sobeys recognized an asset of \$0.3 million relating to this instrument.

To mitigate the risk of changes in the market price of electricity, Sobeys uses financial derivative swap contracts with varying maturities as hedges against the rising costs. As of August 1, 2009, Sobeys recognized a liability of \$4.4 million relating to these instruments.

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;
- Unutilized bank credit facilities; and
- Cash generated from operating activities.

At August 1, 2009, consolidated cash and cash equivalents were \$300.6 million versus \$170.4 million at August 2, 2008 and \$231.6 million at fiscal year-end, May 2, 2009.

At the end of the first quarter of fiscal 2010, on a non-consolidated basis, Empire directly maintained authorized bank lines for operating, general and corporate purposes of \$650 million, of which approximately \$281 million or 43 percent were utilized. On a consolidated basis, Empire's authorized bank credit facilities exceeded borrowings by approximately \$958 million at August 1, 2009 versus \$930 million at May 2, 2009.

Included in the current portion of long-term debt and bank indebtedness is \$354.1 million of debt outstanding under three credit facilities that mature within the next twelve months. Empire's management intends to renew or replace each of these credit facilities prior to their maturity. To that end, management has held preliminary discussions with the financial institutions providing each of the facilities and has developed a timeline for renegotiating each of the credit facilities to ensure the new facilities are in place prior to the maturity of the existing facilities. However, given the current credit environment, the terms of the renewed or replacement credit facilities may not be as favorable as those of the in-place facilities.

The Company anticipates that the above mentioned in-place sources of liquidity will adequately meet its short-term and long-term financial requirements. The Company mitigates potential liquidity risk by ensuring its various sources of funds are diversified by term to maturity and source of credit.

The table below highlights major cash flow components for the 13 weeks ended August 1, 2009 compared to the 13 weeks ended August 2, 2008.

### Major Cash Flow Components

(\$ in millions)	13 Weeks Ended	
	August 1, 2009	August 2, 2008 <sup>(1)</sup>
Earnings for common shareholders	\$ 89.7	\$ 75.6
Items not affecting cash	89.4	85.2
	<b>179.1</b>	160.8
Net change in non-cash working capital	27.9	(11.1)
Cash flows from operating activities	207.0	149.7
Cash flows (used in) from investing activities	(102.6)	(96.2)
Cash flows (used in) from financing activities	(35.4)	(74.5)
Increase (decrease) in cash and cash equivalents	\$ 69.0	\$ (21.0)

(1) Amounts have been restated as a result of a change in accounting policy and a reclassification with respect to goodwill and intangible assets. Please see the section entitled "Accounting Policy Changes" in this MD&A.

### Operating Activities

First quarter cash flows from operating activities equalled \$207.0 million compared to \$149.7 million in the comparable period last year. The increase of \$57.3 million is largely attributed to an increase in the net change in non-cash working capital of \$39.0 million, an increase in earnings available for common shareholders of \$14.1 million and an increase in items not affecting cash of \$4.2 million.

The following tables present non-cash working capital changes on a quarter-over-quarter basis and on a year-over-year basis.

### Non-Cash Working Capital (Quarter-Over-Quarter)

(\$ in millions)	August 1, 2009	May 2, 2009 <sup>(1)</sup>	13 Weeks Ended	
			August 1, 2009 Increase (Decrease) in Cash Flows	August 2, 2008 <sup>(1)</sup> Increase (Decrease) in Cash Flows
Receivables	\$ 319.3	\$ 318.7	\$ (0.6)	\$ (0.9)
Inventories	854.7	842.8	(11.9)	4.6
Prepaid expenses	68.0	63.9	(4.1)	(3.7)
Accounts payable and accrued liabilities	(1,556.1)	(1,487.1)	69.0	24.3
Income taxes receivable (payable)	28.8	4.9	(23.9)	(6.3)
Impact of reclassifications on working capital <sup>(2)</sup>	0.6	-	(0.6)	(29.1)
Total	\$ (284.7)	\$ (256.8)	\$ 27.9	\$ (11.1)

(1) Amounts have been restated as a result of a change in accounting policy and a reclassification with respect to goodwill and intangible assets. Please see the section entitled "Accounting Policy Changes" in this MD&A.

