focus on food

2006 Annual Report

2006 operating and financial highlights

(All amounts expressed in millions)	May 6, 2006	May 7, 2005*	May 1, 2004†
Operating results			
Sales	$ 12,853.3	$ 12,189.4	$ 11,046.8
Earnings before interest, income taxes and minority interest	331.6	322.6	294.3
Net earnings	189.4	186.7	166.5
Weighted average number of common shares outstanding, basic	64.7	64.9	65.3
Financial position			
Cash flows from operating activities	495.3	438.0	364.6
Net working capital	4.8	(188.6)	(194.8)
Property and equipment	1,612.2	1,461.9	1,360.2
Total assets	3,738.6	3,445.8	3,278.9
Total long-term debt	490.0	457.8	453.1
Shareholders' equity	1,834.3	1,682.1	1,561.3

* 53 weeks
† Restated

On the cover:
Christina Wakeham serves customers at the Sobeys Queensway store in Toronto.

Sobeys Inc. is a leading national grocery retailer and food distributor. Based in Stellarton, Nova Scotia and with regional offices in Edmonton, Alberta; Mississauga, Ontario; Montreal, Québec; and Stellarton, Nova Scotia, the Company owns or franchises approximately 1,300 stores in all 10 provinces under retail banners that include Sobeys, IGA, IGA extra and Price Chopper.

At Sobeys Inc., our focus is clear and our commitment unwavering. We are focused on food, driven by our fresh expertise, supported by superior customer service in the right-sized, right format stores for each market we serve, enabled by processes and tools that engage our employees to get the job done well. **Our progress is dynamic – with much more in store.**

+5.4% Sales increase

+1.7% Increase in basic earnings per share

+68.7% Increase in share price over last five years

Table of Contents

our dynamic progress

Message from the President & C.E.O.

At Sobeys Inc., our strategy is to differentiate ourselves from the competition by sustaining our focus on food while meeting the changing needs and expectations of our customers – region by region, community by community, one store at a time. We are determined to "out-food", "out-fresh", "out-service" and "out-market" those who choose to compete with us for a greater share of Canadian consumers' food requirements.

Our progress to date has been fueled by our collective passion for the food business, our knowledge of the distinct markets we serve and our steadfast commitment to building and sustaining a differentiated, healthy and competitive retail food business and infrastructure for the long term.

BILL MCEWAN, President & Chief Executive Officer

Sobeys continues to evolve rapidly, making significant investments in our store network, our products and our people. Our progress to date has been fueled by our collective passion, knowledge and commitment.

Our strategy remains unchanged, but our customer relationships continue to strengthen as a result of the significant investments we have made overall. Over the past three years we have strategically invested $1.6 billion in new, expanded and upgraded stores and infrastructure, as well as the “back shop” systems and processes that support our retail focus. At the same time, we have made substantial product and service improvements and additions in every region of the country, including the successful introduction of our repositioned *Compliments* private label brand.

Highlights of 2006

We continued to make solid progress in fiscal 2006, improving the quality, variety and merchandising execution of our product and promotional programs – with numerous local, regional and national initiatives and innovations. Highlights include:

- SMART Retailing – our store-based operational excellence and productivity program which was implemented in 675 stores by the end of fiscal 2006. As well, we developed and began implementation of the newest element of SMART Retailing – Peer-to-Peer Management – which allows for best practice comparison between groups of similar stores;
- We advanced our urban Fresh Fill-In format with smaller, right-sized Sobeys and Sobeys *express* stores in Toronto;
- We successfully completed the national roll-out of the *Compliments* private label range with the introduction of more than 3,000 products within a three-tier brand portfolio. As well, we developed and introduced the new *Compliments Organics* and the *Compliments balance-équilibre* lines;

As we enter fiscal 2007, we have taken stock – acknowledging the progress we have made to date while **identifying additional significant opportunities.**

- We acquired Rachelle-Béry, a small, specialty chain in Québec focused on organic and natural food, supplements and health and wellness products, as part of our ongoing commitment to build capability to meet the changing needs of our customers; and
- We added hundreds of fresh and ready-to-serve products in our deli, produce, seafood and meat departments – including store specific, local market favourites.

In fiscal 2006, our efforts resulted in solid progress on our top and bottom lines, during a period of continued – and significant – investment in the improvement of our store assets, optimization of our business processes, strengthening of our price competitive position coast to coast, enhancement of our product offerings and development of our people.

The fourth quarter of fiscal 2006 represented the eighth consecutive quarter of industry-leading same-store sales growth and, for the full year, sales grew to a record $12.85 billion. Our market share continued to expand and net earnings grew year-over-year, even after the significant investments made to upgrade our systems and supply chain capabilities.

While we are pleased with the progress we made in a challenging year – progress along a continuum – we know there is much yet to accomplish.

As we enter fiscal 2007, we have **taken stock** – acknowledging the progress we have achieved to date, while identifying the significant opportunities that remain as we strive to achieve our goal of becoming Canada's pre-eminent food retailer. We are also **keeping score** – measuring our progress and the impact of our strategies and initiatives on our operational, financial and competitive performance.

focus on food

taking stock

At Sobeys Inc., we have set ourselves apart with our food-focused strategy. Our customers see and feel the difference. We are improving every aspect of our stores – inside and out, on the shelf and behind the scenes – and the changes are profound.

our right-sized, right format stores

Full service

Profile: Food stores that are ready to serve the total food shopping requirements of our customers with the broadest assortment and specialty items designed for each unique market we serve – from sushi bars and kosher cuisine to health and wellness offerings. Full service also means superior customer care – from full-service meat, deli and seafood counters to the value-added food knowledge and expertise provided by our 1,600 Aide-Gourmet personnel in Québec.

