



Empire Company Limited

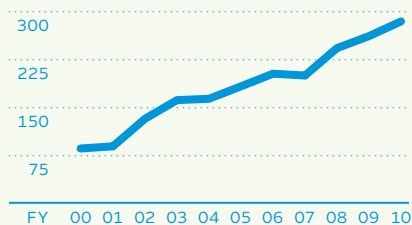
Focused on being the best  
...together

Empire Company Limited is committed to creating sustainable value through cash flow and income growth, and equity appreciation. Since becoming a public company in 1982, we have done that by focusing on businesses that we know and understand. These businesses – food retailing, real estate and corporate investments – will continue to be our foundation and focus.

## 2010 Financial Highlights

(\$ in millions, except per share amounts)	52 Weeks Ended May 1, 2010	52 Weeks Ended May 2, 2009	52 Weeks Ended May 3, 2008
<b>Operations</b>			
Revenue	\$ 15,516.2	\$ 15,015.1	\$ 14,065.0
Operating earnings <sup>(1)</sup>	284.5	261.7	242.8
Capital gains and other items, net of tax	17.4	3.0	73.0
Net earnings	301.9	264.7	315.8
<b>Per Share Information</b>			
Operating earnings (fully diluted)	\$ 4.15	\$ 3.97	\$ 3.69
Capital gains and other items, net of tax	0.25	0.05	1.11
Net earnings (fully diluted)	4.40	4.02	4.80
Book value	43.07	39.07	36.08
Dividends	0.74	0.70	0.66

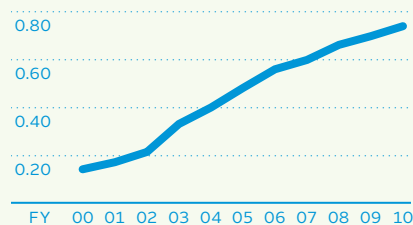
**Operating Earnings<sup>(1)</sup>**  
(\$ in millions)



10-Year Operating Earnings CAGR<sup>(2)</sup>

**12.9%**

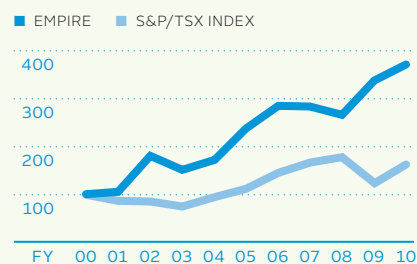
**Dividends**  
(\$ per share)



10-Year DPS CAGR<sup>(2)</sup>

**18.1%**

**Value of Investment of \$100 made 10 years ago**  
(\$)



10-Year Total Return CAGR<sup>(2)</sup>

**14.0%**

(1) Operating earnings is calculated as net earnings before capital gains (losses) and other items.  
(2) Compound Annual Growth Rate.

# Focused on being the best...**together**

Since the privatization of Sobeys Inc. three years ago, Empire's focus and capital resources have been squarely behind food retailing and related real estate, as never before. Today, these businesses generate more than 91 percent of our cash flow and 94 percent of earnings. This annual report explains how the management and employees of both our food retailing and real estate divisions are working in collaboration to support Sobeys' goal of becoming widely recognized as the best food retailer in Canada.

*We are focused on being the best...together*





# Steady progress

Empire achieved another record performance in fiscal 2010. Revenues increased 3.3 percent to \$15.5 billion and operating earnings were up 8.7 percent to \$284.5 million or \$4.15 per share. Our ability to sustain growth in the midst of a serious economic downturn was made possible by the important decisions we took over the past few years to trim our investment portfolio and redeploy capital to support our increased focus on food retailing and related real estate. Despite the turbulence in the broader economy, our core businesses delivered stable cash flow and earnings and they continue to represent our best prospects for steady, long-term growth.

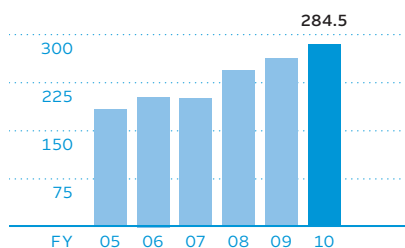
At the same time, we have strengthened our balance sheet which had been leveraged to finance the privatization of Sobeys and other strategic transactions. Over the years, we have accessed credit markets when it made sense to do so in support of compelling growth opportunities. Equally important however, we have prudently retired debt with discipline, when deemed appropriate, and this past year was no exception. Aided by another year of strong cash flow in our food retailing business, Empire improved its ratio of funded debt to total capital from 32.7 percent to 29.3 percent by fiscal year-end. Improvements in Sobeys' financial condition and strong operating performance during fiscal 2010 secured credit rating upgrades from both Standard and Poor's and DBRS credit rating agencies, with each rating Sobeys as investment grade. Sobeys is now well positioned to access longer-term credit at more favourable costs going forward and has done so with its \$150 million Medium Term Note issue completed in June 2010.

## Focused on being the best...together

Sobeys posted another record operating performance this past year as the company continues to work towards its goal to be widely recognized as the best food retailer in the country. Sales increased 3.2 percent to \$15.2 billion and net earnings increased 15.3 percent to \$262.8 million. For the fifth consecutive year, Sobeys also achieved strong same-store sales growth.

These results reflect Sobeys' ongoing progress in building a healthy and sustainable retail food business and infrastructure for the long term, including the continued modernization and expansion of its retail store network. During fiscal 2010, Sobeys invested \$341.4 million to enhance its ability to better serve the needs of its customers, opening or relocating 41 stores, expanding 13 stores and closing 52 stores for a net increase of 0.6 million square feet across the country. Over the last five years, Sobeys has invested more than \$2.0 billion in its store network and supporting infrastructure. Today a significant majority of our stores are at a standard we consider current.

Consolidated Operating Earnings (\$ in millions)



Over the last five years, Empire has its grown operating earnings by **more than \$100 million.**



***“Moving forward, we will continue to focus our energy and resources on the businesses we know best – food retailing and related real estate.”***

**Paul D. Sobey**  
President and CEO  
Empire Company Limited

Equally important are the investments Sobeys has made in business process improvements and in the engagement and training of employees. Several years ago, Sobeys began the migration of several legacy information systems to an enterprise wide, integrated SAP platform. This very significant upgrade enabled the implementation of an advanced point-of-sale information system that now serves as the foundation for a growing range of customer information, sales applications and productivity tools. These include Work Force Management, which facilitates better control of the significant cost and service delivery requirements of our business by scheduling our people in closer alignment with customer shopping patterns. Fresh Item Management, another important SAP-enabled productivity tool, allows for better planning, ordering and production of fresh products to reduce waste without compromising quality or consistency. In addition, Computer Automated Ordering, an advanced forecasting system that has improved our ability to manage inventory more precisely to minimize product out-of-stocks, is beginning to roll out across the company.

The standardization of our business systems has also enabled systematic upgrades in our supply chain which have lowered distribution costs while allowing store personnel to spend less time replenishing inventory and more time serving our customers. Our newest distribution centre in Vaughan, Ontario is the latest advancement along a journey of continuous supply chain improvement. The first of its kind in Canada, it incorporates an automated warehouse and picking system that has markedly reduced order selection time, improved selection accuracy and lowered overall distribution costs. We are just beginning to realize the potential of this facility to

assemble and ship tailored assortments on a store-by-store basis, thereby minimizing the need for individual store deliveries by our suppliers.

Another example of Sobeys' continued investment in technology can be found in the Lawtons drugstore division which has successfully implemented Parata Max in its newest location, a next-generation robotic dispensing technology which increases patient safety and decreases customer wait times for prescriptions – the first of its kind in Atlantic Canada. Lawtons also uses robotics for both packaging and content verification to better serve our long-term care customers. These technologies not only enhance efficiency and safety mechanisms, but allow our pharmacy team to provide more consulting and counseling services to our customers.

Over the past several years, Sobeys has begun to shift from mass marketing to a more localized approach that considers the unique characteristics of our customers across Canada. Our business process and systems upgrades will enable the important next stage in this process which is all about customer individualization. Sobeys' industry-leading Customer Insight Solution (“CIS”) is at the heart of our efforts to connect more directly with our customers.

Drawing upon millions of individual customer transactions captured every day through the Club Sobeys, Club Thrifty Foods and AIR MILES® rewards programs, CIS is providing unprecedented insight into the behaviours, motivations and unique shopping occasion requirements of our customers. The combined learning is being used to refine our decision-making processes in marketing, merchandising and throughout the business to create a more intimate, relevant and efficient offering and shopping experience for our customers.



*“Our progress and success thus far in pursuit of our goal to be widely recognized as the best food retailer in the country tells us we are on the right course. We will continue to build a healthy infrastructure to support our long-term sustainable growth.”*

**Bill McEwan**  
President and CEO  
Sobeys Inc.

*“Empire’s real estate strategy has increased its focus on supporting the growth of our food retailing business. Our strategy relies firmly on Sobeys’ substantial in-house expertise in site selection and property development and Crombie REIT’s excellence in property management.”*

**Frank C. Sobey**  
President  
ECL Properties Limited

Sobeys’ customer insight capabilities have also enabled implementation of leading sales productivity tools including Retail Price Optimization and Market Basket Analytics. Retail Price Optimization is an advanced retail modeling and forecasting technology that allows better understanding of the decisions shoppers are making and helps to create a product and pricing mix that will optimize sales and profitability over time. Market Basket Analytics is an associated sales tool that provides the intelligence to more accurately analyze the relationships between items that individual customers place in their shopping baskets and allows improved predictability about what other items they are most likely to purchase. This information is helping our category managers make more informed decisions on product assortment, placement, pricing and promotional activity.

In addition, these new tools and information capabilities have enabled the successful repositioning of our *Compliments* private label program. Re-launched in October 2009 with the benefit of the Club Sobeys, Club Thrifty Foods, and AIR MILES® rewards programs, the support of *Inspired* magazine and distinctive new packaging, our private label

program now more clearly communicates the qualities of Sobeys’ value-oriented, national brand-equivalent and affordable indulgence tiers. The significant enhancements to our *Compliments* and *Sensations* by *Compliments* private label brands as well as the conversion of our value tier to *Signal* are well underway and the response from customers across the country has been extremely positive.

While smart use of new technology is always important, the efforts are not just about providing tools and processes. Equally important is the ability to create a learning culture where employees are afforded the development opportunities to get the job done well, in line with our strategic objectives. There is a powerful winning spirit that has taken root at Sobeys and you can see it in the appearance of our stores, the presentation of our offering, the energy of our employees and most importantly, in the feedback from our customers.

There is no quick or easy path to sustainable success in the food retailing business. Our ongoing success depends on making steady progress along a continuum of change and challenge while prioritizing investments and initiatives, paying attention to details, and executing well and consistently.

We have more work to do in realizing Sobeys' goal of becoming widely recognized as the best food retailer in the country, but our success to date tells us we are well on course.

We are also pleased with the continuing progress of Empire's real estate division. During the past year, wholly-owned ECL Developments Limited worked hand-in-hand with Sobeys' national and regional site selection teams to support the growth of our food retailing operations. In fact, subsequent to year-end, we took this important relationship one step further by internalizing all site selection and development work for our food retailing network within Sobeys itself. During fiscal 2010, eight shopping plazas were completed – representing over 300,000 square feet of gross leasable area. Another 20 properties in our pipeline were in various stages of development at fiscal year-end. Of these properties, 80 percent are anchored by a Sobeys business.

Crombie REIT, in which Empire holds a 47.4 percent interest, has first option on these developments and purchased eight shopping plazas from Empire (75 percent of which are anchored by a Sobeys business) during the fiscal year for net cash proceeds of \$56.7 million. Crombie REIT's operating income contribution to Empire was \$18.6 million in fiscal 2010. We continue to be pleased with Crombie REIT's operating performance during their most recent fiscal year, as they recorded higher total property revenue and occupancy levels remained strong. We were also pleased to see the market price of Crombie REIT units increase by approximately 69 percent in fiscal 2010.

Genstar's operating income contribution to Empire was \$31.0 million compared to \$33.6 million in fiscal 2009. This contribution level was higher than expected, particularly given the weakness in Western Canada's housing market during most of fiscal 2010. Despite being a cyclical business, Genstar has provided attractive returns over time. Since purchasing our initial 35.7 percent stake in Genstar for \$29 million in January 2001, this investment has returned cash to date in excess of \$300 million. During fiscal 2010, we increased our investment interest in Genstar to 40.7 percent from 35.7 percent.

### Investments and other operations

Wholly-owned Empire Theatres continued to generate same-theatre revenue growth in fiscal 2010 thanks to a steady stream of high-quality movie releases and ongoing efforts to improve our customers' entertainment experiences. Attendance was positively affected by the continuing roll-out of digital cinema and RealD 3D, and the growing popularity of 3D movie releases.

Wajax Income Fund reported that their financial performance in calendar 2009 was impacted by reduced economic activity which curtailed demand in the company's mobile equipment, industrial components and power systems businesses. We continue to believe Wajax is well managed and is financially well positioned to take advantage of growth opportunities as the economy continues to recover.

### The promising road ahead

Moving forward, we will continue to focus our energy and resources on the businesses we know best – food retailing and related real estate. Our significant investment in Sobeys is evidence of not only our passion for food retailing but our belief in its potential for growth.

Sobeys' management team has skillfully directed the modernization of its store and distribution networks. They have continued to grow sales and profitability in a very competitive market by engaging employees and providing them the tools they need to deliver better value to the customer. We are very pleased with Sobeys' progress to date and we are confident the best is yet to come.

### A word of thanks

On behalf of our shareholders, management, and our Board, we would like to pay special tribute to John Bragg, who will be retiring from the Board at our September 10, 2010 Annual General Meeting. John's counsel and advice over the past 12 years to our Board, management and the Sobey family, have been invaluable. We are deeply indebted to John for his wise counsel; indeed he has been a mentor to many of us in management and hopefully will continue to be in the future.

As always, the past year's success was made possible through the skill and dedication of our management teams, our franchise partners and affiliates, and the everyday efforts of approximately 90,000 people employed throughout our combined operations. With their support, and the continued loyalty of our suppliers, business partners and investors, I am confident Empire will extend its record of long-term value creation in the years ahead.



**Paul D. Sobey**  
President and CEO  
Empire Company Limited  
June 25, 2010



# An Integrated Strategy for Growth



## Food Retailing

Sobeys owns or franchises more than 1,300 stores located in every province of Canada under retail banners that include Sobeys, IGA *extra*, Thrifty Foods, IGA, Foodland, FreshCo and Price Chopper, as well as Lawtons Drug Stores. Our five core retail formats are designed to ensure that we have the right offering in the right-sized stores for each individual market we serve – from our full-service format to the convenience format, each tailored to satisfy the unique occasion-based needs of our customers.

### Competitive strengths

- Our passionate “best in food” focus supported by our fresh food expertise.
- Our customer focus and superior service delivery.
- Our committed and knowledgeable national, regional and local management teams, franchisees, affiliates and store operators.
- Our investment in innovation including our *Compliments* private label brand.
- Our enhanced supply chain, back shop processes, systems and tools that support our employees' ability to serve the needs of our customers.
- Our industry-leading customer insight capabilities that are helping us build stronger, one-to-one relationships with our customers.

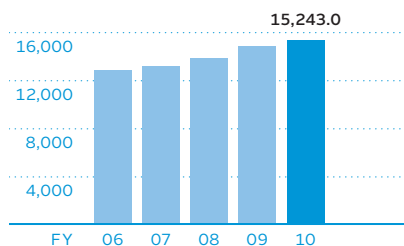
### Strategic priorities

We are determined to be widely recognized as the best food retailer in Canada. Our focus in fiscal 2010 remained on three key imperatives:

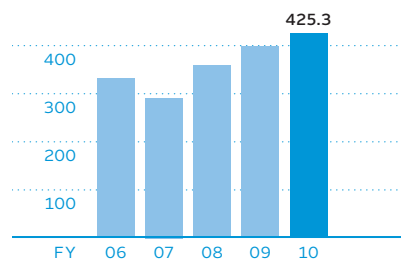
- Continued innovation and differentiation in our product and service offering through our customer insight capabilities.
- Continued improvement in operational execution through the engagement and development of our employees with tools and processes to get the job done well.
- Reducing our cost base and improving sales through the systematic implementation of store and sales productivity initiatives.

### Key performance indicators

**Food Retailing Revenue**  
(\$ in millions)



**Food Retailing Operating Income**  
(\$ in millions)



**1,334** stores  
**28.1** million square feet  
**836** communities







## Real Estate

Empire's real estate business is focused on the 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 which operates principally in communities in Ontario and Western Canada.

### Competitive strengths

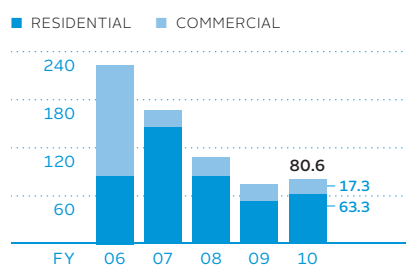
- Our knowledge, experience and management strength in real estate.
- The close working relationship between Sobeys and Crombie REIT optimizes the development of food-anchored shopping plazas across Canada.
- Crombie REIT has the first right to acquire properties from Empire which reduces risk and enhances opportunities for both businesses.
- Through a 40.7 percent interest in Genstar, our residential property operation has attractive land holdings, primarily in Western Canada, and a proven, experienced management team.

### Strategic priorities

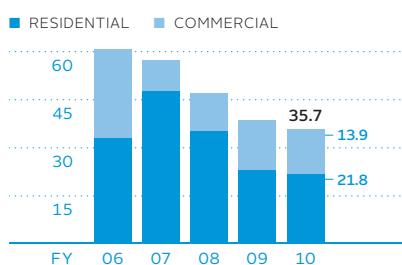
Real estate development at Empire is focused on establishing both certainty and a healthy pace of growth for Sobeys and Crombie REIT. Our strategy relies firmly on Sobeys' substantial in-house expertise in site selection and property development and Crombie REIT's excellence in property management. At all times, we are guided by criteria that exemplify Empire's investment discipline and tradition of building assets to own for the long term.

### Key performance indicators

**Real Estate Revenue<sup>(1)</sup>**  
(\$ in millions)



**Real Estate Funds from Operations<sup>(1)</sup>**  
(\$ in millions)



**Projects in the pipeline**  
20 projects  
1.7 million square feet  
4 provinces



(1) Fiscal 2005-2008 have been restated to exclude Sobeys Leased Properties which was sold on April 22, 2008.







At Sobeys, we know sustainable growth depends on building our business one relationship at a time. We do this through a superior understanding of our customers and by consistently meeting their needs.

Understanding customers was easier before the dawn of modern grocery retail chains. Small shopkeepers knew their customers intimately – what they bought, how much they spent and what mattered most when it came to retaining their business. Such information allowed merchants to confidently source the right products, quickly recognize the impact of merchandizing decisions and earn the continuing loyalty of their best customers.

In our stores – where excellence in fresh service is at the heart of our distinctive banner and brand offerings – the personal touch still makes a big difference. But as our business continues to grow, an intimate understanding of the preferences and expectations of our customers also depends on the disciplined application of new technology. Our superior capability in customer insight is one of the best examples of our progress to date.

Four years ago, we established the technological foundation for customer insight with the migration of most business processes onto a single information system platform. The next order of business was a common point-of-sale transaction system and the subsequent development and roll-out of data collection mechanisms in the form of rewards programs. Since then, Club Sobeys and Club Thrifty Foods rewards programs in Ontario and Western Canada have proved to be enormously popular additions to our AIR MILES® rewards program available in Québec and Atlantic Canada. Today, the majority of our customers earn valued points and rewards every time they shop with us.

While the rewards programs help attract and retain customers, their real benefit lies in the rich transactional information that informs our customer insight activities. Over the past two years, we have worked closely with industry partners to create a proprietary customer insight capability that is the most advanced of its kind in Canadian food retailing. Partnering with us is Clear Cell, a customer intelligence consulting firm that is providing valued expertise and training in the organization and practical application of customer data into strategic action.

Today, every purchase made through our rewards programs is anonymously captured in a virtual information warehouse where sophisticated algorithms sift through raw data to detect generic patterns and segment customer shopping habits into actionable models. While the insights yielded by this process do not dictate actions, they are changing the way we are making decisions, with a powerful new customer lens that allows us to better understand customer needs and behaviour and predict the outcome of our initiatives with a higher degree of confidence. Customer insight has application across a wide range of business functions from product development to merchandizing and almost everything in between.

# Knowing our customers







**We are harnessing the power of new technology to create stronger, more valuable relationships with our customers.**

*The majority of our shoppers belong to the Club Sobeys, Club Thrifty Foods or AIR MILES® programs because they are a great way to earn points that can be spent in-store or redeemed online for valuable rewards. For Sobeys, the millions of transactions that take place through these programs yield unprecedented insight into the needs and motivations of our customers. Such insight is helping to drive our evolution from mass to individual marketing. Our rewards program members receive tailored e-mail offers with store and vendor coupons that have been automatically selected to match their interests.*

Customer insight in action can be most readily seen in our promotional activities where it is facilitating our move from “one-to-many” to “one-to-one” relationships with our customers. While the weekly flyer is still a promotional centrepiece in the Canadian grocery business, we now distribute unique e-mail offers to our rewards program members with store and vendor coupons that are systematically assigned to appeal to their particular interests and requirements. For Sobeys, such customer-specific promotions are a much more effective way to increase basket size, stimulate purchases in relevant categories and respond to competitive developments with greater precision and effectiveness.

Customer insight also plays an increasingly important role in other areas of our business. As a merchandising tool, it is helping category managers better anticipate the impact of pricing and assortment decisions on customer behaviour before we make them. Based on sales volumes alone, for example, we might have once been inclined to de-list

a low-selling product that actually had a high level of engagement with our customers. Customer insight is allowing us to focus more clearly on price and assortment through the eyes of our customers, to better satisfy their needs while optimizing overall sales and profitability.

While customer insight is already a strong core competency and competitive advantage for Sobeys, we have realized only a fraction of its full potential. We will continue to refine our capabilities and extend what we are learning into every facet of our business. We will also continue to share this knowledge with qualified vendors and partners through our Strategic Information Exchange. They are excited by the discoveries we are making and are committing their best resources to help make the most of our opportunities.





“We should...”

“I want...”

“We need...”

“I like...”

Getting to know our customers helps drive growth.

**At Sobeys, there is no such thing as the average customer.**

Understanding the unique needs of individual shoppers and households is critical because it allows us to increase basket size, stimulate purchasing in relevant categories and, most importantly, build customer loyalty. Our superior capabilities in customer insight are helping us realize these objectives.





Sara Reynolds (right), Employee Experience Coordinator/Customer Service Representative, Rymal Road Sobeys, Hamilton, Ontario is a 2010 Sobeys & Empire Future Leader Award recipient.

# People

powering performance



*We continue to invest in the foundation, tools, programs and systems required to help our people managers make the most of Sobeys' greatest competitive advantage.*



Sobeys has earned a proud and enviable reputation as an employer that, for more than 100 years, has recognized that the foundation for our success is in the strength of our people.

But Sobeys is not immune to the shifting workforce and economic dynamics impacting all employers today. We know that providing our people managers with the foundation, tools, programs and systems to manage their teams more effectively than any other retailer is a competitive advantage we cannot ignore.

### Managing talent strategically

Sobeys has made significant investments in tools and programs to better understand and develop our key talent. The introduction of 360-degree employee feedback surveys has helped us develop the competence and leadership capabilities of our department and store managers while driving employee and customer engagement store by store. These surveys have also allowed us to address succession planning more strategically while ensuring a greater focus on people initiatives that will have the greatest impact.

We also continue to invest in several programs to support our talent management strategy, as summarized below.

The Sobeys scholarship program has been redesigned and reintroduced across the organization as the *Sobeys & Empire Work Experience & Scholarship Program*. A key element of the program, which is open to all student employees who attend an accredited university or college, is the Future Leader Award which provides up to \$10,000 over four years to recipients who are selected based on their long-term career fit within the Company as well as their commitment to our organization's core values.

We are also introducing new ways to accelerate the development of our employees who have demonstrated leadership potential. Regional and functional leadership potential programs were rolled out across the company in fiscal 2010. The program was launched in our Atlantic Region where all of the key employees identified have been promoted to new roles or assigned to key projects to accelerate their careers.

Each year Sobeys sends four key individuals to the Consumer Goods Forum's Future Leaders Congress. This global congress is designed to help future leaders develop their potential to become part of senior management, and to enhance their personal contribution to the business.



### Leveraging technology, managing our talent

Sobeys also recognizes the role technology plays in helping our managers make better people decisions and plan for future talent needs.

- Our Applicant Tracking System database, which contains over 100,000 names, allows us to track, access and assess potential new hires based on the core competencies of the role being filled.
- Our Learning Management System (“LMS”) is being rolled out to offer on-going training in a timely and consistent manner. The LMS is a cost effective way to audit, report and deliver training needs to both new and existing employees.
- Our Talent Management System (“TMS”) will provide easy access to talent-related data, helping our managers make better decisions and develop more robust people development and succession plans. The TMS will allow direct and easy access to career and development planning for all employees and managers.

### A holistic approach to talent management

Sobeys leaders review their talent bench strength, succession plans and talent strategy on a regular basis as part of talent forums that are integrated into our annual business planning cycle. This is completed with all key stakeholders in the same room – region by region, function by function and across the country – to leverage Sobeys' entire talent pool.



# Redefining

discount shopping



*FreshCo represents a distinctly different approach to ordinary discount retailing that's all about freshness and value, not what customers have to give up in exchange for low prices.*

We recently launched the FreshCo brand and banner in Ontario. It is the newest concept in discount retailing in North America, where customers can expect everyday low prices without the traditional compromises associated with ordinary discount stores. We are committed to gaining a larger share of this business by delivering a superior and unconventionally fresher and cheaper experience to our customers.

#### Welcome to Discount Done Right



In May 2010, we launched the FreshCo brand and banner in Ontario. It is the newest concept in discount retailing in North America, where customers can expect everyday low prices without the traditional compromises associated with ordinary discount stores.

The first eight stores, located in Brampton and Mississauga, Ontario, are the initial wave in the roll-out of dozens of additional stores over the next 12–18 months.

The culmination of many months of extensive consumer research and careful planning, FreshCo represents a distinctly different approach to ordinary discount retailing. It's all about freshness and value, not what customers have to give up in exchange for low prices.