(2) Reclassifications primarily relate to business acquisitions and rationalization costs and the adoption of the new goodwill and intangibles policy further explained on page 33.

### Non-Cash Working Capital (Year-Over-Year)

(\$ in millions)	August 1, 2009	August 2, 2008 <sup>(1)</sup>	52 Weeks Ended
			August 1, 2009 Increase (Decrease) in Cash Flows
Receivables	\$ 319.3	\$ 292.0	\$ (27.3)
Inventories	854.7	815.6	(39.1)
Prepaid expenses	68.0	65.7	(2.3)
Accounts payable and accrued liabilities	(1,556.1)	(1,372.7)	183.4
Income taxes receivable (payable)	28.8	(9.2)	(38.0)
Impact of reclassifications on working capital <sup>(2)</sup>	(8.6)	-	8.6
Total	\$ (293.9)	\$ (208.6)	\$ 85.3

(1) Amounts have been restated as a result of a change in accounting policy and a reclassification with respect to goodwill and intangible assets. Please see the section entitled "Accounting Policy Changes" in this MD&A.

(2) Reclassifications primarily relate to business acquisitions and rationalization costs and the adoption of the new goodwill and intangibles policy further explained on page 33.

The net change in non-cash working capital of \$27.9 million in the first quarter was largely due to a \$69.0 million increase in accounts payable and accrued liabilities, partially offset by an income taxes receivable increase of \$23.9 million, an inventory increase of \$11.9 million, a \$4.1 million increase in prepaid expenses, the increase in receivables of \$0.6 million and the impact of reclassifications on working capital totalling \$0.6 million. The increase in accounts payable and accrued liabilities is mainly related to a \$68.3 million increase at Sobeys which is partially related to the increased inventory levels at Sobeys.

Compared to the first quarter of fiscal 2009, accounts payable and accrued liabilities increased by \$183.4 million and reclassifications impacted working capital by \$8.6 million, while inventories increased \$39.1 million, income taxes receivable increased by \$38.0 million, receivables increased by \$27.3 million and prepaid expenses increased \$2.3 million. The increase in inventory and related accounts payable and accrued liabilities is necessary to support Sobeys' higher sales volume due to the increased amount of square footage in its expanded store network.

### Investing Activities

Cash used in investing activities of \$102.6 million in the first quarter increased \$6.4 million or 6.7 percent compared to cash used in investing activities of \$96.2 million in the same period last year.

Consolidated purchases of property and equipment totalled \$101.7 million in the first quarter of fiscal 2010 compared to \$121.6 million in the first quarter last year. Proceeds on disposal of property and equipment increased \$28.6 million over the first quarter last year to \$57.6 million in the first quarter.

On July 23, 2009, Sobeys finalized an agreement to sell and leaseback a retail support centre located in Milton, Ontario to a third party. Proceeds on the sale were \$51.0 million resulting in a pre-tax gain of \$5.6 million which will be amortized over the life of the long-term lease agreement which has been entered into for the use of this facility.

Cash used in investing activities for the first quarter of fiscal 2010 included an additional investment of \$30.0 million in Crombie REIT Class B units which coincided with the closing of Crombie REIT's public offering of units on June 25, 2009. As a result of the public offering, Empire's equity ownership interest was reduced modestly to 47.4 percent.

The table below outlines the number of stores Sobeys invested in during the first quarter of fiscal 2010 compared to fiscal 2009:

### Sobeys' Corporate and Franchised Store Construction Activity

# of Stores	13 Weeks Ended	
	August 1, 2009	August 2, 2008
Opened/Acquired/Relocated	14	11
Expanded	3	4
Rebannered/Redeveloped	5	5
Closed	22	10

The following table shows Sobeys' square footage changes for the 13 and 52 weeks ended August 1, 2009 by type:

### Sobeys' Square Footage Changes

(in thousands)

Square Feet	Q1 F10 vs. Q4 F09	Q1 F10 vs. Q1 F09
Opened	379	997
Relocated	23	73
Acquired	-	33
Expanded	41	113
Closed	(257)	(832)
Net Change	185	383

At August 1, 2009, Sobeys' square footage totalled 27.7 million square feet, a 1.5 percent increase over the 27.3 million square feet operated at the end of the first quarter last year.

## Financing Activities

Financing activities during the first quarter of fiscal 2010 used \$35.4 million of cash compared to \$74.5 million of cash used in financing activities in the same quarter last year. The decrease of \$39.1 million in cash flows used in financing activities when compared to the same quarter last year is primarily the result of an increase in long-term debt issuance of \$39.2 million and an increase in bank indebtedness of \$23.9 million during the first quarter of fiscal 2010 compared to a decrease in bank indebtedness of \$38.6 million last year, partially offset by an increase in repayment of long-term debt of \$62.5 million. The increase in long-term debt issuance in the first quarter of fiscal 2010 compared to last year was the result of the additional investment made in Crombie REIT during the quarter as discussed.

Due to the recent global financial crisis, liquidity in the financial markets has tightened, however the Company believes that its cash and cash equivalents, future operating cash flows and available credit facilities will enable the Company to fund future capital investments, pension plan contributions, working capital and ongoing business requirements. The Company believes it has sufficient funding in place to meet these requirements and other long term obligations.

## Free Cash Flow

Free cash flow (see Non-GAAP measures section at the end of this MD&A) is used to measure the change in the Company's cash available for additional investing, dividends and/or debt reduction. The following table reconciles free cash flow to GAAP cash flows used in operating activities for the 13 week period ended August 1, 2009 and August 2, 2008.

(\$ in millions)	13 Weeks Ended	
	August 1, 2009	August 2, 2008 <sup>(1)</sup>
Cash flow from operating activities	\$ 207.0	\$ 149.7
Less: Property and equipment purchases	101.7	121.6
Free cash flow	\$ 105.3	\$ 28.1

*(1) Amounts have been restated as a result of a change in accounting policy and a reclassification with respect to goodwill and intangible assets. Please see the section entitled "Accounting Policy Changes" in this MD&A.*

Free cash flow generation in the first quarter of fiscal 2010 was \$105.3 million compared to free cash flow of \$28.1 million in the first quarter last year. The \$77.2 million increase in free cash flow from the first quarter last fiscal year was due to a \$57.3 million increase in cash flow from operations and a \$19.9 million decrease in property and equipment purchases.

## Accounting Policy Changes

### Accounting standards adopted during fiscal 2010:

#### Goodwill and Intangible Assets

In February 2008, the Canadian Institute of Chartered Accountants ("CICA") issued Section 3064, "Goodwill and Intangible Assets", which replaced existing Section 3062, "Goodwill and Other Intangible Assets", and Section 3450, "Research and Development". The new standard provides guidance on the recognition, measurement, presentation and disclosure of goodwill and intangible assets. As a result of adopting Section 3064, Emerging Issues Committee Abstract 27, "Revenues and Expenditures During the Pre-operating Period" no longer applies. The Company has implemented these requirements effective for the first quarter of fiscal 2010 with a retroactive restatement of the comparative period for the prior fiscal year. The initial impact under the new standard as at May 2, 2009 was a decrease to prepaid expenses of \$6.9 million, a decrease to other assets of \$62.4 million, a decrease in property and equipment of \$33.7 million, an increase to intangibles of \$96.1 million, a decrease of future tax liabilities of \$2.2 million and an opening retained earnings reduction of \$4.7 million. The impact of the implementation on the balance sheet as of August 2, 2008 was a decrease to prepaid expenses of \$4.2 million, a decrease to other assets of \$59.3 million, a decrease in property and equipment of \$27.4 million, an increase to intangibles of \$86.7 million, a decrease of future tax liabilities of \$1.3 million and an opening retained earnings reduction of \$3.5 million. For the 13 weeks ended August 2, 2008, cost of sales, selling and administration expenses decreased \$3.4 million, depreciation and amortization expense increased \$2.6 million and income taxes increased \$0.2 million.