Our customers are noticing the difference from the moment they walk into stores that are as crisp and fresh as the food on display. The layout is bright and inviting with a compelling produce department that immediately promises a better shopping experience. At FreshCo, the emphasis is on having a limited, fast-turning assortment of the freshest and highest quality produce in the market. It's an approach to everyday low pricing that depends on greater operating efficiencies rather than sourcing lower-cost, lower-quality product. That's why FreshCo customers can always expect the foods they are looking for will be both fresher and cheaper.

Our self-serve meat, deli and bakery departments are similarly designed to eliminate traditional discount trade-offs. These departments keep prices low by minimizing in-store labour costs while offering superior quality and choice. FreshCo features what we believe is an unsurpassed assortment of fresh meat and poultry – sourced from local Ontario farms whenever possible – that includes a two-tiered beef program, air-chilled chicken and premium pork. We also offer more than 100 varieties of cheese, and fresh baked breads and pastries that are delivered to our stores twice a day.

Our fresh approach to discount extends to the grocery aisles where customers can find a streamlined assortment that includes many major national brands, our popular private label products and an impressive range of dietary and health conscious choices as well as targeted multi-cultural offerings that meet the specific needs of individual communities. There are also warehouse “big value” aisles where customers can expect to find even greater savings.

It all adds up to a shopping experience that is unconventionally fresher and cheaper. And it's why we believe FreshCo will deliver a lot more than Ontario consumers have come to expect from ordinary discount shopping over the past two decades.





From our beginnings, Empire and Sobeys have created a legacy of success in commercial real estate development to support the growth of our food retail, drug store and theatre operations. We continue to draw upon this wealth of experience as we expand and improve Sobeys' food retail presence across the country.

Over the past several years, we have assembled some of the best site selection and development people in the business. They have been working closely with our regional retail management teams to support Sobeys as it takes advantage of the most promising opportunities for growth. Last year, this talented group completed the construction and development of eight shopping plazas (six of which were anchored by a Sobeys business) representing over 300,000 square feet of gross leasable area. Empire's real estate team ended the year with another 20 projects in the property development pipeline. Activity for fiscal 2011 is consistent with plans for more than \$100 million in development opportunities, primarily in support of Sobeys' growth. We see attractive opportunities for new retail locations in all regions of the country.

Developing our own real estate assets provides significant long-term benefits including the ability to control the exact location of our stores as well as the quality and mix of the surrounding retail environment. Sobeys' various banners are strong anchors in any shopping plaza development, a fact that allows us to attract and retain

other high quality tenants who can help support mutually beneficial levels of customer traffic. Properly designed and located, food-anchored community shopping plazas represent a reliable sector of the commercial real estate market because they contain merchants whose everyday products and services are always in demand.

The natural buyer for these high quality retail developments is Crombie REIT, in which Empire Company Limited holds a 47.4 percent interest. The unique relationship between Empire, Sobeys and Crombie REIT provides a mutually beneficial and distinct competitive advantage which identifies, develops and delivers access to a steady stream of high-quality property opportunities. Sobeys' food stores are typically the largest tenant in those properties. In fact, Sobeys, an investment grade tenant, accounts for more than 32 percent of annual minimum rent and approximately 3.8 million square feet of gross leasable area in Crombie REIT's portfolio. We intend to continue to grow together as we increase our focus on the development of food-anchored shopping plazas in the years ahead.



We see *attractive opportunities* for new retail locations in *all regions* of the country.



# Supporting our growth



*Developing our own real estate provides the ability to control the exact location of our stores as well as the quality and mix of the surrounding retail environment.*

# A history of value creation

Empire's ability to create value is based on investments in core businesses we understand best – food retailing and related real estate. With a focus on meeting the everyday needs of Canadian consumers, these businesses have helped Empire achieve steady performance over years of economic changes and challenges.



The real estate division purchases a 35.7% interest in Genstar Development Partnership for \$29 million.

Sobeys sells its Serca Foodservice operation to SYSCO for \$411 million.

Sobeys' sales surpass \$10 billion and capital expenditures exceed \$400 million. Real estate operations enjoy another record year.

Sobeys acquires Comisso's Food Markets for \$61 million and the real estate division acquires Comisso's real estate assets for \$42.5 million.

Wajax converts to an income trust. Empire sells 2.875 million units, for a \$25.6 million gain.

Empire Theatres acquires 27 movie theatres for \$83 million.

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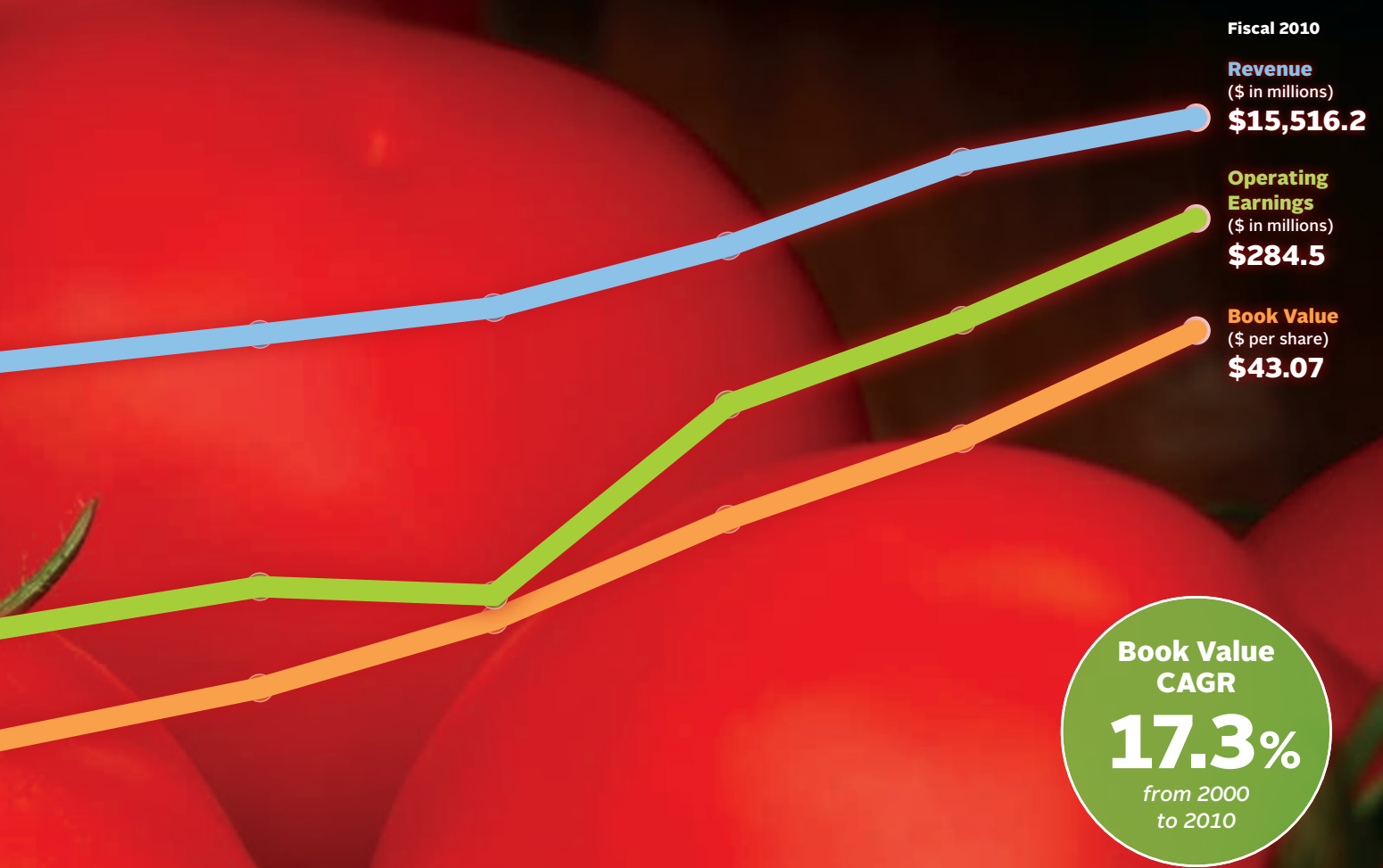
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Crombie REIT completes its initial public offering. Empire sells 44 properties to the REIT for \$468.5 million and retains an initial 48.3% ownership interest.

Sobeys acquires Achille de la Chevrotière Ltée, for \$79.2 million.

Empire acquires the outstanding common shares of Sobeys that it did not own for \$1.06 billion, achieving 100% ownership.

Sobeys acquires Thrifty Foods for \$253.6 million.

Empire sells 61 properties for \$428.5 million to Crombie REIT.

Empire issues 2,713,000 Non-Voting Class A shares at \$49.75 per share for total net proceeds to Empire of approximately \$129 million. Proceeds from this equity issue, coupled with strong cash generation from Sobeys, reduce Empire's ratio of debt to capital to 32.7% from 39.8% at the start of the fiscal year.

Sobeys enjoys another record year and receives credit rating upgrades from Standard & Poor's and DBRS, with both ratings at investment grade. Empire reduces ratio of debt to capital to 29.3% from 32.7% at the start of the fiscal year.

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# Guiding Empire's growth

Our decision to concentrate Empire's resources on food retailing and related real estate continued to pay dividends – literally and figuratively – during one of the most challenging economic periods in memory. Buoyed by a solid operating performance in our core businesses, the Company posted a record financial performance and delivered strong returns for our investors.



The annual dividend payable on shares in Empire Company Limited was increased to \$0.74 in fiscal 2010. In addition, the value of Empire shares climbed 8.1 percent to \$52.98 in the 12 months ending May 1, 2010. Subsequent to fiscal year-end, the Company announced an increase in the annual dividend to \$0.80 per share, representing the 15<sup>th</sup> consecutive annual increase.

Much of our success is the result of the investments we have made to support the expansion and improvement of Sobeys' store and distribution networks, as well as the systems and business process improvements that have been required to realize the company's potential. These investments have really started to pay off as reflected in Sobeys' growing earnings and other performance metrics over the past few years. Equally important, we have continued to reduce our leverage with consolidated net funded debt of \$825 million at the end of fiscal 2010, down from a peak of \$1.75 billion following the privatization of Sobeys and the acquisition of Thrifty Foods in fiscal 2007.

Our progress is a testament to the active stewardship of a talented board of directors. A minority of our directors are Sobeys family representatives who have a distinctly patient and proprietary interest in the business. They are complemented by a majority of independent directors whose diverse skills and experience help foster a challenging and dynamic atmosphere for our deliberations. While the next quarter's results are always important, we firmly believe that good managers thrive best in an environment that gives them the time and latitude to do what's right for the business over the long term. We are also blessed with an outstanding senior management team that knows how to make the most of that opportunity.

This year I would like to pay special tribute to John Bragg, who is retiring from the Board. He has made a significant contribution as a Director of both Empire and Sobeys for the past 12 years. We are deeply indebted to John for his wise counsel to both the Board and our management team.

On behalf of the entire Board, I would also like to extend our sincere appreciation to the thousands of employees throughout Empire's operating companies, together with our franchisees and affiliates. As always, their efforts have been instrumental to our success.

A handwritten signature in black ink that reads "Rob Dexter". The signature is fluid and cursive, with a long horizontal stroke at the end.

**Robert P. Dexter**

Chair

Empire Company Limited

June 25, 2010



## Empire Company Limited Board of Directors

### 1 Robert P. Dexter

Chair  
Halifax, Nova Scotia  
Director since 1987.

### 2 John L. Bragg

Collingwood, Nova Scotia  
Director since 1999.

### 3 Marcel Côté

Montreal, Québec  
Director since 2007.

### 4 Christine Cross

Thundridge, Hertfordshire,  
United Kingdom  
Director since 2007.

### 5 David S. Ferguson

Atlanta, Georgia  
Director since 2007.

### 6 Edward C. Harsant

Woodbridge, Ontario  
Director since 2003.

### 7 David Leslie

Toronto, Ontario  
Director since 2007.

### 8 Bill M'Ewan

New Glasgow, Nova Scotia  
Director since 2007.

### 9 Malen Ng

Toronto, Ontario  
Director since 2007.

### 10 Mel Rhinelander

Toronto, Ontario  
Director since 2007.

### 11 Stephen J. Savidant

Calgary, Alberta  
Director since 2004.

### 12 David F. Sobey

New Glasgow, Nova Scotia  
Director since 1963.

### 13 Donald R. Sobey

Pictou County, Nova Scotia  
Director since 1963.

### 14 Frank C. Sobey

Pictou County, Nova Scotia  
Director since 2007.

### 15 John R. Sobey

Pictou County, Nova Scotia  
Director since 1979.

### 16 Karl R. Sobey

Halifax, Nova Scotia  
Director since 2001.

### 17 Paul D. Sobey

Pictou County, Nova Scotia  
Director since 1993.

### 18 Robert G. C. Sobey

Stellarton, Nova Scotia  
Director since 1998.



# Embracing our responsibilities

*Proudly serving our communities* is more than a statement of what we do at Empire; it reflects one of our most important values. In fiscal 2010, the management, employees, franchisees and affiliates within Empire's operations supported hundreds of charitable causes across Canada at a corporate, regional and personal level.

Our reach is broad, extending to hundreds of Canadian communities from coast to coast. Many of these initiatives are directly related to our businesses, including dozens of health and food-related programs, such as food banks. Here are just a few of the ways we've made a difference over the past year in the communities we serve.

## Feeding the hungry

Our passion for food extends beyond our stores and into the communities in which we operate. Every year we help feed the hungry by raising hundreds of thousands of dollars and donating millions of pounds of food. For example, in 2009, Sobeys stores in Western Canada raised more than \$175,000 for regional food banks through *Hampers of Hope*, an in-store program that encourages our customers to help the less fortunate families in our communities. A similar *Food for Families* program at Thrifty Foods raised more than \$200,000 for 17 food banks in British Columbia.

## Protecting the environment

Sobeys Ontario and Earth Day Canada announced the first grant recipients of the Earth Day Canada Community Environment Fund in November 2009. Twenty-two organizations, ranging from grass roots community groups to local schools, received \$378,000 in funding to support important environmental initiatives.





### Sobeys Art Award 2009 Gala

Empire Board members Donald Sobeys (centre) and Rob Sobeys (fourth from left), with (from left to right) Laura Regan (Gala co-host); Atlantic finalist Graeme Patterson; Prairies & the North finalist Marcel Dzama; David Lee (2008 winner); David Altmejd (2009 winner); Ontario finalist Shary Boyle; West Coast & Yukon finalist Luanne Martineau; and Seamus O'Regan (Gala co-host).

### Seeking cures

Sobeys and its employees are dedicated to improving the quality of life in hundreds of communities. During the past year, we contributed our time and resources in support of the Canadian Cancer Society, the Canadian Breast Cancer Foundation and the Juvenile Diabetes Research Foundation to name a few. We also helped fund important research at some of Canada's leading hospitals. For example, in Québec, IGA stores teamed up with their suppliers to raise \$350,000 during their *Straight to Heart* Campaign in support of the Montreal Heart Institute Foundation.

### Promoting healthier lifestyles

We are also doing our best to help children, youth and athletes reach their full potential through the promotion of healthier lifestyles. This includes Sobeys' partnership in Atlantic Canada with *Breakfast for Learning* – an important school-based nutrition program that helps more than 50,000 kids get off to a better start every day.

### Building better futures

Funding from Sobeys and contributions from the various Sobeys Foundations support several scholarship programs designed to help young people attain the education necessary for their success.

- The *Sobeys & Empire Work Experience & Scholarship Program* awards numerous scholarships each year to our employees across Canada, including the Future Leader Awards which includes financial support and summer internship employment opportunities. In total, these scholarships support over 75 employees with financial awards of more than \$120,000 annually.
- The *D&R Sobeys Scholarship* annually awards \$60,000, over the course of four years' study, to six outstanding students from Atlantic Canada pursuing a commerce degree at Queen's University.

- The *Frank H. Sobeys Award for Excellence in Business Studies* presents six \$10,000 awards to full-time business school students attending schools in Atlantic Canada. Since its inception in 1989, more than \$760,000 has been awarded.

### Celebrating Canada's young artists

The Sobeys Art Award is Canada's premier art award for contemporary young artists. Created in 2002 by the Sobeys Art Foundation and with prize money totaling \$70,000 (\$50,000 to the winner and \$5,000 to each of the four finalists), the Sobeys Art Award was created as a means to showcase Canada's emerging artists and the works they produce. The Sobeys Art Award is organized and administered by the Art Gallery of Nova Scotia.



To learn more about all we are doing to promote the health and well-being of our communities, including our commitment to environmentally sound business practices, please visit us at:

[www.sobeyscorporate.com](http://www.sobeyscorporate.com) – Click on the Social Responsibility tab.  
[www.empireco.ca/en/home/corporateresponsibility/default.aspx](http://www.empireco.ca/en/home/corporateresponsibility/default.aspx)

## Officers of Empire Company Limited



**Robert P. Dexter**  
Chair

**Paul D. Sobey**  
President and  
Chief Executive  
Officer

**Paul V. Beesley**  
Executive  
Vice President  
and Chief  
Financial Officer

**Frank C. Sobey**  
Vice President,  
Real Estate

**Stewart H. Mahoney**  
Vice President,  
Treasury and  
Investor Relations

**Carol A. Campbell**  
Vice President,  
Risk Management

**John G. Morrow**  
Vice President  
and Comptroller

**Karin McCaskill**  
Corporate Secretary

## Officers of Operating Companies

### Sobeys Inc.



**Robert P. Dexter**  
Chair

**Bill McEwan**  
President and  
Chief Executive  
Officer

**François Vimard**  
Chief Financial  
Officer

**Jason Potter**  
President  
Operations,  
Sobeys Atlantic

**Marc Poulin**  
President  
Operations,  
Sobeys Québec

**David Jeffs**  
President  
Operations,  
Sobeys Ontario



**Dennis Folz**  
Chief Human  
Resources Officer

**Belinda Youngs**  
Chief Marketing  
Officer

**Karin McCaskill**  
Senior  
Vice President,  
General Counsel  
and Secretary

**Paul A. Jewer**  
Senior  
Vice President,  
Finance and  
Treasurer

**L. Jane McDow**  
Assistant Secretary

### ECL Properties Limited



**Frank C. Sobey**  
President



**Stuart G. Fraser**  
President and  
Chief Executive  
Officer

**Paul W. Wigginton**  
Vice President,  
Finance and Chief  
Financial Officer



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The following Management's Discussion and Analysis ("MD&A") contains commentary from management on the consolidated financial condition and results of operations of Empire Company Limited ("Empire" or the "Company") for the 52 weeks ended May 1, 2010, compared to the 52 weeks ended May 2, 2009. Management also provides an explanation of the Company's fourth quarter results, changes in accounting policies, critical accounting estimates and factors that the Company believes may affect its prospective financial condition, cash flows and results of operations. This MD&A also provides analysis of the operating performance of the Company's divisions as well as a discussion of cash flows, the impact of risks and the outlook for the business. Additional information about the Company, including the Company's Annual Information Form, can be found on SEDAR at [www.sedar.com](http://www.sedar.com).

This discussion and analysis is the responsibility of management. The Board of Directors carries out its responsibility

## 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. Expressions 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 are generally indicative of forward-looking statements.

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 operations as at and for the periods ended on the dates presented and the Company's strategic priorities and objectives and may not be appropriate for other purposes. By its very nature, forward-looking information requires the Company to make assumptions and is subject to inherent risks and uncertainties which give rise to the possibility that the Company's predictions, forecasts, expectations or conclusions will not prove to be accurate, that the Company's assumptions may not be correct and that the Company's objectives, strategic goals and priorities will not be achieved. Although the Company believes that the predictions, forecasts, expectations or conclusions reflected in the forward-looking information are reasonable, it can give no assurance

for review of this disclosure principally through its Audit Committee, comprised exclusively of independent directors. The Audit Committee has reviewed and approved this disclosure and it has also been approved by the Board of Directors.

This discussion and analysis should be read in conjunction with the audited annual consolidated financial statements of the Company and the accompanying notes for the 52 weeks ended May 1, 2010, compared to the 52 weeks ended May 2, 2009. The consolidated financial statements and accompanying notes have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and are reported in Canadian dollars.

These consolidated financial statements include the accounts of Empire and its subsidiaries and variable interest entities ("VIEs") which the Company is required to consolidate. The information contained in this MD&A is current to June 25, 2010, unless otherwise noted.

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 its results. Readers are urged to consider the risks, uncertainties and assumptions carefully in evaluating the forward-looking information and are cautioned not to place undue reliance on such forward-looking information. Forward-looking statements 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 June 25, 2010, and is subject to change after this date. The Company does not undertake to update any forward-looking statements that may be made from time to time by or on behalf of the Company other than as required by applicable securities laws.

These forward looking statements include the following items:

- The Company's belief that it has sufficient unused capacity under its credit facilities to satisfy its financial obligations as they come due and its expectation that there will not be a material adverse impact on its business as a result of the global disruption in the market for third-party asset-backed commercial paper ("ABCP") liquidity, both of which could be impacted by the challenging economic environment;
- The Company's expectation that its operational and capital structure are sufficient to meet its ongoing business requirements in the current economic environment in Canada;
- The Company's belief 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, and its belief that it has sufficient funding in place to meet these requirements and other long-term obligations, all of which could be impacted by uncertainty in the economy;
- The Company's anticipation that its in place sources of liquidity will adequately meet its short-term and long-term financial requirements which may be impacted by uncertainty in the economy;
- The Company's expectation regarding the purchase of additional Series 2 Preferred Shares for cancellation by the end of calendar 2010 could be impacted by market conditions and availability of sellers;
- The Company's expectations relating to pending tax matters with Canada Revenue Agency ("CRA"), which could be determined differently by CRA. This could cause the Company's effective tax rate and its earnings to be affected positively or negatively in the period the matter is resolved;
- Sobeys' expectations that the new distribution centre opened in Vaughan, Ontario will continue to reduce overall distribution costs;
- Sobeys' expectations that administrative and business rationalization activities as well as system process initiatives in prior years and upcoming quarters will reduce costs as expected and will provide, thereafter, annualized cost reductions, both of which could be impacted by the final scope and scale of these activities;
- The Company's expected contributions to its registered defined benefit plans, which could be impacted by fluctuations in asset values due to market uncertainties;
- The Company's expected use and estimated fair values of financial instruments which could be impacted by, among other things, changes in interest rates, foreign exchange rates and commodity prices;
- Sobeys' expectations of continued sales growth in fiscal 2011;
- Sobeys' expectation that there will be no material labour disruptions in fiscal 2011;
- The Company's expectations relating to the impact of the transition to International Financial Reporting Standards ("IFRS"), which is subject to ongoing assessment by the Company;
- The Company's expectations relating to the sale of 11 properties to Crombie REIT pursuant to a non-binding letter of intent between Sobeys and Crombie REIT announced on July 8, 2010;
- The Company's expectations relating to the public offering of units by Crombie REIT and the concurrent issue of limited partnership units of Crombie Limited Partnership to ECL Developments Limited, all of which is subject to conditions of closing, including regulatory approval; and
- The Company's expectation that existing environmental protection requirements will not have a material financial or operational effect on capital expenditures, earnings or competitive position of Empire during the current fiscal year or in future years.

## Empire's Strategic Direction

Management's primary objective is to maximize the long-term sustainable value of Empire through enhancing the worth of the Company's net assets and in turn, having that value reflected in Empire's share price. This is accomplished through direct ownership and equity participation in businesses that management knows and understands and believes have the potential for long-term growth and profitability, specifically food retailing, real estate and corporate investments.

The Company continues to focus on its core strengths in food retailing and related real estate by continuing to direct its energy and capital towards growing long-term sustainable value through cash flow and income growth. While our core businesses are well established and profitable in their own right, they also offer Empire geographical diversification across Canada which is considered by management to be an additional source of strength.

Together, our core businesses reduce risk and volatility, thereby contributing to greater consistency in consolidated earnings growth over the long-term. Going forward, the Company intends to continue to direct its resources towards the most promising opportunities within these core businesses in order to maximize long-term shareholder value.

In carrying out the Company's strategic direction, Empire's management defines its role as having four fundamental responsibilities: first, to support the development and execution of sound strategic plans for each of its operating companies; second, to regularly monitor the development and the execution of business plans within each operating company; third, to ensure that Empire is well governed as a public company; and fourth, to prudently manage its capital in order to augment the growth in its core operating businesses.



## Overview

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 at fiscal year end on May 1, 2010 included a wholly-owned subsidiary ECL Developments Limited ("ECL Developments"), as well as a 40.7 percent ownership interest in Genstar Development Partnership and a 44.8 percent interest in Genstar Development II Partnership (collectively referred to as "Genstar") and a 47.4 percent ownership interest in 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"), a leading Canadian distributor and service support provider of mobile equipment, industrial components and power systems.

With over \$15 billion in annual revenue and approximately \$6.2 billion in assets, Empire and its related companies employ over 90,000 people, including franchisees and affiliates.

### Food Retailing

Sobeys, a wholly-owned subsidiary, conducts business through more than 1,300 retail stores (corporately owned and franchised) which operate in all 10 provinces 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' seven major banners: Sobeys, IGA *extra*, Thrifty Foods, IGA, Foodland, FreshCo and Price Chopper are the primary focus of these format development efforts.

During the year, Sobeys opened, replaced, expanded, redeveloped, acquired and/or converted the banners in 76 stores (2009 – 74). In fiscal 2010, Sobeys continued to execute a number of programs in support of its food-focused strategy including product and service innovations, productivity initiatives and business process, supply chain and system upgrades.

One example of these initiatives is the opening of eight FreshCo discount stores in Ontario at the beginning of fiscal 2011. These FreshCo discount stores are designed to offer low prices without compromising service which would typically be

experienced at discount grocery retailers. FreshCo shoppers enjoy fresh merchandise at low prices and an expanded selection of meats and produce, including high quality choices and seasonal, locally-produced products. During the fourth quarter of fiscal 2010, Sobeys incurred approximately \$5.0 million in start up costs and fixed asset write-offs related to this initiative.

### Real Estate

Empire's real estate operations are primarily focused on (i) the ownership of retail and office properties through an ownership interest in Crombie REIT, and (ii) residential land development through an ownership interest in Genstar, which operates principally in communities in Ontario and Western Canada.

### Investments and Other Operations

The third component of Empire's business is its investments and other operations, consisting primarily of a 27.6 percent ownership interest in Wajax, wholly-owned Empire Theatres and Kepec.