## **Future Changes in Accounting Policies**

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

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

### Financial Instruments – Disclosures

In June 2009, the CICA issued amendments to the existing Section 3862, "Financial Instruments – Disclosures", to more closely align the section with those required under IFRS. The amendments include enhanced disclosure requirements relating to fair value measurements of financial instruments and liquidity risks. These amendments apply to annual financial statements with fiscal years ending after September 30, 2009. The adoption of the amendments to Section 3862 is not expected to have a material impact on the disclosures of the Company.

### International Financial Reporting Standards

On February 13, 2008, the Accounting Standards Board of Canada announced that GAAP for publicly accountable enterprises will be replaced by 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 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 is currently evaluating the potential impact of the conversion to IFRS on its financial statements. A formal project governance structure has been developed to ensure regular progress reports are provided to senior management, a structured steering committee, as well as the audit committee and board of directors. The Company's IFRS changeover plan is summarized below which details the Company's progress towards completion of selected key activities.

At this time, the impact on the Company's future financial position and results of operations is not reasonably determinable or estimable and can not be quantified. The Company will continue to assess the impact of the transition to IFRS and to review all of the proposed and ongoing projects of the International Accounting Standards Board to determine their impact on the Company. Additional information will be provided as the Company moves towards the changeover date.

	KEY ACTIVITIES	MILESTONES/DEADLINES	PROGRESS TO DATE
Financial statement preparation	<p>Review differences in Canadian GAAP/ IFRS accounting policies</p> <p>Evaluate and select IFRS policies &amp; IFRS 1 choices</p> <p>Develop financial statement format and disclosure</p> <p>Quantify effects of changeover in initial IFRS 1 disclosures and fiscal 2011 financial statements</p>	<p>Steering Committee and Audit Committee sign off for all key IFRS accounting policy choices to occur during fiscal 2010</p> <p>Draft skeleton IFRS annual and interim financial statements by the end of fiscal 2010</p> <p>Final quantification of conversion effects on fiscal 2011 comparative period by fiscal 2012</p>	<p>Completed diagnostic impact assessment during fiscal 2009, which involved a high level review of major differences between IFRS and Canadian GAAP</p> <p>Analysis of IFRS accounting policy choices is ongoing</p> <p>IFRS 1 exemptions applicable to the entity have been identified; assessment of alternatives is underway</p> <p>In the process of obtaining approval for drafted skeleton annual and interim IFRS financial statements</p>
Training and communication	<p>Educate the board of directors, Audit Committee, management, key employees, and other stakeholders</p> <p>Communicate progress of changeover plan to internal and external stakeholders</p>	<p>Ongoing training provided to all groups to align with changeover</p> <p>Additional training will occur as needed during the changeover year</p> <p>Communicate project status updates regularly until completion of IFRS implementation</p>	<p>Completed training for general awareness of IFRS to broad group of finance employees, Steering Committee, Board of Directors, and Audit Committee</p> <p>Frequent project status communications have been provided to internal and external stakeholders</p>
Information systems	<p>Determine if business processes require change to be IFRS compliant</p> <p>Determine if software requires upgrades, changes, or additions to support IFRS reporting requirements</p>	<p>IT implementation approach to be completed in fiscal 2010</p> <p>Changes to systems and dual record-keeping process to be completed at the beginning of fiscal 2011</p>	<p>Assessment of business processes is underway in conjunction with work on accounting policies</p> <p>System impacts for IFRS differences are being assessed, including an assessment of dual record-keeping</p>
Contractual arrangements and compensation	<p>Assess the affect of IFRS on: Financial covenants Compensation arrangements Budgeting and planning</p> <p>Make any required changes to plans and arrangements</p>	<p>Complete necessary covenant negotiations during fiscal 2011</p> <p>Complete review of compensation arrangements during fiscal 2011</p> <p>Complete budgeting plan during fiscal 2011</p>	<p>Preliminary analysis is underway in conjunction with work on accounting policies, and also as part of the key performance indicators (KPI) and budgeting IFRS project groups</p>
Control environment	<p>Assess and design internal controls over financial reporting (ICFR) for all accounting policy changes</p> <p>Assess and design disclosure controls and procedures (DC&amp;P) for all identified accounting policy changes</p>	<p>Changes to ICFR and DC&amp;P to be completed by fiscal 2011</p> <p>Test and evaluate revised controls throughout fiscal 2011</p> <p>Update Chief Executive Officer/Chief Financial Officer certification process by fiscal 2011</p>	<p>Analysis of control issues is underway in conjunction with the review of IFRS accounting issues and policies</p> <p>MD&amp;A disclosures have begun</p> <p>IFRS communications committee, which includes Investor Relations, has been assembled and is engaged</p>

## Internal Controls Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting ("ICFR") to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. The control framework management used to design and assess the effectiveness of ICFR is The Internal Control Integrated Framework published by the Committee of Sponsoring Organization of the Treadway Commission ("COSO"). There have been no changes in the Company's ICFR during the period beginning May 3, 2009 and ended August 1, 2009 that have materially affected, or are reasonably likely to materially affect, our ICFR.

Due to inherent limitations common to all ICFR and disclosure controls and procedures ("DC&P"), Management acknowledges that its ICFR and DC&P may not prevent or detect all misstatements. In addition, Management's evaluation of ICFR and DC&P can provide only reasonable, not absolute, assurance that misstatements will be detected when resulting from fraud or error.

## 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 (\$18.7 million in the first quarter of fiscal 2010) and the charges incurred for administrative and management services are on a cost recovery basis (\$0.6 million in the first quarter of fiscal 2010). The Company has non-interest bearing notes payable to Crombie REIT in the amount of \$9.8 million.

On December 30, 2008, the Company entered into an agreement to provide Crombie REIT with additional financing through a \$20.0 million demand loan facility with substantially the same terms and conditions that govern Crombie REIT's floating rate revolving credit facility. On December 30, 2008, the Company had advanced \$10.0 million to Crombie REIT under this facility. On January 29, 2009, the \$10.0 million advance was repaid in full.

On February 12, 2009, coincident with Crombie REIT completing mortgage financing on eight properties with a Schedule I Canadian bank, Empire provided Crombie REIT with additional financial support through subordinate mortgages on the eight properties totalling \$6.2 million. The terms and conditions of the subordinate mortgages are substantially the same as those governing the first mortgages from the Schedule I Bank except that the interest rate on the second mortgages from the Company will be 50 basis points higher than the interest rate charged by the Schedule I Bank. Concurrent with placing the \$6.2 million in mortgage financing, the authorized amount of the demand loan facility between Empire and Crombie REIT was reduced from \$20.0 million to \$13.8 million.

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

## Designation of Eligible Dividends

The new dividend regime for the favourable tax treatment of "eligible dividends" came into effect on February 21, 2007 as a result of Bill C-28. 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.

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 1, 2009, the Company included in other assets \$30.0 million (May 2, 2009 - \$30.0 million) of third-party Asset-Backed Commercial Paper ("ABCP") against which the Company has taken a pre-tax impairment provision in the amount of \$12.2 million (August 2, 2008 - \$7.5 million). On January 21, 2009, the Company derecognized the existing available for sale assets and received restructured ABCP MAV II notes: A1 - \$7.8 million, A2 - \$17.5 million, B - \$3.2 million, C - \$0.9 million and \$0.6 million of tracking notes (the "restructured notes") as designated in the Montreal Accord as well as accrued interest. The A1 and A2 notes received an A rating from DBRS. The remaining notes have not yet been rated. The restructured notes are floating rate notes with expected payouts in January 2017. The Company has classified these notes as held for trading and as a result will be calculating the fair value of the notes at each reporting period.