The market value of Empire's equity accounted investment in Wajax at the end of fiscal 2010 was \$117.9 million (2009 – \$71.3 million), representing an unrealized gain of \$87.1 million (2009 – \$40.3 million).

Other operations include Empire Theatres and Kepec. Empire Theatres is the second largest movie exhibitor in Canada which, as of May 1, 2010, owned 51 locations representing 380 screens.

## FISCAL 2010 FINANCIAL HIGHLIGHTS

### Highlights

- Revenue of \$15.52 billion, up \$501.1 million or 3.3 percent.
- Sobeys' same-store sales increased 1.9 percent.
- Earnings before capital gains (losses) and other items of \$284.5 million, up \$22.8 million or 8.7 percent.
- Net earnings of \$301.9 million (\$4.40 per share), a \$37.2 million or 14.1 percent increase.
- Sobeys opened, acquired or replaced 41 corporate and franchised stores, opened its new automated Vaughan distribution centre, expanded 13 stores, rebannered/redeveloped 22 stores and closed 52 stores.
- Sobeys' free cash flow of \$340.7 million versus \$280.9 million last year.
- Funded debt to total capital of 29.3 percent, down 3.4 percentage points from the 32.7 percent recorded at the end of last fiscal year.
- Net debt to net total capital of 21.8 percent versus 28.6 percent at the end of fiscal 2009.
- Annual dividend per Non-Voting Class A share and Class B common share increased to \$0.74 from \$0.70 last year.

The consolidated financial overview provided below reports on the financial performance for fiscal 2010 relative to the last two fiscal years.

### Summary Table of Consolidated Financial Results

(\$ in millions, except per share information)	52 Weeks Ended					
	May 1, 2010	% of Revenue	May 2, 2009 <sup>(1)</sup>	% of Revenue	May 3, 2008 <sup>(1)</sup>	% of Revenue
Revenue	\$ 15,516.2	100.00%	\$ 15,015.1	100.00%	\$ 14,065.0	100.00%
Operating income	479.7	3.09%	466.2	3.10%	472.6	3.36%
Operating earnings	284.5	1.83%	261.7	1.74%	242.8	1.73%
Capital gains (losses) and other items, net of tax	17.4	0.11%	3.0	0.02%	73.0	0.52%
Net earnings	\$ 301.9	1.95%	\$ 264.7	1.76%	\$ 315.8	2.25%
<b>Basic earnings per share</b>						
Operating earnings	\$ 4.16		\$ 3.98		\$ 3.69	
Capital gains (losses) and other items, net of tax	0.25		0.05		1.11	
Net earnings	\$ 4.41		\$ 4.03		\$ 4.80	
Basic weighted average number of shares outstanding (in millions) <sup>(2)</sup>	68.4		65.7		65.6	
<b>Diluted earnings per share</b>						
Operating earnings	\$ 4.15		\$ 3.97		\$ 3.69	
Capital gains (losses) and other items, net of tax	0.25		0.05		1.11	
Net earnings	\$ 4.40		\$ 4.02		\$ 4.80	
Diluted weighted average number of shares outstanding (in millions) <sup>(2)</sup>	68.5		65.8		65.7	
Dividends per share	\$ 0.74		\$ 0.70		\$ 0.66	

(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 "Changes in Accounting Policies" in this MD&A.

(2) The increase in the weighted average number of shares outstanding reflects an equity issue completed on April 24, 2009 which resulted in a total of 2,713,000 shares being issued.

## OUTLOOK

Management's primary objective will continue to be to maximize the long-term sustainable value of Empire through enhancing the worth of the Company's net assets and in turn, having that value reflected in Empire's share price.

Management is clearly focused on directing its energy and capital towards growing the long-term sustainable value of its food retailing, real estate and related businesses. In doing so, we remain committed to: a) supporting Sobeys in its goal to be widely recognized as the best food retailer in Canada; b) the profitable growth of our real estate business as it develops new properties that are congruent with growing our food retailing business and which upon completion will be offered for sale to Crombie REIT; and c) capitalizing on opportunities afforded as a result of the

existing strong relationships between our food retailing and real estate businesses.

Finally, we remain committed to continued strengthening of our financial condition through the prudent management of working capital and free cash flow in each operating company.

### Food Retailing Division

Sobeys will continue to invest in infrastructure and productivity improvements in a manner consistent with the expressed intention to build a healthy and sustainable retail business and infrastructure for the long term. This includes continuing to build a strong management team and progressing on the transformation process while improving the customers' in-store experience and our productivity.

Sobeys also plans to focus on its workforce management and in-store programs in fiscal 2011 that will further improve store productivity. These key customer driven initiatives will assist Sobeys' retail store network in delivering the best food shopping experience, building on the strong foundation that has already been put in place.

### Real Estate Division

With respect to residential real estate, Empire remains committed to its investment in Genstar and is very supportive of its management and strategy. Genstar, in our view, continues to be well capitalized and, with a very capable management team, is favourably positioned to take advantage of new profitable growth opportunities. Genstar continues to seek out compelling acquisition opportunities in select regional markets. We will continue to maintain representation on the Genstar Board.

With regard to the commercial real estate, subsequent to fiscal year end, our internal property development function was reorganized under Sobeys, with Sobeys acquiring 12 properties from ECL Properties. This reorganization will better align our real estate development function with the interest of Sobeys and help to streamline operations. As a result of this transfer, our commercial real estate operations consist largely of our 47.4 percent interest in Crombie REIT.

### SHAREHOLDER RETURN

The Company delivered a total shareholder return of 9.9 percent in fiscal 2010 as shown in the table below. The compound annual return on the Company's shares over the past five years has averaged 9.3 percent and over the past ten years has averaged 14.0 percent. This exceeded the compound annual return of the S&P/TSX Composite Index over the past five and ten years of 7.9 percent and 5.0 percent, respectively.

Empire's real estate business continues to benefit from Sobeys' substantial in-house expertise in selecting commercial locations and its development expertise gained from the recent transfer of ECL Development's team to Sobeys and from Crombie REIT which has decades of property management expertise.

As a result of our combined real estate knowledge and expertise, we are confident in our ability to steer our investment capital to locations with the greatest opportunity for economic profit and in doing so will adhere to a set of disciplined investment criteria.

In summary, management is confident that the strength of Sobeys' relationship with Crombie REIT, combined with our strict investment discipline, will prove to be a sustainable competitive advantage and contribute to the enhancement of Empire's shareholder value.

### Investments and Other Operations

With respect to Wajax, it is our view that Wajax continues to be well capitalized and, with a very capable management team, is favourably positioned to capitalize on new profitable growth opportunities.

In fiscal 2010, the Company increased its dividend by 5.7 percent to \$0.74 per share. On June 25, 2010, the Board approved a further dividend increase of 8.1 percent to \$0.80 per share. This was the 15<sup>th</sup> consecutive year of dividend increases. Empire's dividends are declared quarterly at the discretion of the Board.

For the fiscal years ended:	May 1, 2010	May 2, 2009	May 3, 2008	May 5, 2007	May 6, 2006	5 Year CAGR <sup>(1)</sup>
Closing market price per share (\$)	<b>52.98</b>	49.00	39.25	42.33	43.29	7.6%
Dividend paid (\$ per share)	<b>0.74</b>	0.70	0.66	0.60	0.56	9.0%
Dividend yield on prior year closing price (%)	<b>1.5%</b>	1.8%	1.6%	1.4%	1.5%	
Increase (decrease) in share price (%)	<b>8.1%</b>	24.8%	(7.3%)	(2.2%)	18.1%	
Total annual shareholder return (%) <sup>(2)</sup>	<b>9.9%</b>	26.8%	(5.9%)	(0.8%)	19.8%	9.3%

(1) Compound annual growth rate.

(2) Total annual shareholder return assumes reinvestment of quarterly dividends, and therefore may not equal the sum of dividend and share price returns in the table.



## NON-GAAP FINANCIAL MEASURES

There are measures included in this MD&A that do not have a standardized meaning under GAAP and therefore may not be comparable to similarly titled measures presented by other publicly traded companies. 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 (losses) and other items.
- Return on equity is calculated as net earnings payable for common shareholders divided by average common shareholders' equity for the reporting period.
- 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.
- Net debt is calculated as funded debt less cash and cash equivalents.
- Total capital is calculated as funded debt plus shareholders' equity.
- Net total capital is total capital less cash and cash equivalents.
- 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 tables reconcile Empire's funded debt and total capital to GAAP measures reported on the balance sheets as at May 1, 2010, May 2, 2009 and May 3, 2008.

(\$ in millions)	May 1, 2010	May 2, 2009 <sup>(1)</sup>	May 3, 2008 <sup>(1)</sup>
Bank indebtedness	\$ 17.8	\$ 45.9	\$ 92.6
Long-term debt due within one year	379.4	133.0	60.4
Liabilities relating to assets held for sale	–	–	6.4
Long-term debt	829.0	1,124.0	1,414.1
Funded debt	1,226.2	1,302.9	1,573.5
Less: cash and cash equivalents	(401.0)	(231.6)	(191.4)
Net funded debt	825.2	1,071.3	1,382.1
Shareholders' equity	2,952.4	2,678.8	2,378.8
Net total capital	\$ 3,777.6	\$ 3,750.1	\$ 3,760.9

(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 "Changes in Accounting Policies" in this MD&A.

(\$ in millions)	May 1, 2010	May 2, 2009 <sup>(1)</sup>	May 3, 2008 <sup>(1)</sup>
Funded debt	1,226.2	1,302.9	1,573.5
Total shareholders' equity	2,952.4	2,678.8	2,378.8
Total capital	\$ 4,178.6	\$ 3,981.7	\$ 3,952.3

(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 "Changes in Accounting Policies" in this MD&A.

## Management's Explanation of Fiscal 2010 Annual Consolidated Results

The following is a review of Empire's consolidated financial performance for the 52-week period ended May 1, 2010 compared to May 2, 2009.

Revenue and financial performance of each of the Company's businesses (food retailing, real estate and investments and other operations) are discussed in detail in the section entitled "Fiscal 2010 Financial Performance by Division" in this MD&A.

### REVENUE

Consolidated revenue for fiscal 2010 was \$15.52 billion, an increase of \$501.1 million or 3.3 percent compared to fiscal 2009. Sobeys' sales increased by \$478.2 million, real estate division revenue increased by \$6.7 million and revenue from investments and other operations increased by \$22.9 million over the prior fiscal year.

Please refer to the section entitled "Fiscal 2010 Financial Performance by Division" for an explanation of the change in revenue by division.

### OPERATING INCOME

For the full fiscal year, Empire recorded operating income of \$479.7 million, an increase of \$13.5 million or 2.9 percent from the prior year.

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

- Sobeys' operating income contribution to Empire in fiscal 2010 totalled \$425.3 million, an increase of \$25.8 million or 6.5 percent from the \$399.5 million recorded last year.
- Residential property operating income contribution in fiscal 2010 was \$31.0 million, a decrease of \$2.6 million from the \$33.6 million recorded last year.
- Commercial property (including Crombie REIT) operating income in fiscal 2010 was \$19.8 million compared to \$22.3 million last year, a decrease of \$2.5 million. Crombie REIT contributed \$18.6 million to operating income in fiscal 2010 versus a \$19.8 million contribution last year.

- Investments and other operations (net of corporate expenses) contributed operating income of \$3.6 million in fiscal 2010 compared to \$10.8 million last fiscal year. Equity accounted earnings generated from the Company's 27.6 percent interest in Wajax was \$9.2 million versus \$18.5 million last year. Operating income from other operations (net of corporate expenses) amounted to \$(5.6) million compared to \$(7.7) million last year.

Please refer to the section entitled "Fiscal 2010 Financial Performance by Division" for an explanation of the change in operating income for each division.

### INTEREST EXPENSE

For the 52 weeks ended May 1, 2010, consolidated interest expense equalled \$72.5 million versus \$80.6 million in the prior year. The \$8.1 million decrease in fiscal 2010 interest expense compared to last fiscal year is primarily due to lower funded debt levels which are principally related to free cash flow generation by Sobeys and Empire's \$135 million equity issuance which was completed on April 24, 2009. This equity issue did reduce Empire's funded debt levels prior to the end of fiscal 2009; however, it had little impact on reducing interest expense in fiscal 2009 due to the issuance occurring only eight days prior to fiscal year-end.

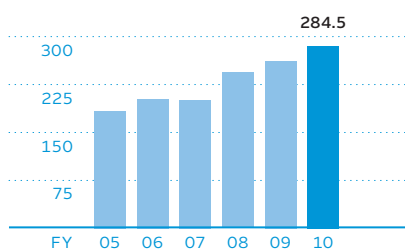
Consolidated funded debt was \$1,226.2 million at the end of fiscal 2010 compared to \$1,302.9 million at the end of fiscal 2009, a \$76.7 million or 5.9 percent decrease.

### INCOME TAXES

The effective tax rate for the year ended May 1, 2010 of 24.4 percent differs from the combined statutory rate of 30.9 percent due primarily to the settlement negotiated with CRA relating to the tax treatment of gains realized on the fiscal 2001 sale of shares in Hannaford Bros. Co. Income tax expense was reduced in the first quarter by \$17.0 as a result of this settlement. Excluding the impact of capital gains (losses) and other items, the effective income tax rate for fiscal 2010 was 28.8 percent versus 30.0 percent last year.

During fiscal 2010, there was a \$4.7 million reduction in the net future tax liabilities and income tax expense as a result of the substantive enactment of Ontario's 2009 budget announcement in November 2009. The budget provides for incremental reductions in the Ontario corporate income tax rate from the current rate of 14 percent to 10 percent between July 1, 2010 and July 1, 2013. In the absence of this substantively enacted incremental rate reduction, Empire's effective tax rate for fiscal 2010 (excluding the impact of capital gains (losses) and other items) would have been 29.9 percent.

**Consolidated Operating Earnings**  
(\$ in millions)



## EARNINGS BEFORE CAPITAL GAINS (LOSSES) AND OTHER ITEMS

For the 52 weeks ended May 1, 2010, earnings before capital gains (losses) and other items amounted to \$284.5 million (\$4.15 per share) compared to \$261.7 million (\$3.97 per share) in the prior fiscal year. The \$22.8 million or 8.7 percent

increase is the result of the \$13.5 million increase in operating income, the \$8.1 million decrease in interest expense, and the \$2.7 million decrease in minority interest, partially offset by a \$1.5 million increase in income taxes.

The table below presents Empire's segmented earnings before capital gains (losses) and items by division for the 52 weeks ended May 1, 2010, compared to the 52 weeks ended May 2, 2009.

(\$ in millions)	52 Weeks Ended			
	May 1, 2010	May 2, 2009 <sup>(1)</sup>	(\$ Change	(%) Change
Food retailing <sup>(2)</sup>	\$ 256.1	\$ 227.9	\$ 28.2	12.4%
Real estate	34.4	36.7	(2.3)	(6.3%)
Investments & other operations	(6.0)	(2.9)	(3.1)	(106.9%)
Consolidated	\$ 284.5	\$ 261.7	\$ 22.8	8.7%

(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 "Changes in Accounting Policies" in this MD&A.

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

## CAPITAL GAINS (LOSSES) AND OTHER ITEMS

In fiscal 2010, the Company recorded capital gains (losses) and other items, net of tax, of \$17.4 million compared to \$3.0 million last year. Capital gains (losses) and other items, net of tax, in fiscal 2010 was primarily the result of a \$17.0 million tax settlement related to the fiscal 2001 sale of shares in Hannaford Bros. Co. and a \$2.9 million positive fair value adjustment on ABCP, partially offset by Empire recording

\$3.1 million for its equity share of an interest rate swap agreement which was settled by Crombie REIT during Empire's fiscal year. Capital gains (losses) and other items, net of tax, in fiscal 2009 were largely the result of the sale of non-core properties for gains of \$6.9 million, net of tax, offset by an increase in the provision on ABCP equal to \$3.1 million, net of tax.

The table below presents capital gains (losses) and other items, net of tax, for the 52 weeks ended May 1, 2010, compared to the 52 weeks ended May 2, 2009.

(\$ in millions)	52 Weeks Ended		
	May 1, 2010	May 2, 2009	(\$ Change
Equity share of Crombie REIT's other expenses	\$ (3.1)	\$ -	\$ (3.1)
Increase (decrease) in fair value of Canadian third-party asset-backed commercial paper	2.9	(3.1)	6.0
Gain (loss) on sale of investments	(0.2)	-	(0.2)
Gain (loss) on sale of properties	0.1	6.9	(6.8)
Foreign exchange gains (losses)	0.7	(0.8)	1.5
Tax recovery related to sale of shares in Hannaford Bros. Co.	17.0	-	17.0
	\$ 17.4	\$ 3.0	\$ 14.4



## NET EARNINGS

Net earnings for the 52 weeks ended May 1, 2010 totalled \$301.9 million (\$4.40 per share) compared to \$264.7 million (\$4.02 per share) recorded last fiscal year, an increase of \$37.2 million or 14.1 percent. The increase in net earnings in

fiscal 2010 over the prior year reflects the increase in earnings before capital gains (losses) and other items of \$22.8 million and the increase in capital gains (losses) and other items of \$14.4 million, as previously discussed.

(\$ in millions)	52 Weeks Ended			
	May 1, 2010	May 2, 2009 <sup>(1)</sup>	(\$ Change	(%) Change
Food retailing <sup>(2)</sup>	\$ 259.0	\$ 224.8	\$ 34.2	15.2%
Real estate	31.3	42.6	(11.3)	(26.5%)
Investments & other operations	11.6	(2.7)	14.3	529.6%
Consolidated	\$ 301.9	\$ 264.7	\$ 37.2	14.1%

(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 "Changes in Accounting Policies" in this MD&A.

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

## Fiscal 2010 Financial Performance by Division

### FOOD RETAILING

#### Highlights

- Fiscal 2010 sales growth of \$478.2 million or 3.2 percent and same-store sales growth of 1.9 percent.
- Operating cash flow of \$682.1 million versus \$635.0 million in fiscal 2009.
- Total capital expenditures equalled \$341.4 million in fiscal 2010, down \$12.7 million from fiscal 2009.
- Free cash flow of \$340.7 million versus \$280.9 million in fiscal 2009.
- Opened, acquired or replaced 41 corporate and franchised stores, opened a new automated distribution centre in Vaughan, Ontario, expanded 13 stores, rebannered/redeveloped 22 stores and closed 52 stores.
- Funded debt to total capital improved to 27.1 percent at the end of fiscal 2010 compared to the 31.3 percent reported at the end of fiscal 2009.

To assess its financial performance and condition, Sobeys' management monitors a set of financial measures, which evaluate sales growth, profitability and financial condition. The primary financial performance and condition measures for Sobeys are set out below.

	52 Weeks Ended		
	May 1, 2010	May 2, 2009 <sup>(1)</sup>	May 3, 2008 <sup>(1)</sup>
Sales growth	3.2%	7.2%	5.6%
Same-store sales growth	1.9%	5.2%	2.8%
Return on equity	11.9%	11.3%	10.0%
Funded debt to total capital	27.1%	31.3%	35.6%
Funded debt to EBITDA	1.2x	1.3x	1.7x
Property and equipment purchases (in millions)	\$ 341	\$ 354	\$ 479

(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 "Changes in Accounting Policies" in this MD&A.

The table below presents Sobeys' contribution to Empire's consolidated revenue, operating income, capital gains (losses) and other items, net of tax, and net earnings.

(\$ in millions)	52 Weeks Ended		Year-over-Year	
	May 1, 2010	May 2, 2009 <sup>(1)</sup>	(\$ Change)	(%) Change
Sales	\$ 15,243.0	\$ 14,764.8	\$ 478.2	3.2%
Operating income <sup>(2)</sup>	425.3	399.5	25.8	6.5%
Capital gains (losses) and other items, net of tax	2.9	(3.1)	6.0	193.5%
Net earnings <sup>(2)</sup>	259.0	224.8	\$ 34.2	15.2%

(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 "Changes in Accounting Policies" in this MD&A.

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

## Sales

In fiscal 2010, Sobeys achieved sales of \$15.2 billion, an increase of \$478.2 million or 3.2 percent over fiscal 2009. During the fiscal year, same-store sales increased by 1.9 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 store level execution and product and service innovation.

Sobeys expects sales growth to continue in fiscal 2011 as a result of continued capital investment in its retail store network and offering, merchandising, pricing and operational execution improvements across the country.

Total store square footage increased by 2.2 percent in fiscal 2010 as a result of the opening of 41 new or replacement stores and the expansion of 13 stores. There were 52 stores closed in fiscal 2010.

## Business Process and Information Systems Transformation and Rationalization Costs

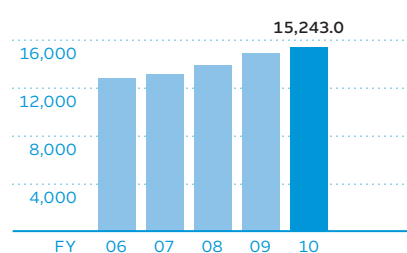
Sobeys continues to make significant progress in the implementation of system-wide business process optimization and rationalization initiatives that are designed to reduce complexity and improve processes and efficiency throughout Sobeys. These system-wide business process and rationalization initiatives support all aspects of the business including operations, merchandising, distribution, human resources and administration. They are an important enabler of further initiatives such as the new distribution facility in Ontario.

Sobeys completed this implementation 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.

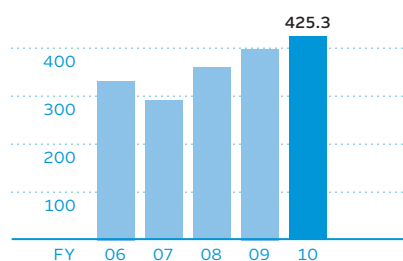
The business process and information systems implementation began in Québec in the first quarter of fiscal 2010. The business process and system initiative costs primarily include labour, implementation and training costs associated with these initiatives. During the 52-week period ended May 1, 2010, \$11.3 million (2009 – \$nil) of pre-tax costs were incurred related to these initiatives.

The new distribution centre, in Vaughan, Ontario, utilizes automation technology and equipment which has significantly increased Sobeys' warehouse and distribution capacity and is expected to reduce overall distribution costs while improving service to its store network and customers. During fiscal 2010, Sobeys recognized \$nil (2009 – \$6.9 million) in severance costs related to the development of this automated facility. Amounts in fiscal 2009 also 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 incurred in fiscal 2009. In the second quarter of fiscal 2010, the distribution centre became fully operational and continues to meet expectations.

**Food Retailing Revenue**  
(\$ in millions)



**Food Retailing Operating Income**  
(\$ in millions)



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 fiscal 2010 (2009 – \$3.8 million).

### Operating Income

For the 52 weeks ended May 1, 2010, Sobeys reported operating income of \$430.8 million, a \$26.6 million or 6.6 percent increase from the prior fiscal year. Operating income margin for fiscal 2010 equalled 2.83 percent compared to 2.74 percent in fiscal 2009. Included in Sobeys' operating income in fiscal 2010 was approximately \$5.0 million in costs related to the launch of the FreshCo discount banner and the rebanner of eight stores in Mississauga and Brampton, Ontario.

After adjusting for the impact of the depreciation and amortization related to the privatization, Sobeys' operating income contribution to Empire for fiscal 2010 was \$425.3 million (2009 – \$399.5 million). Sobeys' operating income margin for fiscal 2010, after adjusting for the above items, equalled 2.79 percent compared to 2.71 percent in fiscal 2009.

Sobeys will continue to focus on disciplined cost management initiatives, supply chain and retail productivity improvements and migration of best practices across its four regions to continue to fuel and fund investments to drive sales and improve margins over time.

## REAL ESTATE

### Highlights

- Increased ownership interest in Genstar Development Partnership from 35.7 percent to 40.7 percent and in Genstar Development II Partnership from 43.4 percent to 44.8 percent.
- Acquired an additional \$30.0 million in Crombie REIT Class B units along with \$10.0 million in Crombie REIT convertible unsecured subordinated debentures.
- Completed the sale of eight properties to Crombie REIT.
- Operating income from Crombie REIT of \$18.6 million versus \$19.8 million last year.
- Market price of Crombie REIT units increased approximately 69 percent in fiscal 2010.
- Operating income from Genstar of \$31.0 million compared to \$33.6 million in fiscal 2009.

Real estate management assesses its financial performance and condition through monitoring of key financial measures. The primary financial performance and condition measures are set out below.

	52 Weeks Ended		
	May 1, 2010	May 2, 2009	May 3, 2008
Funds from operations (\$ in millions)	\$ 35.7	\$ 38.5	\$ 64.3
Return on equity	12.1%	17.8%	17.7%
Funded debt to total capital	15.0%	25.6%	22.4%
Development pipeline (in millions of square feet)	1.7	1.7	1.2

### Net Earnings

Sobeys reported net earnings of \$262.8 million in fiscal 2010 compared to \$228.0 million last year, a \$34.8 million or 15.3 percent increase. The earnings increase is largely a result of the \$26.6 million increase in operating income and an increase in capital gains (losses) and other items, net of tax, of \$6.0 million. Sobeys reported operating earnings, which excludes the changes to the fair value of ABCP, of \$259.9 million, an increase of \$28.8 million or 12.5 percent from the \$231.1 million recorded in fiscal 2009. For additional discussion of ABCP, please see the section titled "Other Matters" in this MD&A.

After adjusting for the impact of the depreciation and amortization related to the privatization and the related tax impact, the food retailing division contributed net earnings of \$259.0 million to Empire for fiscal 2010, an increase of \$34.2 million or 15.2 percent over the \$224.8 million recorded in fiscal 2009.



The table below presents revenue, operating income, capital gains (losses) and other items, net of tax, net earnings and funds from operations for the real estate division's commercial operations and residential operations.

(\$ in millions)	52 Weeks Ended			
	May 1, 2010	May 2, 2009	(\$ Change	(%) Change
<b>Revenue</b>				
Residential	\$ 63.3	\$ 54.6	\$ 8.7	15.9%
Commercial	17.3	19.3	(2.0)	(10.4%)
	\$ 80.6	\$ 73.9	\$ 6.7	9.1%
<b>Operating income</b>				
Residential	\$ 31.0	\$ 33.6	\$ (2.6)	(7.7%)
Crombie REIT <sup>(1)</sup>	18.6	19.8	(1.2)	(6.1%)
Commercial	1.2	2.5	(1.3)	(52.0%)
	\$ 50.8	\$ 55.9	\$ (5.1)	(9.1%)
<b>Net earnings</b>				
Residential operating earnings	\$ 21.8	\$ 23.3	\$ (1.5)	(6.4%)
Commercial operating earnings	12.6	13.4	(0.8)	(6.0%)
Capital gains (losses), net of tax	(3.1)	5.9	(9.0)	(152.5%)
	\$ 31.3	\$ 42.6	\$ (11.3)	(26.5%)
<b>Funds from operations</b>				
Residential	\$ 21.8	\$ 23.2	\$ (1.4)	(6.0%)
Commercial	13.9	15.3	(1.4)	(9.2%)
	\$ 35.7	\$ 38.5	\$ (2.8)	(7.3%)

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

## Revenue

Real estate division revenues amounted to \$80.6 million in fiscal 2010 compared to \$73.9 million in the prior year. The \$6.7 million increase in revenue from the real estate division was the result of higher revenue from residential operations.

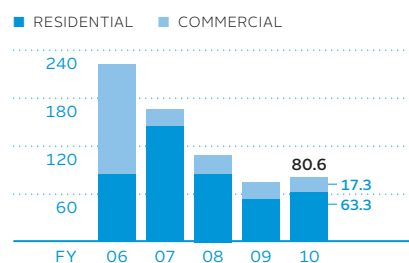
Revenue from residential operations was \$63.3 million in fiscal 2010 compared to \$54.6 million last year, an \$8.7 million or 15.9 percent increase. Commercial property revenues for fiscal 2010 equalled \$17.3 million, a decrease of \$2.0 million or 10.4 percent compared to revenues of \$19.3 million reported last year primarily as a result of the sale of properties that occurred part-way through fiscal 2009.

## Operating Income

For the 52 weeks ended May 1, 2010, real estate division operating income was \$50.8 million versus \$55.9 million in the prior fiscal year. The \$5.1 million decrease in real estate division operating income was largely the result of a \$2.6 million decline in residential operating income due primarily to lower margin on residential lot sales and a \$1.2 million decline in operating income contribution from Empire's investment in Crombie REIT. Other commercial operating income decreased by \$1.3 million in fiscal 2010 compared to the prior fiscal year primarily as a result of the properties sales mentioned above.

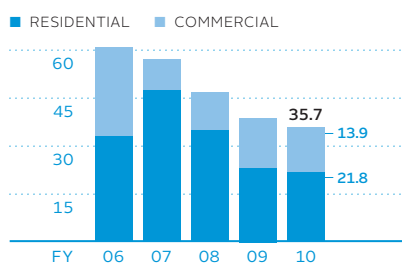
### Real Estate Revenue<sup>(1)</sup>

(\$ in millions)



### Real Estate Funds from Operations<sup>(1)</sup>

(\$ in millions)



(1) Fiscal 2005-2008 have been restated to exclude Sobey Leased Properties which was sold on April 22, 2008.

### Capital Gains (Losses) and Other Items

Capital gains (losses) and other items, net of tax, for the real estate division totalled \$(3.1) million in fiscal 2010 (2009 – \$5.9 million). The capital losses recorded in the current fiscal year are related to Empire's equity share of an interest rate swap agreement settled by Crombie REIT which it deemed was no longer an effective hedge. The capital gains recorded in fiscal 2009 related primarily to the sale of several non-core properties.

### Net Earnings

In fiscal 2010, real estate division net earnings contribution to Empire was \$31.3 million compared to \$42.6 million last year, an \$11.3 million decrease. The earnings decline is largely the result of a \$5.1 million decrease in operating income and a \$9.0 million decrease in net capital gains (losses) as mentioned, partially offset by a \$2.6 million reduction in income tax expense.

### Funds from Operations

Funds from real estate operations in fiscal 2010 of \$35.7 million decreased \$2.8 million compared to \$38.5 million in the prior fiscal year primarily as a result of a decline in operating earnings.

## INVESTMENTS AND OTHER OPERATIONS

### Highlights

- Empire Theatres' revenue in fiscal 2010 increased by 17.4 percent compared to fiscal 2009.
- Maintained a 27.6 percent interest in Wajax which contributed \$9.2 million in equity earnings in fiscal 2010.
- Capital gains (losses) and other items, net of tax, of \$17.6 million in fiscal 2010.

### Investment Value

At the end of fiscal 2010, Empire's total investments, including its investment in Genstar U.S. investments and in Crombie REIT, carried a market value of \$487.7 million (May 2, 2009 – \$255.5 million) on a cost base of \$67.7 million (May 2, 2009 – \$19.9 million), resulting in an unrealized gain of \$420.0 million (2009 – \$235.6 million).

At fiscal year end, May 1, 2010, Empire's investments including equity accounted investments in Crombie REIT and Genstar U.S., consisted of:

(\$ in millions)	May 1, 2010			May 2, 2009		
	Market Value	Carrying Value	Unrealized Gain	Market Value	Carrying Value	Unrealized Gain
Investment in Crombie REIT units	\$ 341.3	\$ 8.4	\$ 332.9	\$ 175.6	\$ (19.7)	\$ 195.3
Investment in Wajax	117.9	30.8	87.1	71.3	31.0	40.3
Investment in Genstar U.S. <sup>(1)</sup>	17.6	17.6	–	7.5	7.5	–
Other investments <sup>(1)(2)</sup>	10.9	10.9	–	1.1	1.1	–
	<b>\$ 487.7</b>	<b>\$ 67.7</b>	<b>\$ 420.0</b>	<b>\$ 255.5</b>	<b>\$ 19.9</b>	<b>\$ 235.6</b>

(1) Assumes market value equals book value.

(2) Fiscal 2010 other investments includes a \$10.7 million Crombie REIT convertible unsecured subordinated debenture.

The table below presents investments and other operations' (net of corporate expenses) financial highlights, excluding equity earnings from Crombie REIT and Genstar U.S., for the 52 weeks ended May 1, 2010 compared to last fiscal year.

(\$ in millions)	52 Weeks Ended		
	May 1, 2010	May 2, 2009	(\$ Change)
Revenue	\$ 202.2	\$ 179.3	\$ 22.9
Operating income			
Wajax	9.2	18.5	(9.3)
Other operations, net of corporate expenses	(5.6)	(7.7)	2.1
Total operating income	3.6	10.8	(7.2)
Operating earnings	(6.0)	(2.9)	(3.1)
Capital gains (losses) and other items, net of tax <sup>(1)</sup>	17.6	0.2	17.4
Net earnings	\$ 11.6	\$ (2.7)	\$ 14.3

(1) Fiscal 2010 capital gains (losses) and other items, net of tax, includes \$17.0 million reflecting the settlement of a CRA tax reassessment relating to the fiscal 2001 sale of Hannaford Bros. Co. shares.

### Revenue

Investments and other operations' revenue, primarily generated by Empire Theatres, equalled \$202.2 million for fiscal 2010 versus \$179.3 million last year, an increase of \$22.9 million or 12.8 percent. This largely reflects higher box office attendance versus last year as a result of strong product offering (including increased 3D content) and the fact that Empire Theatres had an additional week in fiscal 2010.

### Operating Income

Investment and other operations (net of corporate expenses) contributed operating income of \$3.6 million compared to \$10.8 million in the prior fiscal year. The decrease is primarily the result of lower equity accounted earnings generated from the Company's 27.6 percent interest in Wajax. The \$9.3 million reduction in Wajax equity accounted earnings (\$9.2 million versus \$18.5 million in fiscal 2009) was due to decreased market demand in all three of Wajax's operating segments as a result of the weakened economy.

Operating income from other operations (net of corporate expenses) improved from \$(7.7) million to \$(5.6) million in fiscal 2010. The improvement is largely related to the stronger performance by Empire Theatres in the recent fiscal year as a result of the strong box office attendance and the additional week of results as discussed.

### Capital Gains (Losses) and Other Items

Capital gains (losses) and other items, net of tax, in fiscal 2010 amounted to \$17.6 million compared to \$0.2 million last year. Fiscal 2010 capital gains (losses) and other items, net of tax, includes \$17.0 million reflecting the settlement of a CRA tax reassessment relating to the fiscal 2001 sale of Hannaford Bros. Co. shares.

### Net Earnings

Investments and other operations (net of corporate expenses) contributed \$11.6 million to Empire's consolidated fiscal 2010 net earnings compared to a \$(2.7) million net earnings contribution last year. The increase is primarily the result of the settlement of the CRA tax reassessment related to the fiscal 2001 sale of the shares in Hannaford Bros. Co. as discussed.



## Quarterly Results of Operations

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

### Results by Quarter

(\$ in millions, except per share information)	Fiscal 2010				Fiscal 2009 <sup>(1)</sup>			
	Q4 (13 Weeks)	Q3 (13 Weeks)	Q2 (13 Weeks)	Q1 (13 Weeks)	Q4 (13 Weeks)	Q3 (13 Weeks)	Q2 (13 Weeks)	Q1 (13 Weeks)
	May 1, 2010	Jan. 30, 2010	Oct. 31, 2009	Aug. 1, 2009	May 2, 2009	Jan. 31, 2009	Nov. 1, 2008	Aug. 2, 2008
Revenue	\$ 3,836.8	\$ 3,836.2	\$ 3,874.7	\$ 3,968.5	\$ 3,709.0	\$ 3,800.0	\$ 3,727.9	\$ 3,778.2
Operating income	118.5	110.3	120.7	130.2	109.3	115.3	113.3	128.3
Operating earnings <sup>(2)</sup>	71.9	68.3	72.1	72.2	62.9	64.8	63.1	70.9
Capital gains (losses) and other items, net of tax	1.6	–	(1.7)	17.5	(0.8)	(3.5)	2.5	4.8
Net earnings	\$ 73.5	\$ 68.3	\$ 70.4	\$ 89.7	\$ 62.1	\$ 61.3	\$ 65.6	\$ 75.7
<b>Per share information, basic</b>								
Operating earnings	\$ 1.05	\$ 1.00	\$ 1.06	\$ 1.05	\$ 0.96	\$ 0.99	\$ 0.96	\$ 1.08
Capital gains (losses) and other items, net of tax	0.02	–	(0.03)	0.26	(0.01)	(0.05)	0.04	0.07
Net earnings	\$ 1.07	\$ 1.00	\$ 1.03	\$ 1.31	\$ 0.95	\$ 0.94	\$ 1.00	\$ 1.15
Basic weighted average number of shares outstanding (in millions) <sup>(3)</sup>	68.4	68.4	68.4	68.4	65.9	65.6	65.6	65.6
<b>Per share information, diluted</b>								
Operating earnings	\$ 1.05	\$ 0.99	\$ 1.06	\$ 1.05	\$ 0.95	\$ 0.98	\$ 0.96	\$ 1.08
Capital gains (losses) and other items, net of tax	0.02	–	(0.03)	0.26	(0.01)	(0.05)	0.04	0.07
Net earnings	\$ 1.07	\$ 0.99	\$ 1.03	\$ 1.31	\$ 0.94	\$ 0.93	\$ 1.00	\$ 1.15
Diluted weighted average number of shares outstanding (in millions) <sup>(3)</sup>	68.5	68.5	68.5	68.5	66.0	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 "Changes in Accounting Policies" in this MD&A.

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

(3) The increase in the weighted average number of shares outstanding reflects an equity issue completed on April 24, 2009 which resulted in a total of 2,713,000 shares being issued.

Consolidated sales and operating earnings growth have been influenced by the Company's investing activities, the competitive environment, food price and general industry trends, the cyclicity of both residential and commercial real estate and by other risk factors as outlined in this MD&A.

The Company does experience some seasonality, as evidenced in the results presented above, particularly during the summer months and over holidays.

## Summary Table of Consolidated Financial Results for the Fourth Quarter

(\$ in millions, except per share information)	13 Weeks Ended May 1, 2010	% of Revenue	13 Weeks Ended May 2, 2009 <sup>(1)</sup>	% of Revenue
Revenue	\$ 3,836.8	100.00%	\$ 3,709.0	100.00%
Operating income	118.5	3.09	109.3	2.95
Operating earnings	71.9	1.87	62.9	1.69
Capital gains (losses) and other items, net of tax	1.6	0.04	(0.8)	(0.02)
Net earnings	\$ 73.5	1.92%	\$ 62.1	1.67%
<b>Basic earnings per share</b>				
Operating earnings	\$ 1.05		\$ 0.96	
Capital gains (losses) and other items, net of tax	0.02		(0.01)	
Net earnings	\$ 1.07		\$ 0.95	
Basic weighted average number of shares outstanding (in millions) <sup>(2)</sup>	68.4		65.9	
<b>Diluted earnings per share</b>				
Operating earnings	\$ 1.05		\$ 0.95	
Capital gains (losses) and other items, net of tax	0.02		(0.01)	
Net earnings	\$ 1.07		\$ 0.94	
Diluted weighted average number of shares outstanding (in millions) <sup>(2)</sup>	68.5		66.0	
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 "Changes in Accounting Policies" in this MD&A.

(2) The increase in the weighted average number of shares outstanding reflects an equity issue completed on April 24, 2009 which resulted in a total of 2,713,000 shares being issued.

The following is a review of financial performance for the 13 weeks ended May 1, 2010 compared to the 13 weeks ended May 2, 2009.

### Revenue

Revenue for the fourth quarter of fiscal 2010 was \$3.84 billion compared to \$3.71 billion last year, a \$127.8 million or 3.4 percent increase. Revenues for the food retailing division increased by \$103.5 million or 2.8 percent compared to the fourth quarter of fiscal 2009. Sobeys' same-store sales increased 0.5 percent over the same quarter last year. The growth in Sobeys' 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 product and services innovation. Also, during the fourth quarter of fiscal 2010, Sobeys experienced retail food price deflation, which partially offset the growth associated with the above initiatives.

Real estate revenue in the fourth quarter was \$32.8 million, an increase of \$21.1 million from the \$11.7 million recorded in the fourth quarter last year. Residential property revenue increased by \$20.9 million while commercial property revenue increased by \$0.2 million from the fourth quarter last year. The increase in residential property revenue was largely due to higher lot sales activity in Western Canada relative to the same quarter last year.

Revenue from investments and other operations in the fourth quarter of fiscal 2010 equalled \$52.3 million, an increase of \$5.2 million or 11.0 percent over the fourth quarter last year. This is primarily related to stronger box office attendance and increased 3D product exhibited by Empire Theatres.

### Operating Income

Consolidated operating income in the fourth quarter was \$118.5 million, an increase of \$9.2 million or 8.4 percent from the \$109.3 million recorded in the fourth quarter last year.

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

- Sobeys' operating income contribution to Empire in the fourth quarter totalled \$98.4 million, a decrease of \$1.9 million or 1.9 percent from the \$100.3 million recorded in the fourth quarter last year. Included in Sobeys' operating income for the fourth quarter was approximately \$5.0 million in costs related to the launch of the FreshCo discount banner and the rebanner of eight stores in Mississauga and Brampton, Ontario.
- Residential property operating income contribution in the fourth quarter was \$14.8 million, an increase of \$11.0 million from the \$3.8 million recorded in the fourth quarter last year as a result of higher residential lot sales activity.
- Commercial property (including Crombie REIT) operating income for the quarter was \$4.0 million compared to \$4.9 million in the fourth quarter last fiscal year, a decrease of \$0.9 million. Crombie REIT contributed \$4.4 million to operating income in the fourth quarter versus a \$4.9 million contribution in the fourth quarter last year.
- Investments and other operations (net of corporate expenses) contributed operating income of \$1.3 million in the fourth quarter compared to \$0.3 million in the fourth quarter last year. Equity accounted earnings generated from the Company's 27.6 percent interest in Wajax amounted to \$2.3 million in the fourth quarter versus \$2.6 million in the fourth quarter last year. Operating income from other operations (net of corporate expenses) amounted to \$(1.0) million compared to \$(2.3) million in the fourth quarter last year.

### Interest Expense

Interest expense in the fourth quarter amounted to \$18.2 million, a decrease of \$0.6 million or 3.2 percent from the \$18.8 million recorded in the same quarter last year. The decrease in interest expense is primarily due to the lower funded debt for the reasons previously discussed.

### Income Taxes

The effective income tax rate for the fourth quarter (excluding the impact of capital gains (losses) and other items) was 28.0 percent versus 29.6 percent in the fourth quarter last year. Statutory enacted future income tax rate reductions have lowered the overall effective income tax rate compared to the fourth quarter of 2009.

### Earnings before Capital Gains (Losses) and Other Items

For the 13 weeks ended May 1, 2010, Empire recorded earnings before capital gains (losses) and other items of \$71.9 million (\$1.05 per share) versus \$62.9 million (\$0.95 per share) last year, a \$9.0 million or 14.3 percent increase. The increase in earnings before capital gains (losses) and other items is the result of a \$9.2 million increase in operating income, a \$0.6 million reduction in interest expense and a decrease in minority interest of \$0.5 million, partially offset by an increase in income taxes of \$1.3 million.

### Capital Gains (Losses) and Other Items

The Company reported capital gains (losses) and other items, net of tax, of \$1.6 million in the fourth quarter compared to capital gains (losses) and other items, net of tax, of \$(0.8) million last year. Capital gains (losses) and other items in the fourth quarter of fiscal 2010 primarily relate to a positive fair value adjustment to ABCP. Capital gains (losses) and other items in the fourth quarter of last year primarily relate to a loss on the sale of non-core property.

### Net Earnings

Consolidated net earnings in the fourth quarter of fiscal 2010 equalled \$73.5 million (\$1.07 per share) compared to \$62.1 million (\$0.94 per share) in the fourth quarter last year, an increase of \$11.4 million or 18.4 percent. The increase in net earnings is due to the \$9.0 million increase in earnings before capital losses and other items and an increase in capital gains (losses) and other items, net of tax, of \$2.4 million.



## Consolidated Financial Condition

### CAPITAL STRUCTURE AND KEY FINANCIAL CONDITION MEASURES

The Company's financial condition improved in fiscal 2010 as evidenced by the capital structure and key financial condition measures in the table below.

(\$ in millions, except per share and ratio calculations)	May 1, 2010	May 2, 2009 <sup>(1)</sup>	May 3, 2008 <sup>(1)</sup>
Shareholders' equity	\$ 2,952.4	\$ 2,678.8	\$ 2,378.8
Book value per share	\$ 43.07	\$ 39.07	\$ 36.08
Bank indebtedness	\$ 17.8	\$ 45.9	\$ 92.6
Long-term debt, including current portion <sup>(2)</sup>	\$ 1,208.4	\$ 1,257.0	\$ 1,480.9
Funded debt to total capital	29.3%	32.7%	39.8%
Net debt to net total capital ratio	21.8%	28.6%	36.7%
Debt to EBITDA <sup>(3)</sup>	1.50x	1.62x	2.02x
EBITDA to interest expense <sup>(3)</sup>	11.30x	9.95x	7.35x
Total assets	\$ 6,248.3	\$ 5,891.1	\$ 5,729.4

(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 "Changes in Accounting Policies" in this MD&A.

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

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

### SHAREHOLDERS' EQUITY

Book value per common share was \$43.07 at May 1, 2010 compared to \$39.07 at May 2, 2009 and \$36.08 at May 3, 2008.

The increase in book value in the current fiscal year reflects the Company's earnings growth as discussed.

The Company's share capital on May 1, 2010 consisted of:

	Authorized Number of Shares	Issued and Outstanding Number of Shares	\$ in Millions
Preferred shares, par value \$25 each, issuable in series series 2, cumulative, redeemable, rate of 75% prime	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	316.2
Class B common shares, without par value, voting	40,800,000	34,260,763	7.6
			328.0
Employees' Share Purchase Plan			(2.9)
			\$ 325.1

Total Non-Voting Class A and Class B common shares outstanding at May 1, 2010 equalled 68,458,261, unchanged from the previous fiscal year-end. There were 34,197,498 Non-Voting Class A and 34,260,763 Class B common shares outstanding at May 1, 2010.

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

During fiscal 2010, 162,399 options (2009 – 189,967 options) were issued under Empire's long-term incentive plan. The options issued in fiscal 2010 allow the holder to purchase Non-Voting Class A shares at \$46.04 per share (2009 – \$40.26 per share). Empire had 433,209 options outstanding at May 1, 2010 compared to 282,733 options outstanding at May 2, 2009. There were no options exercised during fiscal 2010 or fiscal 2009. During fiscal 2010, 11,923 options (2009 – nil) were forfeited.

The table below presents the number of outstanding options and weighted average exercise price over the last two fiscal years.

	May 1, 2010		May 2, 2009	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Balance, beginning of year	282,733	\$ 41.47	92,766	\$ 43.96
Granted	162,399	46.04	189,967	40.26
Forfeited	(11,923)	40.26	–	–
Balance, end of year	433,209	\$ 43.22	282,733	\$ 41.47
Stock options exercisable, end of year	90,894		23,192	

The 433,209 stock options outstanding as at the fiscal year ended May 1, 2010 represents 0.6 percent (2009 – 0.4 percent) of the outstanding Non-Voting Class A shares and Class B common shares.

During fiscal 2010, there were no Series 2 preferred shares purchased for cancellation compared to 90,200 Series 2 preferred shares purchased for \$2.3 million in fiscal 2009. The Company plans to purchase on a best efforts basis for cancellation additional Series 2 preferred shares by the end of calendar 2010.

As at June 25, 2010, the Company had total Non-Voting Class A and Class B common shares outstanding of 34,197,498 and 34,260,763, respectively, as well as 433,209 options to acquire in aggregate 433,209 Non-Voting Class A shares.

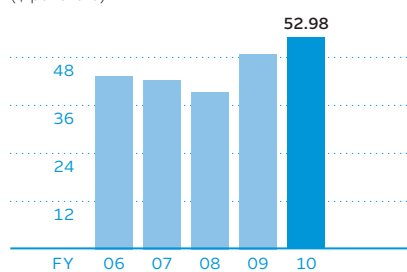
Dividends paid to Non-Voting Class A and Class B common shareholders amounted to \$50.7 million in fiscal 2010 (\$0.74 per share) versus \$46.1 million (\$0.70 per share) in fiscal 2009.

## LIABILITIES

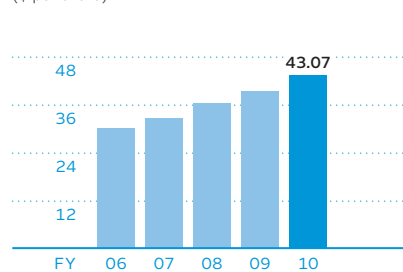
Historically, Empire has financed a significant portion of its assets through the use of long-term debt. Longer-term assets are generally financed with fixed rate, long-term debt, thereby reducing both interest rate and refinancing risk. At the end of fiscal 2010, the Company's total long-term debt (including the current portion long-term debt) was \$1,208.4 million (2009 – \$1,257.0 million), representing 98.5 percent (2009 – 96.5 percent) of Empire's total funded debt of \$1,226.2 million (2009 – \$1,302.9 million).

Consolidated funded debt decreased by \$76.7 million from the \$1,302.9 million reported at the end of fiscal 2009. The decrease in funded debt over the end of the previous fiscal year is primarily the result the free cash flow generated by Sobeys being used to reduce its funded debt. The ratio of funded debt to total capital improved to 29.3 percent from 32.7 percent at the end of fiscal 2009. The 3.4 percentage point improvement is the result of lower funded debt levels and higher equity levels due to growth in retained earnings.

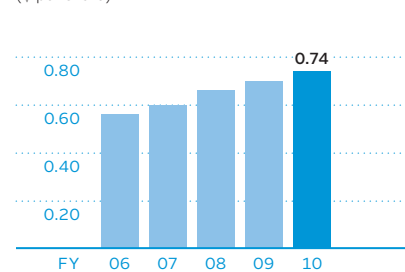
**Share Price**  
(\$ per share)



**Book Value Per Share**  
(\$ per share)



**Common Dividends Per Share**  
(\$ per share)



The long-term debt is segmented by division as follows:

Long-term debt (including current portion) (\$ in millions)	May 1, 2010	May 2, 2009	May 3, 2008
Food retailing	\$ 858.7	\$ 954.0	\$ 1,010.2
Real estate	35.3	39.6	50.1
Investments & other operations	314.4	263.4	420.6
Total	\$ 1,208.4	\$ 1,257.0	\$ 1,480.9

For additional disclosure on Empire's bank indebtedness and long-term debt, see Notes 9 and 10 to the Company's annual audited consolidated financial statements for fiscal 2010 as detailed on page 84 and 85 of the Company's 2010 Annual Report.

On July 23, 2008, 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 & Poor's ("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.

During the second quarter of fiscal 2010, on September 14, 2009, DBRS upgraded Sobeys' credit rating to

BBB with a stable trend. During the third quarter of fiscal 2010, on January 12, 2010, S&P upgraded its credit rating on Sobeys from BB+ with a positive trend to BBB- with a stable trend.

On May 25, 2010 Sobeys filed a short form prospectus providing for the issuance of up to \$500.0 million of unsecured Medium Term Notes. On June 7, 2010, Sobeys issued new Medium Term Notes of \$150.0 million, maturing on June 7, 2040.

Empire's EBITDA to interest expense ratio in fiscal 2010 was 11.3 times, an improvement from the 10.0 times recorded in fiscal 2009. The increase in the EBITDA to interest expense ratio compared to fiscal 2009 was the result of the decline in interest expense related to the reduction of funded debt and an increase in trailing 12-month EBITDA to \$819.4 million from \$802.3 million a year earlier.

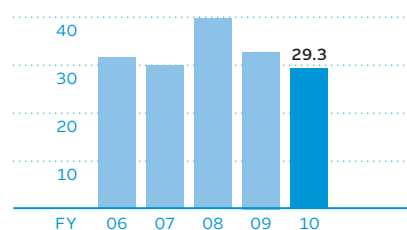
Empire and its subsidiaries have provided covenants to lenders in support of various financing facilities. All covenants were complied with during fiscal 2010 and for fiscal 2009.

## FINANCIAL INSTRUMENTS

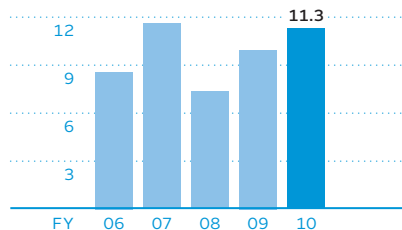
As part of Empire's risk management strategy, the Company actively monitors its exposures to various financial risks including interest rate risk, foreign exchange price risk and commodity price risk. From time to time, Empire or one of its subsidiaries will use a financial instrument for the purpose of mitigating its exposure to one or more types of financial risk. Empire and its subsidiaries do not use financial instruments for speculative purposes. The Company's use of these instruments has not had a material impact on consolidated net earnings for the 52 weeks ended May 1, 2010 or fiscal 2009.