The Company updated its analysis of the fair value of the restructured notes, including factors such as estimated cash flow scenarios and risk adjusted discount rates, and an additional pre-tax provision, net of interest received, of \$3.7 million was recorded in fiscal 2009. The total charge for impairment is approximately 41 percent (May 2, 2009 – 41 percent) of the original value of the ABCP.

Discount rates vary depending upon the credit rating of the restructured long-term floating rate notes. Discount rates have been estimated using Government of Canada benchmark rates plus expected spreads for similarly rated instruments with similar maturities and structure. The Company has performed a sensitivity analysis on estimated discount rates used in the fair value analysis and determined that a change of one percent would result in a pre-tax change in the fair value of these investments of approximately \$1.2 million (May 2, 2009 - \$1.3 million).

Subsequent to August 1, 2009, DBRS downgraded the A2 notes to a BBB rating. The downgrading is not expected to have a material change in the fair value of the notes. Continuing uncertainties regarding the value of assets which underlie the ABCP, the amount and timing of cash flows and the outcome of the restructuring process could give rise to a further material change in the value of the Company's investment in ABCP which could impact the Company's future earnings. The Company believes it has sufficient credit facilities to satisfy its financial obligations as they come due and does not expect there will be a material adverse impact on its business as a result of this current third party ABCP liquidity issue.

## **Employee Future Benefit Obligations**

During the first quarter of fiscal 2010, the Company contributed \$1.0 million (2009- \$nil) to its registered defined benefit plans. The Company expects to contribute approximately \$4.1 million in fiscal 2010 to these plans. The Company continues to assess the impact of the capital markets on its funding requirements.

## 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.
- 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.
- Free cash flow is calculated as cash flows from operating activities less property and equipment purchases.

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 1, 2009, May 2, 2009 and August 2, 2008, respectively:

(\$ in millions)	August 1, 2009	May 2, 2009 <sup>(1)</sup>	August 2, 2008 <sup>(1)</sup>
Bank indebtedness	\$ 69.8	\$ 45.9	\$ 53.5
Long-term debt due within one year	364.9	133.0	55.5
Liabilities relating to assets held for sale	-	-	6.3
Long-term debt	852.9	1,124.0	1,400.6
Funded debt	1,287.6	1,302.9	1,515.9
Less: cash and cash equivalents	(300.6)	(231.6)	(170.4)
Net funded debt	987.0	1,071.3	1,345.5
Total shareholders' equity	2,764.7	2,678.8	2,422.1
Total capital under management	\$ 3,751.7	\$ 3,750.1	\$ 3,767.6

*(1) Amounts have been restated as a result of a change in accounting policy and a reclassification with respect to goodwill and intangible assets. Please see the section entitled "Accounting Policy Changes" in this MD&A.*

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

Dated: September 11, 2009  
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  
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)

145,263

### DIVIDEND RECORD AND PAYMENT DATES FOR FISCAL 2010

Record Date	Payment Date
July 15, 2009	July 31, 2009
October 15, 2009	October 30, 2009
January 15, 2010*	January 29, 2010*
April 15, 2010*	April 30, 2010*

\*Subject to approval by Board of Directors

### OUTSTANDING SHARES

As of September 11, 2009

Non-Voting Class A shares	34,197,498
Class B common shares, voting	34,260,763

### TRANSFER AGENT

CIBC Mellon Trust Company  
Investor Correspondence  
P.O. Box 7010  
Adelaide Street Postal Station  
Toronto, Ontario  
M5C 2W9  
Telephone: (800) 387-0825  
Email: enquires@cibcmellon.com

### 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 Bank Financial Group

### SOLICITORS

Stewart McKelvey  
Halifax, Nova Scotia

### AUDITORS

Grant Thornton, LLP  
New Glasgow, Nova Scotia

### 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



At Sobeyscareers.com it is all about "Careers that fit your life". Launched in 2009, the site allows visitors to explore the endless opportunities and benefits offered by a career in our stores, distribution centres and offices.