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

**Funded Debt to Capital**  
(%)



**EBITDA to Interest Expense**  
(times)



### In-Place 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 May 1, 2010, there were four interest rate hedges in place with a fair value of \$(15.6) million. Sensitivity analysis has been prepared to determine the impact of a change in the underlying forward rate curves on the fair values reported as of May 1, 2010. A parallel shift up/(down) in the underlying forward rate curve of 0.25 percent would impact in the fair value of the swaps by plus or minus \$1.3 million and impact other comprehensive income by plus or minus \$0.9 million.

In July 2008, Sobeys entered into a floating-for-floating currency swap with a fixed rate of \$1.015 Canadian Dollar ("CAD")/United States Dollar ("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 May 1, 2010, Sobeys recognized a liability of \$0.2 million relating to this instrument. Sobeys estimates that a 10.0 percent increase/(decrease) in applicable foreign currency exchange rates would impact the fair value of the swap by plus or minus \$1.2 million and would impact other comprehensive income by plus or minus \$0.9 million.

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 May 1, 2010, Sobeys recognized a liability of \$1.3 million relating to these instruments. Sobeys estimates that a 10.0 percent increase/(decrease) in applicable energy prices would impact the fair value of the swaps by plus or minus \$0.1 million.

In October 2009, Sobeys entered into heating oil swaps to mitigate the price volatility of a portion of its future diesel fuel

purchases. As diesel fuel derivative contracts are not actively traded on any organized futures exchange, there are limited opportunities to hedge diesel fuel prices directly; however, Sobeys uses heating oil derivatives due to the historically high correlations between changes in diesel fuel prices and heating oil prices. As of May 1, 2010, the contracts had expired and no asset or liability was recorded.

### Fair Value Methodology

When a financial instrument is designated as a hedge for financial accounting purposes, it is classified as "Held for Trading" on the balance sheet and recorded at fair value. The estimated fair values of the financial instruments as at May 1, 2010 were based on relevant market prices and information available at the reporting date. The Company determines fair value of each financial instrument by reference to external and third-party quoted bid, ask, and mean prices, as appropriate, in an active market. In inactive markets, fair values are based on internal and external valuation models, such as discounted cash flows using market observed inputs. Fair values determined using valuation models require the use of assumptions to determine the amount and timing of forecasted future cash flows and discount rates. The Company primarily uses external market inputs, including factors such as interest yield curves and forward exchange rates. Changes in interest rates and exchange rates, along with other factors, may cause the fair value amounts to change in subsequent periods. The fair value of these financial instruments reflects the amount the Company would pay or receive if it were to settle the contracts at the reporting date.

For additional disclosure on Empire's use of financial instruments, see Notes 1 and 21 to the Company's annual audited financial statements for fiscal 2010 as detailed on pages 74 and 93 of the Company's 2010 Annual Report.

## Liquidity and Capital Resources

Empire's liquidity remained strong at May 1, 2010 as a result of the following sources:

- Cash and cash equivalents on hand;
- Unutilized bank credit facilities; and
- Cash generated from operating activities.

At May 1, 2010, consolidated cash and cash equivalents were \$401.0 million versus \$231.6 million at the prior fiscal year end on May 2, 2009.

At the end of fiscal 2010, on a non-consolidated basis, Empire maintained an authorized bank line for operating, general and corporate purposes of \$650.0 million, of which approximately \$298.5 million or 45.9 percent was utilized. On a consolidated basis, Empire's authorized bank credit facilities exceeded borrowings by approximately \$840.1 million at May 1, 2010.

Empire's non-consolidated credit facility of \$650.0 million matured on June 8, 2010. Subsequent to fiscal year end, on June 4, 2010, Empire renewed its credit facility for an additional three-year term, to expire on June 30, 2013. The size of the facility was reduced to \$450.0 million from \$650.0 million reflecting both strong cash generation and lower debt levels.

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 following table highlights major cash flow components for the 13 and 52 weeks ended May 1, 2010 compared to the 13 and 52 weeks ended May 2, 2009.

(\$ in millions)	13 Weeks Ended		52 Weeks Ended	
	May 1, 2010	May 2, 2009 <sup>(1)</sup>	May 1, 2010	May 2, 2009 <sup>(1)</sup>
Earnings for common shareholders	\$ 73.5	\$ 62.1	\$ 301.8	\$ 264.6
Items not affecting cash	72.8	103.0	358.0	352.9
	146.3	165.1	659.8	617.5
Net change in non-cash working capital	174.5	40.1	124.3	50.5
Cash flows from operating activities	320.8	205.2	784.1	668.0
Cash flows used in investing activities	(92.8)	(139.9)	(466.1)	(413.9)
Cash flows used in financing activities	(83.5)	(58.0)	(148.6)	(213.9)
Increase in cash and cash equivalents	\$ 144.5	\$ 7.3	\$ 169.4	\$ 40.2

(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 "Changes in Accounting Policies" in this MD&A.

## OPERATING ACTIVITIES

Fourth quarter cash flows from operating activities equalled \$320.8 million compared to \$205.2 million in the comparable period last year. The increase of \$115.6 million is due to an increase in the net change in non-cash working capital of \$134.4 million and an increase in earnings available for common shareholders of \$11.4 million, partially offset by a decrease in items not affecting cash of \$30.2 million.

In fiscal 2010, cash flows from operating activities equalled \$784.1 million compared to \$668.0 million in the prior year. The increase of \$116.1 million is attributed to an increase in the net change in non-cash working capital of \$73.8 million, an increase in net earnings available for common shareholders of \$37.2 million and an increase in items not affecting cash of \$5.1 million.

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

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

(\$ in millions)	May 1, 2010	Jan. 30, 2010	13 Weeks Ended	
			May 1, 2010 Increase (Decrease) in Cash Flows	May 2, 2009 <sup>(1)</sup> Increase (Decrease) in Cash Flows
Receivables	\$ 336.9	\$ 291.0	\$ (45.9)	\$ (19.4)
Inventories	880.3	924.0	43.7	17.9
Prepaid expenses	70.1	51.1	(19.0)	(31.5)
Accounts payable and accrued liabilities	(1,621.6)	(1,463.6)	158.0	95.4
Income taxes receivable (payable)	(19.5)	(7.3)	12.2	(17.1)
Impact of reclassifications on working capital <sup>(2)</sup>	(25.5)	–	25.5	(5.2)
Total	\$ (379.3)	\$ (204.8)	\$ 174.5	\$ 40.1

(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 "Changes in Accounting Policies" 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 in Note 1 to the financial statements.

**Non-Cash Working Capital (Year-over-Year)**

(\$ in millions)	May 1, 2010	May 2, 2009 <sup>(1)</sup>	52 Weeks Ended May 1, 2010 Increase (Decrease) in Cash Flows
Receivables	\$ 336.9	\$ 308.9	\$ (28.0)
Inventories	880.3	842.8	(37.5)
Prepaid expenses	70.1	63.9	(6.2)
Accounts payable and accrued liabilities	(1,621.6)	(1,487.1)	134.5
Income taxes receivable (payable)	(19.5)	4.9	24.4
Impact of reclassifications on working capital <sup>(2)</sup>	(37.1)	-	37.1
<b>Total</b>	<b>\$ (390.9)</b>	<b>\$ (266.6)</b>	<b>\$ 124.3</b>

(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 "Changes in Accounting Policies" 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 in Note 1 to the financial statements.

The net change in non-cash working capital of \$174.5 million in the fourth quarter was largely due to a \$158.0 million increase in payables, a \$43.7 million decrease in inventories, a \$12.2 million increase in income taxes payable and the impact of reclassifications on working capital of \$25.5 million, partially offset by an increase in receivables of \$45.9 million and an increase in prepaid expenses of \$19.0 million. The increased accounts payable and accrued liabilities largely reflects Sobeys' focus on managing working capital as evidenced by increased levels of cash at fiscal year end. The decrease in inventories compared to the third quarter reflects the seasonality typically experienced by Sobeys over these quarters. The increase in receivables of \$45.9 million at Sobeys is primarily as a result of rent receivables being recorded prior to the end of the period compared to the third quarter.

**INVESTING ACTIVITIES**

Cash used in investing activities of \$92.8 million in the fourth quarter is down from cash used in investing activities of \$139.9 million in the fourth quarter last fiscal year. The decrease in cash used in investing activities of \$47.1 million was largely the result of an increase in proceeds on disposal of property and equipment of \$52.4 million primarily from the sale of eight properties to Crombie REIT in the fourth quarter of fiscal 2010.

For the 52 weeks ended May 1, 2010, cash used in investing activities of \$466.1 million was \$52.2 million higher than last fiscal year. The increase in cash used in investing activities was largely the result of an increase in the cash used for investments in fiscal 2010 of \$48.6 million, an increase of \$33.4 million in property and equipment purchases and an increase cash used in loans and other receivables of \$29.4 million, partially offset by an increase in proceeds on disposal of property and equipment of \$59.1 million.

Year-over-year non-cash working capital increased \$124.3 million. This is primarily the result of a \$134.5 million increase in accounts payable and accrued liabilities, an increase in income taxes payable of \$24.4 million, a \$37.1 million impact of reclassifications on working capital partially offset by a \$37.5 million increase in inventories, a \$28.0 million increase in receivables and a \$6.2 million increase in prepaid expenses compared to the prior year. The increase in receivables, inventories and related accounts payable and accrued liabilities is necessary to support Sobeys' higher sales volumes due to the increased amount of square footage in its expanded store network.

Consolidated purchases of property and equipment totalled \$128.0 million in the fourth quarter of fiscal 2010 compared to \$112.0 million in the fourth quarter last year. Consolidated purchases of property and equipment totalled \$434.0 million in fiscal 2010 compared to \$400.6 million in the same period last year.

Proceeds on disposal of property and equipment increased \$52.4 million from the fourth quarter last year to \$65.6 million in the fourth quarter of fiscal 2010. Proceeds on disposal of property and equipment in the fourth quarter of fiscal 2010 were largely related to the sale of eight properties to Crombie REIT for cash proceeds of \$56.7 million as discussed in the "Related-Party Transactions" section of this MD&A. Proceeds on disposal of property and equipment for the fourth quarter of last year of \$13.2 million were largely related to the sale of several non-core properties.

For the fiscal 2010, proceeds on disposal of property and equipment equalled \$137.1 million compared to \$78.0 million last year, a \$59.1 million increase. Proceeds on disposal of property and equipment in fiscal 2010 are largely related to:

- The sale leaseback of a distribution 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; and
- The sale of eight properties to Crombie REIT as discussed.

Proceeds on disposal of property and equipment last year of \$78.0 million were primarily related to the sale of several non-core properties.

In fiscal 2010, ECL increased its ownership of Genstar for cash consideration of \$17.2 million. This acquisition was accounted for using the purchase method with net identifiable assets, primarily land inventory, recorded at \$22.6 million and future income taxes recorded at \$5.4 million.

Included in cash used in investing activities for fiscal 2010 is an additional investment of \$30.0 million in Crombie REIT Class B units along with an investment of \$10.0 million in Crombie REIT convertible unsecured subordinated debentures as discussed in the "Related-Party Transactions" section of this MD&A.

The table below outlines the number of stores Sobeys invested in during the fourth quarter of fiscal 2010 compared to the same quarter of fiscal 2009, as well as for the 52 weeks ended May 1, 2010 compared to the 52 weeks ended May 2, 2009.

### Sobeys' Corporate and Franchised Store Construction Activity

# of Stores	13 Weeks Ended		52 Weeks Ended	
	May 1, 2010	May 2, 2009	May 1, 2010	May 2, 2009
Opened/Acquired/Relocated	11	13	41	47
Expanded	4	3	13	11
Rebanneder/Redeveloped	14	2	22	16
Closed	17	20	52	52

The following table shows Sobeys' square footage changes for the 13 and 52 weeks ended May 1, 2010 by type.

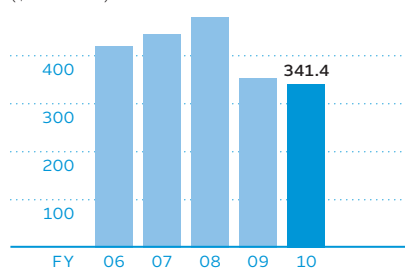
### Sobeys' Square Footage Changes

Square Feet (in thousands)	May 1, 2010 vs. Jan. 30, 2010	May 1, 2010 vs. May 2, 2009
Opened	222	856
Relocated	63	115
Acquired	3	8
Expanded	38	140
Closed	(193)	(554)
Net Change	133	565

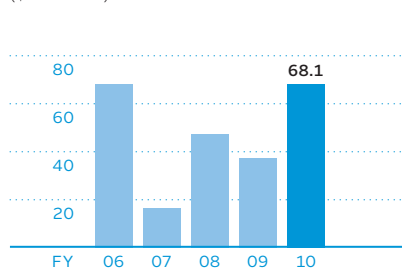
At May 1, 2010, Sobeys' square footage totalled 28.1 million square feet, a 2.2 percent increase over the 27.5 million square feet in operation at the end of the fourth quarter of last year.

Capital expenditures for the food retailing division in fiscal 2010 equalled \$341.4 million compared to \$354.1 million in fiscal 2009. Capital expenditures for the real estate division equalled \$68.1 million in fiscal 2010 (\$36.9 million in fiscal 2009) as a result of ongoing property developments and land additions. Capital spending by investments and other operations equalled \$24.5 million in fiscal 2010 (\$9.6 million in fiscal 2009).

**Food Retailing Capital Expenditures**  
(\$ in millions)



**Real Estate Capital Expenditures**  
(\$ in millions)



## FINANCING ACTIVITIES

Financing activities during the fourth quarter of fiscal 2010 used \$83.5 million of cash compared to \$58.0 million of cash used in the same quarter last year. The increase of \$25.5 million in cash flows used in financing activities when compared to the same quarter last year is primarily the result of an increase in cash flow used to repay bank indebtedness.

Financing activities during the 52 weeks ended May 1, 2010 used \$148.6 million of cash compared to \$213.9 million of cash used in financing activities in the same period last year. The decrease in cash flows used in financing activities of \$65.3 million in the 52 weeks ended May 1, 2010 when compared to the same period last year is primarily the result of: (i) a decrease in long-term debt repayment of \$149.1 million; (ii) an increase in issuance of long-term debt of \$30.9 million;

and (iii) a decrease in cash flow used to reduce bank indebtedness of \$18.6 million; partially offset by a decrease in cash flow from the issue of Non-Voting Class A shares of \$129.1 million.

As previously discussed, on April 24, 2009 Empire issued 2,713,000 Non-Voting Class A shares at a price of \$49.75 per share. The total net proceeds raised of \$129.1 million (gross proceeds of \$135 million) were used to repay a portion of Empire's non-consolidated bank facility.

The Company believes that its cash and cash equivalents, future operating cash flows and available credit facilities will enable the Company to fund its 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.

## GUARANTEES AND COMMITMENTS

The following illustrates the Company's significant contractual obligations, over the next five fiscal years and thereafter.

### Gross Obligations Excluding Lease Income

(\$ in millions)	2011	2012	2013	2014	2015	Thereafter	Total
Long-term debt	\$ 364.2	\$ 23.8	\$ 218.0	\$ 32.6	\$ 25.1	\$ 494.5	\$ 1,158.2
Capital leases	17.6	14.1	9.7	6.4	5.1	6.2	59.1
Operating leases							
Third-parties	281.3	268.0	250.5	232.9	216.7	1,432.7	2,682.1
Related-parties	45.2	37.2	37.2	38.1	38.2	440.2	636.1
Total operating leases	326.5	305.2	287.7	271.0	254.9	1,872.9	3,318.2
Total contractual obligations	\$ 708.3	\$ 343.1	\$ 515.4	\$ 310.0	\$ 285.1	\$ 2,373.6	\$ 4,535.5

### Operating Leases, Net of Expected Lease Income Received by the Company

(\$ in millions)	2011	2012	2013	2014	2015	Thereafter	Total
Third-parties	\$ 187.9	\$ 180.0	\$ 170.8	\$ 161.9	\$ 153.3	\$ 1,013.0	\$ 1,866.9
Related-parties	45.2	37.2	37.2	38.1	38.2	440.2	636.1
	\$ 233.1	\$ 217.2	\$ 208.0	\$ 200.0	\$ 191.5	\$ 1,453.2	\$ 2,503.0

## Franchise Affiliates

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

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

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

During fiscal 2009, Sobeys entered into an additional credit enhancement contract in the form of a standby letter of credit for certain independent franchisees for the purchase and installation of equipment. Under the terms of the contract, should franchisee affiliates be unable to fulfill their lease obligations or other remedy, Sobeys would be required to fund the greater of \$4.0 million or 10.0 percent (2009 – \$4.0 million or 10.0 percent) of the authorized and outstanding obligation annually.



Under the terms of the agreement, Sobeys is required to obtain a letter of credit in the amount of the outstanding guarantee, to be revisited each calendar year. This credit enhancement allows Sobeys to provide favorable financing terms to certain independent franchisees. The contract terms have been reviewed and Sobeys has determined that there were no material implications with respect to the consolidation of VIEs. As of May 1, 2010, the amount of the guarantee was \$4.0 million (2009 – \$4.0 million).

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

(\$ in millions)	Third Parties
2011	\$ 22.1
2012	16.2
2013	10.2
2014	3.3
2015	0.4
Thereafter	1.2

## FREE CASH FLOW

Free cash flow (see Non-GAAP measures section) 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 and 52 week periods ended May 1, 2010 and May 2, 2009.

(\$ in millions)	13 Weeks Ended		52 Weeks Ended	
	May 1, 2010	May 2, 2009 <sup>(1)</sup>	May 1, 2010	May 2, 2009 <sup>(1)</sup>
Cash flow from operating activities	\$ 320.8	\$ 205.2	\$ 784.1	\$ 668.0
Less: Property and equipment purchases	128.0	112.0	434.0	400.6
Free cash flow	\$ 192.8	\$ 93.2	\$ 350.1	\$ 267.4

(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 "Changes in Accounting Policies" in this MD&A.

Free cash flow generation in the fourth quarter of fiscal 2010 was \$192.8 million compared to free cash flow of \$93.2 million in the fourth quarter last year. The \$99.6 million increase in free cash flow from the fourth quarter last fiscal year was due to a \$115.6 million increase in cash flow from operations, partially offset by a \$16.0 million increase in property and equipment purchases.

## Other

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

Upon entering into the lease of its Mississauga distribution centre in March 2000, Sobeys Capital Incorporated, a direct subsidiary of Sobeys, guaranteed to the landlord the performance by Serca Foodservice Inc., of all of its obligations under the lease. The remaining term of the lease is 10 years with an aggregate obligation of \$31.6 million (2009 – \$34.6 million). At the time of the sale of assets of Serca Foodservice Inc. to SYSCO Corp., the lease of the Mississauga distribution centre was assigned to and assumed by a subsidiary of the purchaser and SYSCO Corp. agreed to indemnify and hold Sobeys Capital Incorporated harmless from any liability it may incur pursuant to its guarantee.

For the 52 weeks ended May 1, 2010, free cash flow equalled \$350.1 million, an increase of \$82.7 million over the \$267.4 million in free cash flow recorded for the same period last year. The improvement is due to a \$116.1 million increase in cash flow from operating activities, partially offset by an increase of \$33.4 million in property and equipment purchases.

## Controls and Accounting Policies

### CHANGES IN ACCOUNTING POLICIES

*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, in compliance with transitional provisions, effective for the first quarter of fiscal 2010 with a retroactive restatement of the comparative periods. The initial impact under the new standard as at May 2, 2009 was a decrease to prepaid expenses of \$6.9 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 as well as a reduction of retained earnings of \$4.7 million. For the 52 weeks ended May 2, 2009, cost of sales, selling and administration expenses decreased \$9.4 million, depreciation and amortization expense increased \$11.3 million, and income taxes decreased \$0.7 million.

#### **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 Company has implemented these enhanced disclosure requirements in compliance with transitional provisions. The new disclosures did not have a material impact.

*Future Changes in Accounting Policies:*

#### **Business Combinations, Consolidated Financial Statements and Non-Controlling Interests**

In January 2009, the CICA issued three new accounting standards which are based on the International Accounting Standards Board's IFRS 3, "*Business Combinations*". Section 1582, "*Business Combinations*", which replaces Section 1581 with the same title, aims to improve the relevance, reliability and comparability of the information provided in financial statements about business combinations. This section is to be applied prospectively to business combinations for which the acquisition date is on or after January 1, 2011 and assets and liabilities that arose from business combinations that preceded the adoption of this standard should not be adjusted upon adoption. Section 1601, "*Consolidated Financial Statements*", and Section 1602, "*Non-controlling Interests*", replace Section 1600, "*Consolidated Financial Statements*", and establish standards for the preparation of consolidated financial statements and 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.

#### **Multiple Deliverable Revenue Arrangements**

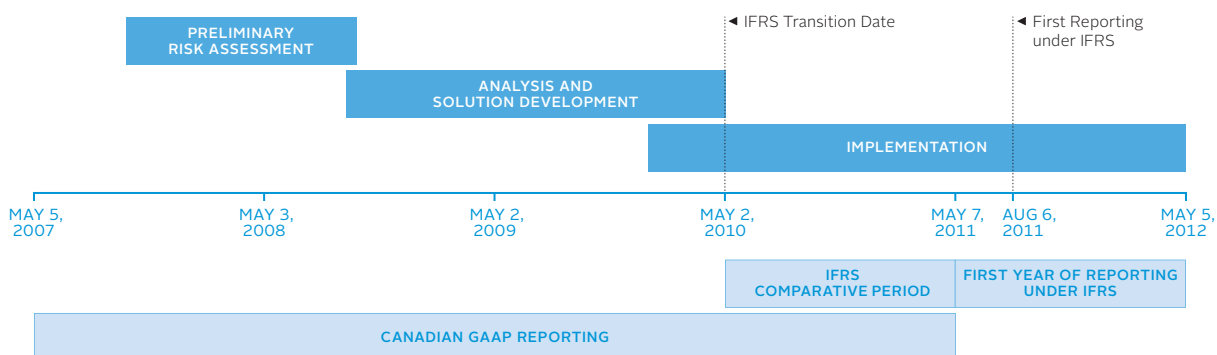
In December 2009, the CICA issued EIC 175, "*Multiple Deliverable Revenue Arrangements*". EIC 175, which replaces EIC 142, "*Revenue Arrangements with Multiple Deliverables*", addresses some aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue-generating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

## TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS

On February 13, 2008, the Accounting Standards Board of Canada announced that Canadian 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 Canadian

GAAP to IFRS will be applicable to the Company's reporting for the first quarter of fiscal 2012 specifically August 6, 2011, for which the current and comparative information will be prepared under IFRS. The Company has developed a three phase changeover plan for the IFRS conversion. The following timeline captures the key dates for the Company:

### IFRS Implementation Timeline



### Project Status

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.

	Key Activities	Milestones/Deadlines	Progress to Date
<b>Financial statement preparation</b>	<ul style="list-style-type: none"> <li>Identify differences in Canadian GAAP/IFRS accounting policies.</li> <li>Evaluate and select IFRS policies &amp; IFRS 1 choices.</li> <li>Develop financial statement format and disclosure.</li> <li>Quantify effects of changeover in initial IFRS 1 disclosures and fiscal 2011 financial statements.</li> </ul>	<ul style="list-style-type: none"> <li>Steering Committee and Audit Committee approval for all key IFRS accounting policy choices to occur during fiscal 2010.</li> <li>Draft skeleton IFRS annual and interim financial statements by the end of fiscal 2010.</li> <li>Final quantification of conversion effects on fiscal 2011 comparative period by fiscal 2012.</li> </ul>	<ul style="list-style-type: none"> <li>Completed diagnostic impact assessment during fiscal 2009, which involved a high level review of major differences between IFRS and Canadian GAAP.</li> <li>Completed approval of key IFRS accounting policy choices in fiscal 2010; quantification of transition opening balance sheet impacts is underway.</li> <li>Obtained approval of key IFRS 1 exemptions applicable to the entity in fiscal 2010; quantification of transition impact is underway.</li> <li>Obtained approval for drafted skeleton annual and interim IFRS financial statements.</li> </ul>

	Key Activities	Milestones/Deadlines	Progress to Date
<b>Training and communication</b>	<ul style="list-style-type: none"> <li>Educate the Board of Directors, Audit Committee, management, key employees and other stakeholders.</li> <li>Communicate progress of changeover plan to internal and external stakeholders.</li> <li>Monitor ongoing IFRS accounting standards developments.</li> </ul>	<ul style="list-style-type: none"> <li>Ongoing training provided to all groups to align with changeover.</li> <li>Additional training will occur as needed during the changeover year.</li> <li>Communicate project status updates regularly until completion of IFRS implementation.</li> <li>Ongoing monitoring of future developments of standards and interpretations to occur until completion of IFRS implementation.</li> </ul>	<ul style="list-style-type: none"> <li>Completed training for general awareness of IFRS to broad group of finance employees, Steering Committee, Board of Directors and Audit Committee.</li> <li>Completed IFRS Implementation training for finance personnel across the organization on key impacts of transition for the Company, changes in accounting policy and dual reporting year requirements.</li> <li>Frequent project status communications have been provided to internal and external stakeholders.</li> <li>Frequent attendance by key personnel at relevant seminars, participation in industry peer groups and utilization of key technical resources.</li> <li>Ongoing monitoring of future developments of standards and interpretations through review of the International Accounting Standards Board ("IASB") work plan and projects underway.</li> </ul>
<b>Information systems</b>	<ul style="list-style-type: none"> <li>Determine if business processes require change to be IFRS compliant.</li> <li>Determine if software requires upgrades, changes, or additions to support IFRS reporting requirements.</li> </ul>	<ul style="list-style-type: none"> <li>IT implementation approach to be completed in fiscal 2010.</li> <li>Changes to systems and dual record-keeping process to be completed at the beginning of fiscal 2011.</li> <li>Preparation of quarterly financial information during fiscal 2011 to produce comparative information required in the Company's fiscal 2012 IFRS financial statements.</li> </ul>	<ul style="list-style-type: none"> <li>Assessment of business processes is underway in conjunction with work on accounting policies.</li> <li>Completed IT implementation plan in fiscal 2010 to address new information requirements under IFRS particularly related to a significant increase in note disclosures.</li> <li>Changes to information systems required to prepare the opening balance sheet and gather appropriate information for dual reporting for fiscal 2011 have been completed.</li> </ul>



	Key Activities	Milestones/Deadlines	Progress to Date
<b>Contractual arrangements and compensation</b>	<ul style="list-style-type: none"> <li>Assess the affect of IFRS on: <ul style="list-style-type: none"> <li>Financial covenants;</li> <li>Compensation arrangements;</li> <li>Budgeting and planning.</li> </ul> </li> <li>Make any required changes to plans and arrangements.</li> </ul>	<ul style="list-style-type: none"> <li>Complete necessary covenant negotiations during fiscal 2011.</li> <li>Complete review of compensation arrangements during fiscal 2011.</li> <li>Complete budgeting plan during fiscal 2011.</li> </ul>	<ul style="list-style-type: none"> <li>Preliminary analysis is underway in conjunction with work on accounting policies. Additionally, key performance indicators (“KPI”) and budgeting IFRS project groups have been formed to assess transition impacts.</li> </ul>
<b>Control environment</b>	<ul style="list-style-type: none"> <li>Assess, design, and implement internal controls over financial reporting (“ICFR”) for all accounting policy changes.</li> <li>Assess, design, and implement disclosure controls and procedures (“DC&amp;P”) for all identified accounting policy changes.</li> </ul>	<ul style="list-style-type: none"> <li>Changes to ICFR and DC&amp;P to be completed during fiscal 2011.</li> <li>Test and evaluate revised controls throughout fiscal 2011.</li> <li>Update Chief Executive Officer/Chief Financial Officer certification process by the end of fiscal 2011.</li> </ul>	<ul style="list-style-type: none"> <li>Analysis of control issues is underway in conjunction with the review of IFRS accounting issues and policies.</li> <li>MD&amp;A disclosures are regularly reviewed and updated with changes in the project status.</li> <li>IFRS Communications Committee, which includes Investor Relations, has been assembled and is engaged.</li> </ul>

### Significant Changes in Accounting Policies

The Company continues to assess the effect of the adoption of IFRS and the resulting changes in accounting policies. Any significant accounting policy changes that have been identified to date are detailed below. The list is for significant accounting policy changes identified only, and should not be considered a complete list of all IFRS accounting policy differences for the Company. 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 IASB to determine their impact on the Company.

At this time, the Company is assessing the quantitative impact of the opening balance sheet transitional adjustments and expects to report quantified IFRS results later in fiscal 2011. As IFRS results are quantified throughout the changeover year, the results will be reported on a timely basis.

Key Accounting Policy	Key Difference Between IFRS and Canadian GAAP for the Company	Potential Key Impacts for the Company
<b>Property, Plant &amp; Equipment</b>	<ul style="list-style-type: none"> <li>IFRS allows the measurement of fixed assets using a cost model or a revaluation model. Canadian GAAP only permits the use of a cost model. The Company has selected to continue using the cost model approach under IFRS.</li> <li>IFRS requires separate amortization of major components of an asset. Under Canadian GAAP this requirement exists, however is less explicit.</li> </ul>	<ul style="list-style-type: none"> <li>Opening balance sheet: The impact is currently being evaluated by the Company.</li> <li>Subsequent to transition: No significant impact is expected because the Company has selected the same measurement model under IFRS as is utilized under Canadian GAAP.</li> <li>Opening balance sheet: No significant impact is expected. Significant components of assets have been reviewed to determine that the Company separates major components of assets under Canadian GAAP, therefore no change is required.</li> <li>Subsequent to transition: No significant impact is expected. Assets will be reviewed to identify separate components at each reporting date.</li> </ul>

Key Accounting Policy	Key Difference Between IFRS and Canadian GAAP for the Company	Potential Key Impacts for the Company
<b>Investment property</b>	<ul style="list-style-type: none"> <li>Investment property is a new concept under IFRS that does not exist under Canadian GAAP. Investment properties are defined as properties that are held to earn rentals and/or held for capital appreciation. Investment properties are separately recorded and disclosed under IFRS, while they are recorded with property, plant, and equipment under Canadian GAAP.</li> </ul>	<ul style="list-style-type: none"> <li>Opening balance sheet: Investment properties will be identified at the date of transition to IFRS and will be separately recorded and disclosed from property, plant and equipment in the opening IFRS balance sheet. The impact is currently being evaluated by the Company.</li> <li>Subsequent to transition: No significant impact is expected. The Company has selected the cost model for the measurement of investment properties. Therefore, the investment properties identified will continue to be measured as they were under Canadian GAAP when classified as property, plant, and equipment. Investment properties will be assessed at each reporting date.</li> <li>When utilizing the cost model, the Company must disclose the aggregated fair value of all investment properties. The Company is in the process of obtaining information for this disclosure.</li> </ul>
<b>Impairment of long-lived assets</b>	<ul style="list-style-type: none"> <li>IFRS tests asset groups for impairment at the independent cash-generating unit ("CGU") level based on generation of cash inflows. Under Canadian GAAP, asset groups are defined based on net cash flows.</li> <li>IFRS has guidelines surrounding the highest asset group that goodwill and indefinite-life intangible assets can be allocated to for impairment testing purposes that may differ from Canadian GAAP for certain entities.</li> </ul>	<ul style="list-style-type: none"> <li>Grouping of assets for impairment purposes will be at a lower level than under Canadian GAAP.</li> <li>Opening balance sheet: Impairment testing for CGUs where an indicator of impairment exists will be conducted on the Company's transition date. The Company has not yet completed the assessment of the impact.</li> <li>Subsequent to transition: New monitoring of indicators of impairment will have to be conducted at the CGU level, which represents an individual retail store outlet or theatre for the Company. Increased impairment testing may need to be conducted if indicators exist.</li> <li>Opening balance sheet: No significant impact is expected. Goodwill and indefinite-life impairment testing from previous acquisitions will be at a level consistent with Canadian GAAP.</li> <li>Subsequent to transition: Goodwill arising from future business acquisitions will be allocated to asset groups based on the synergies expected from the transaction.</li> </ul>

Key Accounting Policy	Key Difference Between IFRS and Canadian GAAP for the Company	Potential Key Impacts for the Company
<b>Impairment of long-lived assets (continued)</b>	<ul style="list-style-type: none"> <li>IFRS requires a single-step impairment test for long-lived assets based on discounted cash flows. Under Canadian GAAP, a two-step approach is used which first compares undiscounted cash flows to the carrying amount and only measures an impairment based on fair value if the undiscounted cash flow is less than its carrying value.</li> <li>Under IFRS previously recognized impairment losses must be considered for reversal when a change in circumstances indicates impairment has been reduced for long-lived assets other than goodwill or indefinite life intangible assets. Reversals of impairment are prohibited under Canadian GAAP.</li> </ul>	<ul style="list-style-type: none"> <li>Opening balance sheet: No significant impact is expected.</li> <li>Subsequent to transition: The one step impairment test under IFRS may result in more frequent write-downs of assets.</li> <li>Opening balance sheet: No significant impact is expected.</li> <li>Subsequent to transition: No significant impact is expected. Additional monitoring surrounding indicators of impairment reversal will need to be conducted. Reversal of previous impairments may be required.</li> </ul>
<b>Leases</b>	<ul style="list-style-type: none"> <li>IFRS does not provide the same quantitative guidelines as Canadian GAAP, but rather has additional qualitative considerations for classification of leases between 'operating' and 'finance' ('capital' under Canadian GAAP) leases.</li> <li>IFRS has different recognition principles surrounding sale leaseback transactions where the lease is classified as an 'operating' lease and the transaction occurs at fair market value.</li> <li>IFRS permits recognition of the realized portion of gains on transactions between related parties to the extent of ownership by non-related parties.</li> </ul>	<ul style="list-style-type: none"> <li>Opening balance sheet: No significant impact is expected as the Company had already applied a classification approach which included both quantitative and qualitative considerations.</li> <li>Subsequent to transition: All new leases will continue to be assessed as 'operating' or 'finance' leases. No significant impact is expected.</li> <li>Opening balance sheet: Certain gains related to historical sale leaseback transactions will be recognized on transition to IFRS. Realized portions of historical gains related to sale leaseback transactions with related parties will be recognized on transition to IFRS.</li> <li>Subsequent to transition: Gains on sale leaseback transactions where the lease is an 'operating' lease and the transaction occurs at fair market value will result in the immediate recognition of any gain rather than deferral over the lease term as under Canadian GAAP. Transactions between related parties will result in the recognition of gains for the realized portion if certain criteria are met.</li> </ul>

Key Accounting Policy	Key Difference Between IFRS and Canadian GAAP for the Company	Potential Key Impacts for the Company
<b>Provisions</b>	<ul style="list-style-type: none"> <li>• IFRS uses different terminology than Canadian GAAP and provides more extensive guidance on recognition of provisions defined as liabilities with uncertain timing and/or amount, including the following:                             <ul style="list-style-type: none"> <li>– provisions are recognized when it is probable (more likely than not) that an outflow of resources will be required to settle the obligation, while a higher threshold is used under Canadian GAAP;</li> <li>– provisions will be separately classified from other liabilities (current and non-current) on the face of the balance sheet and subject to additional disclosure requirements;</li> <li>– provisions are recognized if either a legal obligation or constructive obligation exists, while only legal obligation is considered under Canadian GAAP;</li> <li>– a provision must be recognized if a contract becomes onerous where the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received from it; and</li> <li>– provisions are discounted when impact is material.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Opening balance sheet and subsequent to transition: The Company has not yet finalized the assessment of the impact on its opening IFRS balance sheet. It is possible that additional provisions will be recognized under IFRS and/or measurement or timing of recognition of existing liabilities may differ.</li> </ul>
<b>Customer loyalty programs</b>	<ul style="list-style-type: none"> <li>• IFRS requires a deferred revenue recognition approach for customer loyalty programs with the fair value of the award credits to be recognized as a separate component of the sales transaction. Under Canadian GAAP an entity can use a deferred revenue approach or account for the program as an expense. The Company uses the latter approach under Canadian GAAP.</li> </ul>	<ul style="list-style-type: none"> <li>• Opening balance sheet impact: There will be a one-time adjustment related to the deferral of revenue recognized under Canadian GAAP. While the amount is currently being assessed, the Company expects this will not have a significant impact on transition.</li> <li>• Subsequent to transition: No significant impact is expected. The Company will account for its customer loyalty programs using the deferred revenue approach.</li> </ul>



Key Accounting Policy	Key Difference Between IFRS and Canadian GAAP for the Company	Potential Key Impacts for the Company
<b>Employee benefits</b>	<ul style="list-style-type: none"> <li>• IFRS requires vested past service costs of defined benefit pension plans to be expensed immediately and unvested past service costs to be recognized on a straight-line basis until the benefits become vested. Under Canadian GAAP, all past service costs are generally amortized on a straight-line basis over the average remaining service period of employees active at the date of the amendment, or a shorter period.</li> <li>• IFRS requires an entity to make an accounting policy choice regarding the recognition of actuarial gains and losses. The three options that are available are as follows: <ul style="list-style-type: none"> <li>– deferred recognition using a “corridor” approach;</li> <li>– immediate recognition through the income statement; or</li> <li>– immediate recognition through other comprehensive income.</li> </ul> </li> <li>• The Company has chosen to recognize actuarial gains and losses immediately through other comprehensive income. This policy was not available to the Company under Canadian GAAP. Previously the Company delayed recognition of actuarial gains and losses by utilizing a “corridor” approach.</li> </ul>	<ul style="list-style-type: none"> <li>• Opening balance sheet impact: There will be a one-time adjustment to recognize any vested past service costs at the date of transition to IFRS. While the amount is currently being assessed, the Company expects this will not have a significant impact on transition.</li> <li>• Subsequent to transition: The Company will recognize vested past service costs immediately at the date of a plan amendment rather than amortizing those costs on a straight-line basis.</li> <li>• Opening balance sheet impact: No significant impact is expected as a result of this policy choice; however an adjustment to retained earnings is expected as a result of the Company opting to utilize an IFRS 1 exemption to recognize all unamortized actuarial gains and losses through retained earnings upon transition to IFRS.</li> <li>• Subsequent to transition: The Company will recognize actuarial gains and losses into other comprehensive income immediately as they are incurred rather than delaying their recognition and amortizing those gains and losses over time.</li> </ul>
<b>Consolidation – Special Purpose Entities (“SPEs”)</b>	<ul style="list-style-type: none"> <li>• IFRS uses a more principles-based control model for consolidation of SPEs. Entities are to be consolidated if the Company has the majority of the risks and rewards of ownership over the subject entity. The control factors considered include: <ul style="list-style-type: none"> <li>– a majority share ownership;</li> <li>– ability to control the Board;</li> <li>– power to govern financial and operating policies; and</li> <li>– contracted arrangements conferring effective control.</li> </ul> </li> <li>• Under Canadian GAAP, VIEs are consolidated based on their equity investment at risk.</li> </ul>	<ul style="list-style-type: none"> <li>• Opening balance sheet impact: The control factors under IFRS for consolidation will be considered as at the transition date to IFRS, specifically related to consolidation of certain franchises. No significant impact is expected as a result of preliminary assessments as most VIEs under Canadian GAAP will continue to be consolidated as SPEs under IFRS.</li> <li>• Subsequent to transition: At each reporting date the Company will continue to assess whether entities must be consolidated by using the IFRS control model.</li> </ul>

Key Accounting Policy	Key Difference Between IFRS and Canadian GAAP for the Company	Potential Key Impacts for the Company
<b>Consolidation – subsidiaries and investments in associates</b>	<ul style="list-style-type: none"> <li>IFRS requires the use of consistent group accounting policies which is not explicitly required under Canadian GAAP.</li> </ul>	<ul style="list-style-type: none"> <li>Opening balance sheet impact and subsequent to transition: No significant changes are expected, however, the Company is working closely with all of its investments to ensure that IFRS transition impacts are appropriately captured.</li> </ul>
<b>Joint Ventures</b>	<ul style="list-style-type: none"> <li>Existing IAS 31, <i>Interests in Joint Ventures</i>, allows an entity to account for jointly controlled operations using proportionate consolidation or the equity method. The IASB has a current project underway that will require joint ventures to be accounted for using the equity method, which is expected to be issued in June 2010. Under Canadian GAAP these type of investments are accounted for using proportionate consolidation.</li> </ul>	<ul style="list-style-type: none"> <li>Opening balance sheet impact and subsequent to transition: Certain investments in joint ventures will be accounted for using the equity method rather than proportionate consolidation method used for Canadian GAAP.</li> </ul>

### First-Time Adoption of IFRS

IFRS 1, "First-time Adoption of International Financial Reporting Standards", provides guidance for an entity's initial year of IFRS adoption. The Company must apply this standard in fiscal 2012. IFRS 1 generally requires retrospective application of all IFRSs at the reporting date, with the exception of limited optional exemptions and certain mandatory exceptions that are detailed in the standard. The most significant optional IFRS 1 exemptions that the Company expects to apply in its opening IFRS balance sheet are summarized as follows:

#### Business Combinations

The Company expects to apply IFRS 3, "Business Combinations", prospectively from the date of transition to IFRS. IFRS 3 will only be applied to business combinations that occur after the date of transition, however specific requirements must be met for historical business combinations, such as: maintaining the classification of the acquirer and the acquiree, recognizing or derecognizing certain acquired assets or liabilities as required under IFRSs and re-measuring certain assets and liabilities at fair value. There is no expected impact to the Company's opening IFRS balance sheet as a result of this election.

#### Fair Value as Deemed Cost

The Company expects to elect to report certain items of property, plant and equipment, investment property, and/or intangible assets in its opening IFRS balance sheet at a deemed cost instead of the actual cost that would be determined under IFRSs. The deemed cost of an item may be either its fair value at the date of transition to IFRSs or an amount determined by a previous revaluation under Canadian GAAP (as long as that amount was close to either its fair value, cost or adjusted cost). The exemption can be applied on an asset-by-asset basis, and

the Company is currently evaluating individual assets for which the election may apply. The impact on the Company's opening IFRS balance sheet is not currently known as the assessment is currently in progress.

#### Employee Benefits

The Company expects to make the election to recognize all cumulative actuarial gains and losses through retained earnings at the date of transition to IFRSs. Actuarial gains and losses would have to be recalculated under IFRSs from the inception of each of the Company's defined benefit plans if the exemption was not taken. This election must be applied to all defined benefit plans consistently. The quantified amount of this adjustment is currently being assessed to determine its impact on the opening IFRS balance sheet.

#### Cumulative Translation Differences

The Company expects to elect not to calculate the currency translation difference in accordance with IAS 21, *The Effects of Changes in Foreign Exchange Rates*, from the date a foreign subsidiary or associate was formed or acquired. Instead, the cumulative translation balance for all foreign operations will be set to zero at the date of transition to IFRS.

#### Assets and Liabilities of Subsidiaries

The Company has subsidiaries that will adopt IFRS at an earlier date than the Company. The Company expects to elect to measure in its financial statements, the assets and liabilities of these subsidiaries by using the carrying amounts included in the subsidiaries' own financial statements.

## CRITICAL ACCOUNTING ESTIMATES

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

### Pension, Post-Retirement and Post-Employment Benefits

Certain estimates and assumptions are used in actuarially determining the Company's defined pension and employee future benefits obligation.

Significant assumptions used to calculate the pension and employee future benefits obligation are the discount rate, the expected long-term rate of return on plan assets and expected growth rate of health care costs. These assumptions depend on various underlying factors such as economic conditions,

investment performance, employee demographics and mortality rates. These assumptions may change in the future and may result in material changes in the pension and employee benefit plans expense. The magnitude of any immediate impact, however, is mitigated by the fact that net actuarial gains and losses in excess of ten percent of the greater of the accrued benefit plan obligation and the market value of the benefit plan assets are amortized on a straight-line basis over the average remaining service period of the active employees. Changes in financial market returns and interest rates could also result in changes in funding requirements for the Company's defined benefit pension plans.

The discount rate is based on current market interest rates assuming a portfolio of corporate AA bonds with terms to maturity that, on average, match the terms of the obligation. The appropriate discount rates are determined on April 30th every year. For fiscal 2010, the discount rate used for calculation of pension and other benefit plan expense was 5.50 percent and 5.75 percent, respectively (fiscal 2009 – 6.25 percent and 6.00 percent). The expected long-term rate of return on plan assets for pension benefit plans for fiscal 2010 was 7.0 percent (fiscal 2009 – 7.0 percent). The expected growth rate in health care costs was 9.0 percent for fiscal 2009, fiscal 2010 and fiscal 2011 then grading down by 0.5 percent per annum to an ultimate rate of 5.0 percent in fiscal 2019. The expected future growth rate is evaluated on an annual basis.

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

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

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

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

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

### Goodwill and Long-Lived Assets

Goodwill is not amortized and is assessed for impairment at the reporting unit level. This is done annually at a minimum. Any potential goodwill impairment is identified by comparing the fair value of a reporting unit to its carrying value. If the fair value of the reporting unit exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value of the reporting unit exceeds its fair value, potential goodwill impairment has been identified and must be quantified by comparing the estimated fair value of the reporting unit's goodwill to its carrying value. Any goodwill impairment will result in a reduction in the carrying value of goodwill on the consolidated balance sheet and in the recognition of a non-cash impairment charge in operating income.

The Company periodically assesses the recoverability of long-lived assets when there are indications of potential impairment. In performing these analyses, the Company considers such factors as current results, trends and future prospects, current market value and other economic factors.

A substantial change in estimated undiscounted future cash flows for these assets could materially change their estimated fair values, possibly resulting in additional impairment. Changes which may impact future cash flows include, but are not limited to, competition and general economic conditions and unrecoverable increases in operating costs.

### Income Taxes

Future income tax assets and liabilities are recognized for the future income tax consequences attributable to temporary differences between the financial statement carrying values of assets and liabilities and their respective income tax bases. Future income tax assets or liabilities are measured using enacted or substantively enacted income tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The

calculation of current and future income taxes requires management to make estimates and assumptions and to exercise a certain amount of judgment. The financial statement carrying values of assets and liabilities are subject to accounting estimates inherent in those balances. The income tax bases of assets and liabilities are based upon the interpretation of income tax legislation across various jurisdictions. The current and future income tax assets and liabilities are also impacted by expectations about future operating results and the timing of reversal of temporary differences as well as possible audits of tax filings by the regulatory authorities. Management believes it has adequately provided for income taxes based on current available information.

Changes or differences in these estimates or assumptions may result in changes to the current or future income tax balances on the consolidated balance sheet.

### Valuation of Inventories

Inventories are valued at the lower of cost and estimated net realizable value. Significant estimation or judgment is required in the determination of (i) inventories counted at retail and adjusted to cost and (ii) estimated inventory reductions due to spoilage and shrinkage occurring between the last physical inventory count and the balance sheet date, and (iii) estimated inventory provisions associated with vendor allowances and internal charges. Changes or differences in any of these estimates may result in changes to inventories on the consolidated balance sheet and a charge or credit to operating income in the consolidated statement of earnings.

Inventory shrinkage, which is calculated as a percentage of the related inventory, is evaluated throughout the year and provides for estimated inventory shortages from the last physical count to the balance sheet date. To the extent that actual losses experienced vary from those estimated, inventories, operating income and consolidated earnings may be impacted.

## CONTROLS AND PROCEDURES

Management is responsible for establishing and maintaining DC&P to provide reasonable assurance that material information relating to Empire is made known to management by others, particularly during the period in which the annual filings are being prepared, and that information required to be disclosed by the Company and its annual filings, interim filings and other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time periods specified in securities legislation. The CEO and CFO have evaluated the effectiveness of the Company's DC&P and have concluded as at May 1, 2010 that Empire's DC&P were designed and operating effectively, and that there were no material weaknesses relating to the design or operation of the DC&P.

Management is also responsible for establishing and maintaining adequate 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"). The CEO and CFO have evaluated the effectiveness of Empire's ICFR and have concluded as at May 1, 2010 that Empire's ICFR was designed and operating effectively, and that there were no material weaknesses relating to the design or operations of the ICFR. There have been no changes in the Company's ICFR during the period beginning on January 31, 2010 and ended on May 1, 2010 that have materially affected, or are reasonably likely to materially affect, Empire's ICFR.

## RELATED-PARTY TRANSACTIONS

The Company rents premises from Crombie REIT. In addition, for a period of five years commencing March 23, 2006, Crombie REIT provides administrative and management services to the Company pursuant to a management cost sharing agreement dated March 23, 2006, between a subsidiary of Crombie REIT and ECL. The rental payments are at exchange amount which represents the amount negotiated between the parties as part of the lease agreement. The charges incurred for administrative and management services are on a cost recovery basis (billed at the cost incurred by the invoicing party). For the 52 weeks ended May 1, 2010, the aggregate rental payments to Crombie REIT were \$57.3 million (2009 – \$46.4 million). For the 52 weeks ended May 1, 2010, charges incurred for administrative and management services were \$2.1 million (2009 – \$2.9 million). The Company has non-interest bearing notes payable to Crombie REIT in the amount of \$7.7 million related to the subsidy payments to Crombie REIT pursuant to an omnibus subsidy agreement dated March 23, 2006 between certain subsidiaries of Crombie REIT and ECL.

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. During Empire's second quarter, as a result of the improved financial market conditions, this facility was cancelled.

The Company has provided Crombie REIT with fixed rate second mortgage in the amount of \$5.9 million (2009 – \$6.2 million). The second mortgages have a weighted average interest rate of 5.38 percent with a maturity date of March 2014.

Concurrent with placing the \$6.2 million in mortgage financing in fiscal 2009, the authorized amount of the demand loan facility between Empire and Crombie REIT was reduced from \$20.0 million to \$13.8 million prior to its cancellation in the second quarter as discussed.

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.

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

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

On a fully diluted basis (assuming conversion of all outstanding convertible securities of Crombie REIT), the Company's interest in Crombie REIT would be approximately 40.3 percent.

## Subsequent Events

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

On June 4, 2010, the Company renewed its non-consolidated \$650.0 million credit facility that matured on that date for an additional three-year term to expire on June 30, 2013. When completing the credit renewal, Empire's management determined that the Company's credit requirements had decreased and, as a result, the size of the facility was reduced to \$450.0 million from \$650.0 million.

On July 8, 2010, it was announced that Sobeys has entered into a non-binding letter of intent for the sale of \$102 million of Canadian retail properties to Crombie REIT comprising a portfolio of 11 retail properties (the "Portfolio"). The Portfolio totals approximately 496,630 square feet and consists of eight properties located in Western Canada, two in Ontario and

one in Atlantic Canada. The sale price represents a going in capitalization rate of approximately 7.7 percent.

Crombie REIT has also entered into an agreement with a syndicate of underwriters to issue, on a bought-deal basis, 2,670,000 units (the "Units") at a price of \$11.05 per unit for gross proceeds of approximately \$29.5 million. Concurrently, ECL Developments, in satisfaction of its pre-emptive right with respect to the public Unit offering, will subscribe for 1,855,000 Exchangeable LP Units at a price of \$11.05 per unit for additional gross proceeds of \$20.5 million. Consequently, the Company's interest in Crombie REIT is expected to decrease from 47.4 percent to 47.0 percent. The total \$50 million offering is subject to regulatory approval. The terms of the offering will be described in a short form prospectus to be filed with Canadian securities regulators. The offering of Units is expected to close on or about August 4, 2010 and is not conditional upon completion of Crombie REIT's acquisition of the Portfolio.



## Other Matters

### Asset Backed Commercial Paper

As of May 1, 2010, the Company included in other long-term assets is \$30.0 million (2009 – \$30.0 million) of third-party ABCP which the Company estimates the fair value to be \$21.2 million (2009 – \$17.8 million), approximately 71 percent (2009 – 59 percent) of the face value. On January 21, 2009, the Company derecognized the existing held to maturity assets and received restructured ABCP MAV II notes: A1 – \$7.8 million, A2 – \$17.5 million, B – \$3.2 million, C – \$0.9 million and \$0.6 million of tracking notes (collectively 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 are fair valued at each reporting period. During fiscal 2009, the Company received \$1.0 million of interest and recorded a \$4.7 million pre-tax provision. The Company updated its analysis of the fair value of the restructured notes, including factors such as estimated cash flow scenarios and risk adjusted discount rates, and a pre-tax gain of \$3.4 million was recorded in the year ended May 1, 2010.

Discount rates vary depending upon the credit rating of the restructured long-term floating rate notes. Discount rates have been estimated using Government of Canada benchmark rates plus expected spreads for similarly rated instruments

with similar maturities and structure. The Company has performed a sensitivity analysis on estimated discount rates used in the fair value analysis and determined that a change of one percent would result in a pre-tax change in the fair value of these investments of approximately \$1.6 million (2009 – \$1.3 million).

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

### Employee Future Benefit Obligations

For the 52 weeks ended May 1, 2010, the Company contributed \$6.0 million (2009 – \$5.8 million) to its registered defined benefit plans. The Company expects to contribute approximately \$6.1 million in fiscal 2011 to these plans. The Company continues to assess the impact of the capital markets on its funding requirement.

## Designation for Eligible Dividends

“Eligible dividends” receive favorable treatment for income tax purposes. To be an eligible dividend, a dividend 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.

## Contingencies

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

On June 21, 2005 Sobeys received a notice of reassessment from CRA for fiscal years 1999 and 2000 related to Lumsden Brothers Limited (“Lumsden”), a wholesale subsidiary of

Sobeys, and the Goods and Service Tax (“GST”). The reassessment related to GST on sales of tobacco products to status Indians. CRA asserts that Lumsden was obliged to collect GST on the sales of these tobacco products to status Indians. The total tax, interest and penalties in the reassessment amounts to \$13.6 million. Lumsden 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 statements of earnings any of the tax, interest or penalties in the notice of reassessment. Sobeys has deposited with CRA funds to cover the total tax, interest and penalties in the reassessment and has recorded this amount as an other long-term receivable from CRA pending resolution of the matter.

## Risk Management

Through its operating companies and its equity-accounted investments, Empire is exposed to a number of risks in the normal course of business that have the potential to affect operating performance. The Company has operating and risk management strategies and insurance programs to help minimize these operating risks.

Empire has adopted an annual enterprise risk management assessment which is overseen by the Company's senior management and reported to the Board of Directors and the Audit Committee. The enterprise risk management framework sets out principles and tools for identifying, evaluating, prioritizing and managing risk effectively and consistently across Empire.

### Competition

Empire's food retailing business, through Sobeys, operates in a dynamic and competitive market. Other national and regional food distribution companies along with non-traditional competitors, such as mass merchandisers and warehouse clubs, represent a competitive risk to Sobeys' ability to attract customers and operate profitably in its markets.

Sobeys maintains a strong national presence in the Canadian retail food and food distribution industry through regionally managed operations. The most significant risk to Sobeys is the potential for reduced revenues and profit margins as a result of increased competition. To mitigate this risk, Sobeys' strategy is to be geographically diversified with the benefits of national scale and regional management deployment, to be customer and market-driven, to be focused on superior execution, and to have efficient, cost effective operations. Sobeys reduces its exposure to competitive or economic pressures in any one region of the country by operating in each region of Canada through a network of corporate, franchised, and affiliated stores, and through servicing the needs of thousands of independent, wholesale accounts. Sobeys approaches the market with five distinct formats, with a variety of banners and store sizes to meet anticipated needs of its customers in order to enhance profitability by region and by target market.

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.

Empire's real estate operations, through ECL, compete with numerous other developers, managers, and owners of real estate properties in seeking tenants and new properties for future development. The existence of competing developers, managers and owners could affect our real estate group's ability to: (i) acquire a prospective property in compliance with our investment criteria; (ii) lease space in its properties and (iii) maximize rents charged and minimize concessions granted. Commercial property revenue is also dependent on the renewal of lease arrangements by key tenants. These factors could adversely affect revenues and cash flows.

Continued growth of rental income is dependant on renewing expiring leases and finding new tenants to fill vacancies at market rental rates, thereby ensuring an attractive return on our investment. The success of the real estate portfolio is also subject to general economic conditions, the supply and demand for rental property in key markets served, and the availability of attractive financing to expand the real estate portfolio where deemed prudent.

Genstar faces competition from other residential land developers in securing attractive sites for new residential lot development. Although Genstar does hold land for future development, it faces significant competition when looking to acquire new land for future development.

### Financial

Empire and its operating companies have adopted a number of key financial policies to manage financial risk. Risks can also arise from changes in the rules or standards governing accounting or financial reporting. The Company employs numerous professionally accredited accountants throughout its finance group.

In the ordinary course of managing its debt, the Company utilizes financial instruments from time to time to manage the volatility of borrowing costs. Financial instruments are not used for speculative purposes. The majority of the Company's debt is at fixed rates; accordingly, there is a limited exposure to interest rate risk.

### Liquidity Risk

Liquidity risk is the risk that the Company may not have cash available to satisfy financial obligations as they come due. The Company actively maintains committed credit facilities to ensure that it has sufficient available funds to meet current and foreseeable future financial requirements at a reasonable cost. The Company monitors capital markets and the related economic conditions. Market conditions allowing, the Company will access debt capital markets for various long-term debt maturities and as other liabilities come due or as assessed to be appropriate in order to minimize risk and optimize pricing.

### Interest Rate Risk

Interest rate risk is the potential for financial loss arising from changes in interest rates. The majority of the Company's long-term debt is at fixed interest rates or hedged with interest rate swaps. Bank indebtedness and approximately 17 percent of the Company's long-term debt is exposed to interest rate risk due to floating rates.

### Insurance

Empire and its subsidiaries are self-insured on a limited basis with respect to certain operational risks and also purchase insurance coverage from financially stable third-party insurance companies. In addition to maintaining comprehensive loss prevention programs, the Company maintains management programs to mitigate the financial impact of operational risks.

### Human Resources

Empire is exposed to the risk of labour disruption in its operating companies. Labour disruptions pose a moderate operational risk, as Sobeys operates an integrated network of 24 distribution centres across the country for the food retailing division. Sobeys has good relations with its employees and unions and does not anticipate any material labour disruptions in fiscal 2011. However, Sobeys has stated that it will accept the short-term costs of a labour disruption to support a commitment to building and sustaining a competitive cost structure for the long-term.

Effective leadership is very important to the growth and continued success of the Company. The Company develops and delivers training programs at all levels across its various operating regions in order to improve employee knowledge and to better serve its customers. The ability of the Company to properly develop, train and retain its employees with the appropriate skill set could affect the Company's future performance.

There is always a risk associated with the loss of key personnel. Succession plans have been identified for key roles including the depth of management talent throughout the Company and its subsidiaries which is reviewed annually by the Human Resources Committee of the Board.

### Business Continuity

The Company is subject to unexpected events and natural hazards which could cause sudden or complete cessation of its day to day operations. One such unexpected and natural hazard is the risk of a pandemic. Sobeys has worked with industry and government sources to develop a pandemic preparedness plan. Responsibility for business continuity planning has been designated to the Human Resources Committee of the Board.

### Environmental, Health and Safety

The Company is continually enhancing its programs in areas of environmental, health and safety and is in compliance with relevant legislation. Employee awareness and training programs are conducted and environmental, health and safety risks are reviewed on a regular basis.

Any environmental site remediation is completed using appropriate, qualified internal and external resources and health and safety issues are proactively dealt with. The Board of Directors receives regular reports which review outstanding matters, identify new legislation and outline new programs being implemented across the Company to positively impact the environment and employee health and safety. Existing environmental protection regulatory requirements are not expected to have a material financial or operational effect on the capital expenditures, earnings or competitive position of the Company during the current fiscal year or in future years.

### Occupational Health and Safety

Empire and Sobeys have developed programs to promote a healthy and safe workplace, as well as progressive employment policies focused on the well-being of the thousands of employees who work in stores, distribution centres and offices. These policies and programs are reviewed regularly by the Human Resources Committee of the Board.

Each operating business conducts an ongoing, comprehensive environmental monitoring process and the Company is unaware of any material environmental liabilities in any of its operating companies. Empire's Board of Directors receives quarterly reports that review any outstanding issues including plans to resolve them.

### Food Safety and Security

Sobeys is subject to potential liabilities connected with its business operations, including potential liabilities and expenses associated with product defects, food safety and product handling. Such liabilities may arise in relation to the storage, distribution and display of products and, with respect to Sobeys' private label products, in relation to the production, packaging and design of products.

A large majority of Sobeys' sales are generated from food products and Sobeys could be vulnerable in the event of a significant outbreak of food-borne illness or increased public health concerns in connection with certain food products. Such an event could materially affect financial performance. Procedures are in place to manage food crises, should they occur. These procedures identify risks, provide clear communication to employees and consumers and ensure that potentially harmful products are removed from inventory immediately. Food safety related liability exposures are insured by the Company. In addition, Sobeys has food safety procedures and programs, which address safe food handling and preparation standards. Sobeys employs best practices for the storage and distribution of its food products.

### **Technology**

The Company and each of its operating companies are committed to improving their respective operating systems, tools and procedures in order to become more efficient and effective. The implementation of major information technology projects carries with it various risks, including the risk of realization of benefits, that must be mitigated by disciplined change management and governance processes. Sobeys has a business process optimization team staffed with knowledgeable internal and external resources that is responsible for implementing the various initiatives. The Company's Board of Directors have also created an Oversight Committee to ensure appropriate governance of these change initiatives is in place and this committee receives regular reports from the Company's management.

### **Real Estate**

The Company utilizes a capital allocation process which is focused on obtaining the most attractive real estate locations for its retail grocery stores as well as for its commercial property and residential development operations, with direct Company ownership being an important, but not overriding, consideration. Sobeys develops certain retail store locations on owned sites; however, the majority of its store development is done in conjunction with external developers. The availability of high potential new store sites and/or the ability to expand existing stores is therefore in large part contingent upon successful negotiation of operating leases with these developers and Sobeys ability to purchase these sites.

### **Legal, Taxation and Accounting**

Changes to any of the various federal and provincial laws, rules and regulations related to the Company's business could have a material impact on its financial results. Compliance with any proposed changes could also result in significant cost to the Company. Failure to fully comply with various laws, rules and regulations may expose the Company to proceedings which may materially affect its performance.

Similarly, income tax regulations and/or accounting pronouncements may be changed in ways which could negatively affect the Company. The Company mitigates the risk of not being in compliance with the various laws, rules and regulations by monitoring for newly adopted regulations, improving technology systems and controls, improving internal controls to detect and prevent errors and overall, application of more scrutiny to ensure compliance. 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.

### **Operations**

The success of Empire is closely tied to the performance of Sobeys' network of retail stores. Franchise affiliates operate approximately 53 percent of Sobeys' retail stores. Sobeys relies on the franchise affiliates and corporate store management to successfully execute retail strategies and programs.

To maintain control over Sobeys' brands and the quality and range of products and services offered at its stores, each franchisee agrees to purchase merchandise from Sobeys. In addition, each store agrees to comply with the policies, marketing plans and operating standards prescribed by Sobeys. These obligations are specified under franchise agreements which expire at various times for individual franchisees. As well, Sobeys maintains head lease control or has long-term buying agreements to control the vast majority of its retail locations.

### **Supply Chain**

Sobeys is exposed to potential supply chain disruptions that could result in shortages of merchandise in its retail store network. Sobeys mitigates this risk through effective supplier selection and procurement practices along with a reliance on the efficient maintenance and evolution of its supply and logistics chain to sustain and meet growth objectives.

### **Seasonality**

The Company's operations as they relate to food, specifically inventory levels, sales volume and product mix, are impacted to some degree by certain holiday periods in the year.

### **Product Costs**

Sobeys is a significant purchaser of food product which may be at risk of cost inflation given rising commodity prices and other costs of production to food manufacturers. Should rising cost of product materialize in excess of expectations and should Sobeys not be able to offset such cost inflation through higher retail prices and/or other cost savings, there could be a negative impact on sales and margin performance. Sobeys has various procurement and merchandising programs in place to mitigate this risk.

### Utility and Fuel Prices

The Company is a significant consumer of electricity, other utilities and fuel. Unanticipated cost increases in these items could negatively affect the Company's financial performance. The Company has various consumption and procurement programs in place to minimize utility risk.

### Foreign Operations

Empire does not directly carry out foreign operations; however, Sobeys does have certain foreign operations. Sobeys' foreign operations are limited to a small number of produce brokerage operations based in the United States. These foreign operations are relatively small and are not considered material to Empire on a consolidated basis; as such, the Company does not have any material risks associated with foreign operations.

### Foreign Currency

The Company conducts the majority of its operating business in Canadian dollars and its foreign exchange risk is limited to currency fluctuations between the Canadian dollar, the Euro, and the U.S. dollar. U.S. dollar purchases of product by the food division represent approximately three percent of Sobeys' total annual purchases with Euro purchases limited to specific contracts for capital expenditures. Sobeys has processes in place to use forward contracts with high quality counter-parties to fix the exchange rate on some of its expected requirements for Euros and U.S. dollars.

### Ethical Business Conduct

Any failure of the Company to adhere to its policies, the law or ethical business practices could significantly affect its reputation and brands and could therefore negatively impact the Company's financial performance. The Company's framework for managing ethical business conduct includes the adoption of a Code of Business Conduct and Ethics which directors and employees of the Company are required to acknowledge and agree to on a regular basis and, as part of an independent audit and security function, maintenance of a whistle-blowing hotline.

### Information Management

The integrity, reliability and security of information in all its forms are critical to the Company's daily and strategic operations. Inaccurate, incomplete or unavailable information and/or inappropriate access to information could lead to incorrect financial and/or operational reporting, poor decisions, privacy breaches and/or inappropriate disclosure or leaks of sensitive information.

Information management is identified as a risk in its own right, separate from the technology risk. The Company recognizes that information is a critical enterprise asset. Currently, the information management risk is being managed at the regional and national levels through the development

of policies and procedures pertaining to security access, system development, change management and problem and incident management. With a view to enhancing and standardizing the controls to manage the information management risk, the Company is developing corporate operating policies which establish minimum standards for the usage, security and appropriate destruction of information. Furthermore, enterprise metrics are being identified to assist in monitoring significant information management risks.

### Capital Allocation

The risk associated with capital allocation is high for a holding company, especially due to the amount of capital invested in the operating companies. It is important to ensure the capital allocation decisions result in an appropriate return on capital. The Company has a number of strong mitigation strategies in place regarding the allocation of capital, including the Board review of capital allocation decisions. The Company has established prudent hurdle rates for capital investments that are evaluated through a strong due diligence process.

### Access to Capital

Access to capital risk refers to Empire being unable to obtain required capital at reasonable terms, given the prevailing market conditions. There are several factors that impact the level of inherent risk: the state of the capital markets; the level of capital required; the credit rating assigned by the rating agencies and the availability of credit from the banks. Empire mitigates these risks by maintaining strong relationships with its banks and access to the capital markets.

### Economic Environment

Economic conditions have shown some improvement from fiscal 2009 to the end of fiscal 2010; however, management continues to regard conditions as unfavourable which could result in a potential risk to the Company. Management continues to closely monitor economic conditions, including interest rates, inflation, employment rates and capital markets. Management believes that although a weakening economy has an impact on all businesses and industries, the Company has an operational and capital structure that is sufficient to meet its ongoing business requirements.

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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).

Stellarton, Nova Scotia, Canada  
June 25, 2010



## Management's Statement of Responsibility for Financial Reporting

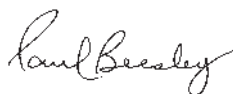
Preparation of the consolidated financial statements accompanying this annual report and the presentation of all other information in the report is the responsibility of management. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and reflect management's best estimates and judgements. All other financial information in the report is consistent with that contained in the consolidated financial statements.

Management of the Company has established and maintains a system of internal control that provides reasonable assurance as to the integrity of the consolidated financial statements, the safeguarding of Company assets, and the prevention and detection of fraudulent financial reporting.

The Board of Directors, through its Audit Committee, oversees management in carrying out its responsibilities for financial reporting and systems of internal control. The Audit Committee, which is chaired by and composed solely of directors who are unrelated to, and independent of, the Company, meet regularly with financial management and external auditors to satisfy itself as to reliability and integrity of financial information and the safeguarding of assets. The Audit Committee reports its findings to the Board of Directors for consideration in approving the annual consolidated financial statements to be issued to shareholders. The external auditors have full and free access to the Audit Committee.



**Paul D. Sobey**  
President and  
Chief Executive Officer  
June 25, 2010



**Paul V. Beesley**  
Executive Vice President and  
Chief Financial Officer  
June 25, 2010

## Auditors' Report

To the shareholders of Empire Company Limited

We have audited the consolidated balance sheets of Empire Company Limited as at May 1, 2010 and May 2, 2009, and the consolidated statements of retained earnings, comprehensive income, earnings and cash flows for the 52 week fiscal years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at May 1, 2010 and May 2, 2009, and the results of its operations and its cash flows for the fiscal years then ended in accordance with Canadian generally accepted accounting principles.



**Chartered Accountants**  
New Glasgow, Canada  
June 15, 2010 (except for Note 29(c) which is at July 8, 2010)

## Consolidated Balance Sheets

(\$ in millions)	May 1, 2010	May 2, 2009 Restated (Note 1)
<b>Assets</b>		
Current		
Cash and cash equivalents	\$ 401.0	\$ 231.6
Receivables	336.9	308.9
Loans and other receivables (Note 5)	105.8	65.6
Income taxes receivable	–	4.9
Inventories (Note 3)	880.3	842.8
Prepaid expenses	70.1	63.9
	<b>1,794.1</b>	<b>1,517.7</b>
Investments at realizable value	10.9	1.1
Investments, at equity (realizable value \$476.8; 2009 – \$254.4) (Note 4)	56.8	18.8
Loans and other receivables (Note 5)	79.2	75.3
Other assets (Note 6)	94.5	89.0
Property and equipment (Note 7)	2,548.7	2,567.8
Assets held for sale	36.5	8.5
Intangibles (Note 8)	455.0	441.5
Goodwill	1,172.6	1,171.4
	<b>\$ 6,248.3</b>	<b>\$ 5,891.1</b>
<b>Liabilities</b>		
Current		
Bank indebtedness (Note 9)	\$ 17.8	\$ 45.9
Accounts payable and accrued liabilities	1,621.6	1,487.1
Income taxes payable	19.5	–
Future income taxes (Note 17)	50.9	40.5
Long-term debt due within one year (Note 10)	379.4	133.0
	<b>2,089.2</b>	<b>1,706.5</b>
Long-term debt (Note 10)	829.0	1,124.0
Employee future benefits obligation (Note 24)	125.1	118.4
Future income taxes (Note 17)	86.4	89.5
Other long-term liabilities (Note 11)	130.6	135.0
Minority interest	35.6	38.9
	<b>3,295.9</b>	<b>3,212.3</b>
<b>Shareholders' equity</b>		
Capital stock (Note 12)	325.1	324.5
Contributed surplus	3.2	1.7
Retained earnings	2,652.2	2,401.1
Accumulated other comprehensive loss (Note 13)	(28.1)	(48.5)
	<b>2,952.4</b>	<b>2,678.8</b>
	<b>\$ 6,248.3</b>	<b>\$ 5,891.1</b>

Guarantees, commitments and contingent liabilities (Note 22)

Subsequent events (Note 29)

Approved on behalf of the Board



Director

See accompanying notes to the consolidated financial statements



Director

## Consolidated Statements of Retained Earnings

52 Weeks Ended (\$ in millions)	May 1, 2010	May 2, 2009 Restated (Note 1)
Balance, beginning of year as previously reported	\$ 2,405.8	\$ 2,207.6
Adjustment due to implementation of new accounting standard (Note 1)	(4.7)	(25.0)
Balance, beginning of year as restated	2,401.1	2,182.6
Net earnings	301.9	264.7
Dividends		
Preferred shares	(0.1)	(0.1)
Common shares	(50.7)	(46.1)
Balance, end of year	\$ 2,652.2	\$ 2,401.1

See accompanying notes to the consolidated financial statements

## Consolidated Statements of Comprehensive Income

52 Weeks Ended (\$ in millions)	May 1, 2010	May 2, 2009 Restated (Note 1)
Net earnings	\$ 301.9	\$ 264.7
Other comprehensive income (loss)		
Unrealized gains (losses) on available-for-sale financial assets, net of income taxes of \$0.2 (2009 – \$(0.1))	0.8	(0.4)
Reclassification of loss on available-for-sale financial assets to earnings, net of income taxes of \$nil	0.2	–
Unrealized gains (losses) on derivatives designated as cash flow hedges to earnings, net of income taxes of \$4.1 (2009 – \$(7.3))	7.6	(16.2)
Reclassification of loss on derivative instruments designated as cash flow hedges to earnings, net of income taxes of \$2.9 (2009 – \$1.5)	6.4	3.5
Share of comprehensive income (loss) of entities accounted for using the equity method, net of income taxes of \$4.0 (2009 – \$(7.3))	7.6	(14.1)
Foreign currency translation adjustment	(2.2)	0.2
	20.4	(27.0)
Comprehensive income	\$ 322.3	\$ 237.7

See accompanying notes to the consolidated financial statements

## Consolidated Statements of Earnings

52 Weeks Ended (\$ in millions except per share amounts)	May 1, 2010	May 2, 2009 Restated (Note 1)
Revenue	\$ 15,516.2	\$ 15,015.1
Operating expenses		
Cost of sales, selling and administrative expenses	14,728.2	14,251.7
Depreciation and amortization	339.7	336.1
	448.3	427.3
Investment income (Note 15)	31.4	38.9
Operating income	479.7	466.2
Interest expense		
Long-term debt	67.9	75.9
Short-term debt	4.6	4.7
	72.5	80.6
	407.2	385.6
Capital (losses) gains and other items (Note 16)	(0.6)	2.8
Earnings before income taxes and minority interest	406.6	388.4
Income taxes (Note 17)		
Current	109.2	122.1
Future	(10.1)	(6.7)
	99.1	115.4
Earnings before minority interest	307.5	273.0
Minority interest	5.6	8.3
Net earnings	\$ 301.9	\$ 264.7
Earnings per share (Note 2)		
Basic	\$ 4.41	\$ 4.03
Diluted	\$ 4.40	\$ 4.02
Weighted average number of common shares outstanding, in millions		
Basic	68.4	65.7
Diluted	68.5	65.8

See accompanying notes to the consolidated financial statements

## Consolidated Statements of Cash Flows

52 Weeks Ended (\$ in millions)	May 1, 2010	May 2, 2009 Restated (Note 1)
<b>Operating Activities</b>		
Net earnings	\$ 301.9	\$ 264.7
Items not affecting cash (Note 18)	358.0	352.9
Preferred dividends	(0.1)	(0.1)
	<b>659.8</b>	617.5
Net change in non-cash working capital	<b>124.3</b>	50.5
Cash flows from operating activities	<b>784.1</b>	668.0
<b>Investing Activities</b>		
Net increase in investments	(50.5)	(1.9)
Purchase of property and equipment	(434.0)	(400.6)
Proceeds on disposal of property and equipment	137.1	78.0
Additions to intangibles	(34.7)	(41.7)
Loans and other receivables	(44.1)	(14.7)
(Increase) decrease in other assets	(5.9)	8.4
Business acquisitions (Note 25)	(34.0)	(41.4)
Cash flows used in investing activities	<b>(466.1)</b>	(413.9)
<b>Financing Activities</b>		
Decrease in bank indebtedness	(28.1)	(46.7)
Issue of long-term debt	97.7	66.8
Repayment of long-term debt	(158.6)	(307.7)
Minority interest	(8.9)	(7.0)
Repurchase of preferred shares	–	(2.3)
Issue of Non-Voting Class A shares (Note 12)	–	129.1
Common dividends	(50.7)	(46.1)
Cash flows used in financing activities	<b>(148.6)</b>	(213.9)
Increase in cash and cash equivalents	<b>169.4</b>	40.2
Cash and cash equivalents, beginning of year	<b>231.6</b>	191.4
Cash and cash equivalents, end of year	<b>\$ 401.0</b>	\$ 231.6

See accompanying notes to the consolidated financial statements



## 1 Summary of significant accounting policies

### Basis of consolidation

Empire Company Limited (the "Company") is a diversified Canadian company whose key businesses include food retailing, real estate and corporate investment activities. These consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP"), and include the accounts of the Company, all subsidiary companies, including 100 percent owned Sobeys Inc. ("Sobeys"), and certain enterprises considered variable interest entities ("VIEs") where control is achieved on a basis other than through ownership of a majority of voting rights. Investments in which the Company has significant influence are accounted for using the equity method. Investments in significant joint ventures are consolidated on a proportionate basis.

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

### Changes in accounting policies

*Adopted during fiscal 2010*

#### Goodwill and intangible assets

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

#### Financial instruments – disclosures

In June 2009, the CICA issued amendments to the existing Section 3862, "Financial Instruments – Disclosures", to more closely align the section with those required under International Financial Reporting Standards ("IFRS"). The amendments include

enhanced disclosure requirements relating to fair value measurements of financial instruments and liquidity risks. These amendments apply for annual financial statements with fiscal years ending after September 30, 2009. The Company has implemented these enhanced disclosure requirements in compliance with transitional provisions. The new disclosures did not have a material impact.

*Adopted during fiscal 2009*

#### Inventories

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

#### Capital disclosures

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

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

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

### **Financial instruments – recognition and measurement**

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

*Future changes in accounting policies*

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

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

### **Multiple deliverable revenue arrangements**

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

### **Cash and cash equivalents**

Cash and cash equivalents are defined as cash, treasury bills and guaranteed investments with a maturity less than 90 days at date of acquisition.

### **Inventories**

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

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

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

### Long-lived assets

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

### Property and equipment

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

Depreciation on real estate buildings is calculated using the straight-line method with reference to each property's book value, its estimated useful life (not exceeding 40 years) and its residual value. Deferred leasing costs are amortized over the terms of the related leases.

Depreciation of other property and equipment is recorded on a straight-line basis over the estimated useful lives of the assets as follows:

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

Assets to be disposed are classified as held for sale and are no longer depreciated. Assets held for sale are recognized at the lower of book value and fair value less cost of disposal.

The Company follows the full cost method of accounting for its exploration and development of petroleum and natural gas reserves. Costs initially capitalized are depleted and depreciated using the unit-of-production method based on production volumes, before royalties, in relation to the Company's share of estimated proved petroleum and natural gas reserves.

### Capitalization of costs

#### (a) Construction projects

Certain subsidiary companies capitalize interest during the construction period until the project opening date. The amount of interest capitalized to construction in progress in the current year was \$0.6 (2009 – \$3.1).

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

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

### Deferred charges

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

### Leases

Leases meeting certain criteria are accounted for as capital leases. The imputed interest is charged against income. If the lease contains a term that allows ownership to pass to the Company, or there is a bargain purchase option, the capitalized value is depreciated over the estimated useful life of the related asset. Otherwise, the capitalized value is depreciated on a straight-line basis over the lesser of the lease term and its estimated useful life. Capital lease obligations are included in the long-term debt of the Company and are reduced by rental payments net of imputed interest. All other leases are accounted for as operating leases.

Lease allowances and incentives are recorded as other long-term liabilities and amortized as a reduction of lease expense over the term of the lease. Real estate lease expense is amortized straight-line over the entire term of the lease including free rent periods related to store fixturing. A store fixturing period varies by store but is generally considered to be one month prior to the store opening.

### Assets held for sale

Certain land and buildings have been listed for sale and reclassified as "Assets held for sale" in accordance with CICA Handbook Section 3475, "Disposal of Long-lived Assets and Discontinued Operations". These assets are expected to be sold within a twelve-month period and are no longer productive assets with no interest to develop them for future use. Assets held for sale are valued at the lower of book value and fair value less cost of disposal. Liabilities assumed upon sale of assets or debts to be repaid as part of a sale transaction are also classified as "Liabilities relating to assets held for sale".

### Intangibles

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

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

### Goodwill and intangibles with indefinite useful lives

Goodwill represents the excess of the purchase price of the business acquired over the fair value of the underlying net tangible and intangible assets acquired at the date of acquisition.

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

### Financial instruments

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

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

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

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

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

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

Inputs into the determination of fair value require significant management judgment or estimation.

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

### Guarantees

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

## Hedges

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

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

Significant derivatives include the following:

- (1) Foreign currency forward contracts for the primary purpose of limiting exposure to exchange rate fluctuations relating to expenditures denominated in foreign currencies. These contracts are designated as hedging instruments for accounting purposes. Accordingly, the effective portion of the change in the fair value of the forward contracts are accumulated in other comprehensive income until the variability in cash flows being hedged is recognized in earnings in future accounting periods.
- (2) Electricity contracts to manage the cost of electricity designated as cash flow hedges of anticipated transactions. The portion of gain or loss on derivative instruments designated as cash flow hedges that are deferred in accumulated other comprehensive income is reclassified into other income/expense when the product containing the hedged item impacts earnings.
- (3) Interest rate swaps designated as cash flow hedges to manage variable interest rates associated with some of the Company's debt portfolio. Hedge accounting treatment results in interest expense on the related debt being reflected at hedged rates rather than variable interest rates.

## Customer loyalty programs

A Club Sobeys loyalty card program (the "Program") was launched during fiscal 2009. The Program allows members to earn points on their purchases in certain Sobeys stores. As well, a Club Sobeys credit card entitles the customer to earn points for their purchases on the credit card. Members can redeem these points, in accordance with the Program rewards schedule,

for discounts on future grocery purchases, purchase products or services or elect to convert the points into Aeroplan miles which is a loyalty program run by a third party. When points are earned by Program members, the Company records an expense in its consolidated statements of earnings and establishes a liability for future redemptions by multiplying the number of points issued by the estimated cost per point. The Program liability is included in accounts payable and accrued liabilities on the Company's consolidated balance sheets. The actual cost of Program redemptions is charged against the liability account. During fiscal 2010, a loyalty card program, Club Thrifty Foods, was launched. It follows a similar point earning and redemption structure as the Club Sobeys loyalty card program.

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

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

## Future income taxes

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

## Deferred revenue

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



### Foreign currency translation

Assets and liabilities of self-sustaining foreign investments are translated at exchange rates in effect at the balance sheet date. The revenues and expenses are translated at average exchange rates for the year. Cumulative gains and losses on translation are shown in accumulated other comprehensive income.

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

### Revenue recognition

Food sales are recognized at the point-of-sale. Sales include revenues from customers through corporate stores operated by the Company and consolidated VIEs, and revenue from sales to non-VIE franchised stores, affiliated stores and independent accounts. Revenue received from non-VIE franchised stores, affiliated stores and independent accounts is mainly derived from the sale of product. The Company also collects franchise fees under two types of arrangements. Franchise fees contractually due based on the dollar value of product shipped are recorded as revenue when the product is shipped. Franchise fees contractually due based on the franchisee's retail sales are recorded as revenue weekly upon invoicing based on the franchisee's retail sales.

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

### Pension benefit plans and other benefit plans

The cost of the Company's pension benefits for defined contribution plans are expensed at the time active employees are compensated. The cost of defined benefit pension plans and other benefit plans is accrued based on actuarial valuations, which are determined using the projected benefit method pro-rated on service and management's best estimate of the expected long-term rate of return on plan assets, salary escalation, retirement ages and expected growth rate of health care costs.

Current market values are used to value benefit plan assets. The obligation related to employee future benefits is measured using current market interest rates, assuming a portfolio of Corporate AA bonds with terms to maturity that, on average, match the terms of the obligation.

The impact of changes in plan amendments is amortized on a straight-line basis over the expected average remaining service life ("EARSL") of active members. For pension benefit plans, the actuarial gains and losses and the impact of changes in the actuarial basis in excess of 10 percent of the greater of the projected benefit obligation and the market value of assets are amortized on a straight-line basis over the EARSL of the active members. For the Company's Supplemental Executive Retirement Plan ("SERP"), the impact of changes in the plan provisions are amortized over five years.

### Vendor allowances

The Company receives allowances from certain vendors whose products are purchased for resale. Included in these vendor programs are allowances for volume purchases, exclusivity allowances, listing fees and other allowances. The Company recognizes these allowances as a reduction of cost of sales, selling and administrative expenses and related inventories in accordance with EIC 144, "Accounting by a Customer (including a Reseller) for Certain Consideration Received from a Vendor". Certain allowances from vendors are contingent on the Company achieving minimum purchase levels. These allowances are recognized when it is probable that the minimum purchase level will be met and the amount of allowance can be estimated. As of the year ended May 1, 2010, the Company has recognized \$4.8 (2009 – \$5.7) of allowances in income where it is probable that the minimum purchase level will be met and the amount of allowance can be estimated.

### Use of estimates

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

### Earnings per share

Earnings per share is calculated by dividing the earnings available to common shareholders by the weighted average number of common shares outstanding during the year. Diluted earnings per share is determined based on the treasury stock method which assumes that all outstanding stock options with an exercise price below the average market price are exercised and the assumed proceeds are used to purchase the Company's common shares at the average market price during the year.

## 2 Earnings per share

Earnings applicable to common shares is comprised of the following:

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

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

Earnings per share is comprised of the following:

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

## 3 Inventories

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

## 4 Investments, at equity

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

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

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

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

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

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

## 5 Loans and other receivables

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

### Loans and mortgages receivable

Loans and mortgages receivable represent long-term financing to certain retail associates. These loans and mortgages are primarily secured by inventory, fixtures and equipment, bear various interest rates and have repayment terms up to ten years. The carrying amount of the loans and mortgages receivable approximates fair value based on the variable interest rates charged on the loans and the operating relationship of the associates with the Company.

## 6 Other assets

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

**Asset-backed commercial paper**

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

On August 11, 2009, DBRS downgraded the A2 notes from A to BBB (low) under a negative watch. The downgrade did not have a material change in the fair value of the notes. Continuing uncertainties regarding the value of assets which underlie the ABCP, the amount and timing of cash flows and the outcome of the restructuring process could give rise to a further material change in the value of the Company’s investment in ABCP

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

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

**7 Property and equipment**

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

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

## Intangibles

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



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

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

## 9 Bank indebtedness

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

## 10 Long-term debt

	May 1, 2010	May 2, 2009
	Total	Total
First mortgage loans, average interest rate 9.0%, due 2011 – 2021	\$ 65.7	\$ 71.5
Medium Term Notes, interest rate 5.8%, due October 6, 2036	125.0	125.0
Medium Term Notes, interest rate 6.1%, due October 29, 2035	175.0	175.0
Medium Term Notes, interest rate 7.2%, due February 26, 2018	100.0	100.0
Debentures, average interest rate 9.9%, due 2011 – 2016	48.2	62.6
Notes payable and other debt primarily at interest rates fluctuating with the prime rate	149.8	146.2
Credit facility, floating interest rate tied to bankers' acceptance rates, due June 8, 2010	294.5	244.0
Credit facility, floating interest rate tied to bankers' acceptance rates, due July 23, 2012	200.0	200.0
Credit facility, floating interest rate tied to bankers' acceptance rates, due November 8, 2010	–	75.0
Unamortized financing costs	(2.0)	(3.0)
Capital lease obligations, weighted average interest rate 5.38%, due 2010 – 2040	52.2	60.7
	<b>1,208.4</b>	1,257.0
Less amount due within one year	<b>379.4</b>	133.0
	<b>\$ 829.0</b>	\$ 1,124.0

Long-term debt is secured by land and buildings, specific charges on certain assets and additional security as described in Note 9. Capital lease obligations are secured by the related capital lease asset.

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

On June 27, 2007, pursuant to the terms of the Credit Facilities, the Company and Sobeys filed notice with the lenders requesting the establishment of a new \$300.0 five-year credit in favour of Sobeys at the same interest rate and substantially on the same terms and conditions as the Credit Facilities. At July 23, 2007, Sobeys drew down \$300.0 from its new credit facility, the proceeds of which were used to pay a dividend to

the Company. The Company used the proceeds from the dividend to reduce its indebtedness under the Credit Facilities and the Credit Facilities were reduced to \$650.0 accordingly. On that date, the Company also transferred the second swap to Sobeys. At May 1, 2010, the Credit Facilities have a balance outstanding of \$294.5 (May 2, 2009 – \$244.0). Subsequent to year-end, the Credit Facilities were renewed (refer to Note 29).

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

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

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

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

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

## 11 Other long-term liabilities

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

## 12 Capital stock

### Authorized

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

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

Loans receivable from officers and employees of \$2.9 (2009 – \$3.4) under the Company's share purchase plan are classified as a reduction of Shareholders' Equity. Loan repayments will result in a corresponding increase in share capital. The loans are non-interest bearing and non-recourse, secured by 101,510 (2009 – 110,148) Non-Voting Class A shares. The market value of the shares at May 1, 2010 was \$5.4 (May 2, 2009 – \$5.5).

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

Under certain circumstances, where an offer (as defined in the share conditions) is made to purchase Class B common shares, the holders of the Non-Voting Class A shares shall be entitled to receive a follow-up offer at the highest price per share paid, pursuant to such offer to purchase Class B common shares.

## 13 Accumulated other comprehensive loss

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

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

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

## 14 Capital management

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

grade credit rating with each rating agency that assesses the credit worthiness of Sobeys Inc. No changes were made to these objectives in the current year.

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

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

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

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

The primary investments undertaken by the Company include additions to the selling square footage of its store network via the construction of new, relocated and expanded stores, including related leasehold improvements and features and the purchase of land bank sites for future store construction.

The Company makes capital investments in information technology and its distribution capabilities to support an expanding store network. In addition, the Company makes capital expenditures in support of its real estate and other operations. The Company largely relies on its cash flow from operations to fund its capital investment program and dividend distributions to its shareholders. This cash flow is supplemented, when necessary, through the borrowing of additional debt or the issuance of additional capital stock.

Management monitors certain key ratios to effectively manage capital:

	May 1, 2010	May 2, 2009 Restated (Note 1)
Funded debt to total capital <sup>(1)</sup>	29.3%	32.7%
Funded debt to EBITDA <sup>(2)</sup>	1.50x	1.62x
EBITDA to interest expense	11.30x	9.95x

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

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

As part of existing debt agreements, two financial covenants are monitored and communicated, as required by the terms of credit agreements, on a quarterly basis by management to ensure compliance with the agreements. The covenants are: (i) adjusted total debt/EBITDA – calculated as funded debt plus letters of credit, guarantees and commitments divided by

EBITDA (for previous 52 weeks); and (ii) debt service coverage ratio – calculated as EBITDA divided by interest expense plus repayments of long-term debt (all amounts are based on previous 52 weeks).

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

## 15 Investment income

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

## 16 Capital (losses) gains and other items

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



## 17 Income taxes

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

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

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

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

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

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

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

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

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

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

## 18 Supplementary cash flow information

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

## 19 Joint ventures

The financial statements include the Company's proportionate share of the accounts of incorporated and unincorporated joint ventures. A summary of these amounts is as follows:

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

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

## 20 Segmented information

### Revenue

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

**Operating income**

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

**Identifiable assets**

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

**Inventories**

	May 1, 2010	May 2, 2009
Food retailing	\$ 780.4	\$ 750.7
Real estate – residential	98.9	90.4
Other operations	1.0	1.7
	<b>\$ 880.3</b>	<b>\$ 842.8</b>

**Depreciation and amortization**

	2010	2009 Restated (Note 1)
Food retailing	\$ 318.3	\$ 313.1
Real estate	1.3	1.8
Investment and other operations	20.1	21.2
	<b>\$ 339.7</b>	<b>\$ 336.1</b>

**Capital expenditures**

	2010	2009 Restated (Note 1)
Food retailing	\$ 341.4	\$ 354.1
Real estate	68.1	36.9
Investment and other operations	24.5	9.6
	<b>\$ 434.0</b>	<b>\$ 400.6</b>

The Company operates principally in two business segments: food retailing and real estate. The food retailing segment consists of distribution of food products in Canada. The real estate segment consists of development and ownership of both commercial and residential properties. Commercial real estate is mainly land held for the development of food-anchored retail strip plazas. Residential real estate is the development of housing lots for resale. Inter-segment transactions are recorded at amounts equivalent to transactions with outside parties.

## 21 Financial instruments

### Credit risk

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

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

The Company mitigates credit risk associated with its trade accounts receivable, loans and other receivables through established credit approvals, limits and a regular

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

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

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

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

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

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



**Liquidity risk**

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

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

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

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

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

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

**Fair value of financial instruments**

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

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

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

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

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

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

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

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

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

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

### Derivative financial instruments

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

### Interest rate risk

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

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

### Foreign currency exchange risk

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

### Commodity price risk

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

## 22 Guarantees, commitments and contingent liabilities

### Guarantees and commitments

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

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

During fiscal 2008, Sobeys entered into an additional guarantee contract. Under the terms of the guarantee should franchise affiliates be unable to fulfil their lease obligations, Sobeys would be required to fund the greater of \$7.0 or 9.9 percent (2009 – \$6.0 or 9.9 percent) of the authorized and outstanding obligation. The terms of the guarantee contract are

reviewed annually each August. As at May 1, 2010, the amount of the guarantee was \$7.0 (May 2, 2009 – \$6.0).

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

During fiscal 2009, Sobeys entered into an additional credit enhancement contract in the form of a standby letter of credit for certain independent franchisees for the purchase and installation of equipment. Under the terms of the contract

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

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

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

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

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

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

### Contingencies

On June 21, 2005, Sobeys received a notice of reassessment from CRA for fiscal years 1999 and 2000 related to the Goods and Services Tax (“GST”). CRA asserts that Sobeys was obliged to collect GST on sales of tobacco products to status Indians. The total tax, interest and penalties in the reassessment was \$13.6. Sobeys has reviewed this matter, has received legal

advice, and believes it was not required to collect GST. During the second quarter of fiscal 2006, Sobeys filed a Notice of Objection with CRA. Accordingly, Sobeys has not recorded in its statement of earnings any of the tax, interest or penalties in the notice of reassessment. Sobeys has deposited with CRA funds to cover the total tax, interest and penalties in the reassessment and has recorded this amount as a long-term receivable from CRA pending resolution of the matter.

The Company has agreed to indemnify its directors and officers and particular employees in accordance with the Company's policies. The Company maintains insurance policies that may provide coverage against certain claims.

There are various claims and litigation, which the Company is involved with, arising out of the ordinary course of business operations. The Company's management does not consider the exposure to such litigation to be material, although this cannot be predicted with certainty.

## 23 Related-party transactions

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

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

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

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

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

## 24 Employee future benefits

The Company has a number of defined benefit and defined contribution plans providing pension and other retirement benefits to most of its employees.

### Defined contribution pension plans

The contributions required by the employee and the employer are specified. The employee's pension depends on what level of retirement income (for example, annuity purchase) that can be achieved with the combined total of employee and employer contributions and investment income over the period of plan membership, and the annuity purchase rates at the time of the employee's retirement.

### Other benefit plans

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

### Defined benefit pension plans

The ultimate retirement benefit is defined by a formula that provides a unit of benefit for each year of service. Employee contributions, if required, pay for part of the cost of the benefit, but the employer contributions fund the balance. The employer contributions are not specified or defined within the plan text; they are based on the result of actuarial valuations which determine the level of funding required to meet the total obligation as estimated at the time of the valuation.

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

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

### Defined contribution plans

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

2010	<b>\$ 20.5</b>
2009	\$ 19.1

## Defined benefit plans

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

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

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



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

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

	Pension Benefit Plans 2010	Pension Benefit Plans 2009	Other Benefit Plans 2010	Other Benefit Plans 2009
Accrued benefit obligation	\$ 25.4	\$ 24.3	\$ 125.1	\$ 118.4

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

	Pension Benefit Plans 2010	Pension Benefit Plans 2009	Other Benefit Plans 2010	Other Benefit Plans 2009
Discount rate	5.50%	6.25%	6.25%	6.00%
Expected long-term rate of return on plan assets	7.00%	7.00%		
Rate of compensation increase	4.00%	4.00%		

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

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

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

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

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

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

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

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

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

	2010	% of Plan Assets	2009	% of Plan Assets
	\$ 115.5	12.7%	\$ 104.4	13.7%

## 25 Business acquisitions

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

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

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

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

## 26 Stock-based compensation

### Deferred share units

Members of the Board of Directors may elect to receive all or any portion of their fees in deferred share units (“DSUs”) in lieu of cash. The number of DSUs received is determined by the market value of the Company’s Non-Voting Class A shares on each director’s fee payment date. Additional DSUs are received as dividend equivalents. DSUs cannot be redeemed for cash until the holder is no longer a director of the Company. The redemption value of a DSU equals the market value of an

Empire Company Limited Non-Voting Class A share at the time of the redemption. On an ongoing basis, the Company values the DSU obligation at the current market value of a corresponding number of Non-Voting Class A shares and records any increase in the DSU obligation as an operating expense. At May 1, 2010, there were 104,527 (May 2, 2009 – 84,195) DSUs outstanding. During the year, the compensation expense was \$1.3 (2009 – \$1.8).

### Stock option plan

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

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

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

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

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

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

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

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

**Share purchase plan**

The Company has a share purchase plan for employees of the Company whereby loans are granted to purchase Non-Voting Class A Shares. These loans have been treated as stock-based compensation in accordance with EIC Abstract 132.

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

**Phantom performance option plan**

Sobeys has a Phantom Performance Option Plan for eligible employees of Sobeys. Under the plan, units are granted at the discretion of the Board based on a notional equity value of Sobeys tied to a specified formula. Upon implementation, the

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

**27 Business rationalization costs**

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

**28 Variable interest entities**

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

The Company has identified the following entities as VIEs:

**Franchise affiliates**

The Company has identified 273 (May 2, 2009 – 271) franchise affiliate stores whose franchise agreements result in the Company being deemed the primary beneficiary of the entity according to AcG 15. The results for these entities were consolidated with the results of the Company.

**Warehouse and distribution agreement**

The Company has an agreement with an independent entity to provide warehouse and distribution services for one of its distribution centres. The terms of the agreement with this entity require the Company to consolidate its results with those of the Company pursuant to AcG 15.

## 29 Subsequent events

- (a) On May 25, 2010, Sobeys filed a short form prospectus providing for the issuance of up to \$500.0 of unsecured Medium Term Notes. On June 7, 2010, Sobeys issued new Medium Term Notes of \$150.0, bearing an interest rate of 6.64%, maturing on June 7, 2040.
- (b) On June 4, 2010, the Company renewed its Credit Facilities which were reduced from \$650.0 to \$450.0, maturing on June 30, 2013.
- (c) On July 8, 2010, it was announced that Sobeys entered into a non-binding letter of intent to sell 11 retail properties to Crombie REIT for proceeds of approximately \$102.0. Crombie REIT also agreed to issue, on a bought-deal basis, additional units at a price of \$11.05 per unit. In satisfaction of its pre-emptive right with respect to the public offering, the Company will subscribe for approximately \$20.5 of Class B units. The Company's interest in Crombie REIT will reduce from 47.4% to 47.0%.

## 30 Comparative figures

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



# Eleven-year Financial Review

Years Ended <sup>(1)</sup>	2010	2009	2008	2007
<b>Financial Results</b> (\$ in millions; except ROE)				
Revenue	\$ 15,516.2	\$ 15,015.1	\$ 14,065.0	\$ 13,366.7
Operating income	479.7	466.2	472.6	431.1
Interest expense	72.5	80.6	105.8	60.1
Income taxes	99.1	115.4	125.9	116.9
Minority interest	5.6	8.3	12.8	55.4
Earnings from continuing operations before net capital gains and other items	284.5	261.7	242.8	200.1
Earnings from discontinued operations <sup>(2)</sup>	–	–	–	–
Operating earnings <sup>(3)</sup>	284.5	261.7	242.8	200.1
Capital gains (losses) and other items, net of tax	17.4	3.0	73.0	5.7
Net earnings	301.9	264.7	315.8	205.8
Return on equity	10.7%	10.5%	14.0%	10.1%
<b>Financial Position</b> (\$ in millions)				
Total assets	6,248.3	5,891.1	5,732.9	5,241.5
Long-term debt (excluding current portion)	829.0	1,124.0	1,414.1	792.6
Shareholders' equity	2,952.4	2,678.8	2,382.3	2,131.1
<b>Per Share Data on a Fully Diluted Basis</b> (\$ per share)				
Operating earnings	4.15	3.97	3.69	3.04
Capital gains (losses) and other items, net of tax	0.25	0.05	1.11	0.09
Net earnings	4.40	4.02	4.80	3.13
Dividends				
Non-Voting Class A shares	0.740	0.700	0.660	0.600
Class B common shares	0.740	0.700	0.660	0.600
Book value	43.07	39.07	36.08	32.31
<b>Share Price, Non-Voting Class A Shares</b> (\$ per share)				
High	53.95	55.05	55.19	45.25
Low	39.70	35.00	35.40	39.49
Close	52.98	49.00	39.25	42.33
<b>Diluted weighted average number of shares outstanding</b> (in millions)				
	68.5	65.8	65.7	65.7

(1) Fiscal years ended April 30th except fiscal 2005, which ended May 7, 2005, fiscal 2006, which ended May 6, 2006, fiscal 2007, which ended May 5, 2007, fiscal 2008, which ended May 3, 2008, fiscal 2009, which ended May 2, 2009 and fiscal 2010, which ended May 1, 2010, reflecting a change in fiscal year end to the first Saturday in May, consistent with the fiscal year-end of Sobeys Inc.

(2) Discontinued operations reflect the financial contribution of SERCA Foodservice operations, which was sold at the end of 2002.

(3) Operating earnings equals net earnings before capital gains (losses) and other items.

2006	2005	2004	2003	2002	2001	2000
\$ 13,063.6	\$ 12,435.2	\$ 11,284.0	\$ 10,624.2	\$ 9,926.5	\$ 9,331.1	\$ 9,100.1
491.4	463.7	422.8	444.4	416.2	341.1	309.7
83.8	86.7	92.4	93.7	111.6	145.8	159.6
153.1	131.2	111.0	120.0	104.8	131.9	68.1
67.1	63.6	58.5	67.5	50.0	34.3	32.9
202.0	182.9	163.3	159.3	123.5	78.5	78.8
-	-	-	-	8.7	10.0	5.9
202.0	182.9	163.3	159.3	132.2	88.5	84.7
94.8	3.7	9.2	(6.0)	63.7	491.5	2.1
296.8	186.6	172.5	153.3	195.9	580.0	86.8
16.2%	11.4%	11.6%	11.4%	16.4%	69.1%	13.3%
5,051.5	4,929.2	4,679.7	4,519.3	4,318.0	4,254.3	4,171.0
707.3	727.4	913.0	923.1	975.0	1,107.2	1,332.0
1,965.2	1,709.0	1,567.6	1,418.5	1,290.6	1,115.0	602.8
3.07	2.78	2.47	2.42	2.00	1.33	1.10
1.44	0.05	0.14	(0.09)	0.97	7.49	0.03
4.51	2.83	2.61	2.33	2.97	8.82	1.13
0.560	0.480	0.400	0.330	0.214	0.170	0.140
0.560	0.480	0.400	0.330	0.214	0.170	0.140
29.77	25.87	23.67	21.41	19.47	16.82	8.73
44.35	38.00	29.50	33.25	33.30	18.25	16.98
33.37	24.25	23.10	23.70	15.75	13.88	12.33
43.29	36.66	26.65	23.85	28.88	17.00	16.05
65.7	65.7	65.8	65.8	65.7	65.6	75.6

**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 & 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.sobeyscorporate.com  
www.empiretheatres.com

**Shareholders' Annual General Meeting**

September 10, 2010, at 11:00 a.m. (ADT)  
Empire Studio 7 Cinemas  
610 East River Road  
New Glasgow, Nova Scotia

**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)**

115,813

**Dividend Record and Payment Dates for Fiscal 2011**

Record Date	Payment Date
July 15, 2010	July 30, 2010
October 15, 2010*	October 29, 2010*
January 14, 2011*	January 31, 2011*
April 15, 2011*	April 29, 2011*

\*Subject to approval by Board of Directors

**Outstanding Shares**

As of June 25, 2010

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: inquires@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.



# Delivering the Future

## **Sobeys' newest distribution centre represents a quantum leap in distribution and store efficiency.**

Eight times the size of a football field, 65 feet high and encompassing 500,000 square feet of space, our Vaughan, Ontario distribution centre meets the dry grocery requirements for most of the stores in Sobeys' Ontario retail network. But what is truly remarkable about this facility is not the massive scale. It is the exclusive, completely automated warehouse storage and picking technology that is allowing us to dramatically improve the timeliness, accuracy and flexibility of our deliveries. The results are significant savings in per case distribution costs and far less time spent receiving and restocking inventory in our stores.

**To learn more, watch the video at:**

<http://www.sobeyscorporate.com/en/video.aspx>





## Sustainability @ Sobeys

We are committed to promoting the well-being of our customers, communities and company without compromising the ability of future generations to prosper on the precious planet that sustains us. To learn more about what we are doing to minimize the impact of our operations on the environment, please visit us at:

<http://www.sobeyscorporate.com/sustainability>