Branding: Sobeys, IGA extra

Locations: Atlantic Canada, Québec, Ontario, Western Canada

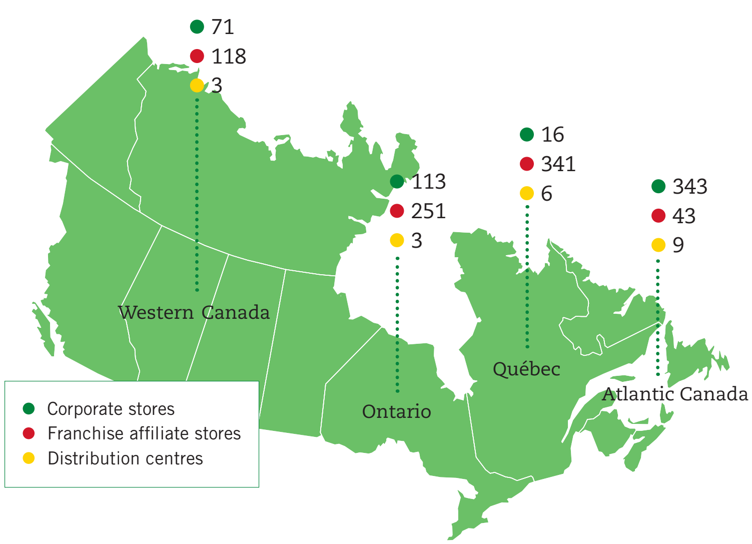
Fresh service

Profile: Food stores that are ready to serve the "fresh fill-in" and "today's meal" needs of customers, with superior service and customized offerings.

Branding: Sobeys, IGA (Québec), Sobeys *express* (Ontario)

Locations: Ontario, Québec

our markets at-a-glance



1,296
Total stores

814
Communities served

25.4 million
Total sq. footage

We strive to satisfy the needs of our customers in each individual market we serve.

Community service

Profile: Food stores that are ready to serve the "routine and fill-in" food shopping occasions of our customers in rural and one-store communities.

Branding: IGA, Foodland

Locations: Atlantic Canada, Québec, Ontario, Western Canada

Price service

Profile: Food stores that are ready to serve customers with low prices every day, in markets and for customers where low prices are the driving factor for store selection.

Branding: Price Chopper

Locations: Atlantic Canada, Ontario, Western Canada

Convenience service

Profile: Stores that are ready to serve the "on-the-go" convenience needs of our customers.

Branding: Needs, Marché Bonichoix, Les Marchés Tradition

Locations: Atlantic Canada, Québec

Western Canada

Store sq. footage:	**4,365,819**
Store numbers:	
Sobeys	74
Western Cellars	21
IGA	88
Thrifty Foods	2
Price Chopper	1
Cash & Carry	3
Total	**189**

Ontario

Store sq. footage:	**8,524,874**
Store numbers:	
Sobeys	67
Sobeys *express*	3
IGA	105
Price Chopper	89
Foodland	88
Commisso's	12
Total	**364**

Québec

Store sq. footage:	**7,646,483**
Store numbers:	
IGA extra	70
IGA	175
Marché Bonichoix	83
Les Marchés Tradition	29
Total	**357**

Atlantic Canada

Store sq. footage:	**4,875,914**
Store numbers:	
Sobeys	83
Price Chopper	28
Clover Farm	3
Needs	158
Cash & Carry	7
Sobeys Fast Fuel	6
Foodland	41
Lawtons	60
Total	**386**

With each initiative – from products, to service, to operational execution – we are improving what we do and how we do it.

Fresh Food Offering

At the very core of Sobeys Inc.'s strategy is our unwavering focus on food, driven by our fresh food expertise. Whether through the great selection and quality of our produce offering or the knowledgeable advice of specialists at our full-service meat, deli and seafood counters, our fresh food expertise is the cornerstone of our impassioned commitment to be "best in food".

Optimum Assortment

To set ourselves apart with our focus on food, we deliver optimum choice to customers in our fresh, grocery and health and beauty offerings. That means providing the broadest range of products, category by category, satisfying our customers' needs with the right combination of national brands and *Compliments* private label products.

Private Label

Since the 2005 launch of our exclusive private label *Compliments* brand, we have converted 3,200 products and introduced an additional 500 new products. The *Compliments* brand portfolio represents the best combination of quality, price and product performance and inspires customers with optimum choice through our unique three-tier offering.

Compliments Organics and *Compliments balance-équilibre*

Responding to changing customer needs, we launched two innovative new *Compliments* product lines in fiscal 2006. All *Compliments Organics* products are certified and meet the highest standards for organic products in Canada. All *Compliments balance-équilibre* products bear the Heart and Stroke Foundation of Canada's Health Check™ symbol – a first for private label brands in Canada.

Deli and Ready-To-Eat, Heat and Serve

Our focus on food is driven by our fresh expertise and nowhere is that more apparent than with our deli and our ready-to-go prepared food offerings, customized to each market – a perfect example of how great product and great service come together to meet the growing convenience meal requirements of time-pressed customers.

Common Point-Of-Sale System

Improved customer service at the check-out counter is one of the many benefits of our common point-of-sale (POS) system being implemented across the country. This system also provides better customer information, streamlines administration and improves cash office efficiency. By year-end, implementation was completed in 343 stores, with roll-out continuing through fiscal 2007.

Training

Delivering superior customer service while implementing SMART Retailing and other productivity initiatives requires the ongoing engagement and commitment of all our employees. We have been developing and implementing innovative programs to educate and train our employees to ensure customers see and feel the difference in our stores.

Pharmacy

A strong pharmacy offering, both in-store and at our stand-alone Lawtons Drug Stores in Atlantic Canada, is supported by trained professionals providing trustworthy advice to our customers. This helps meet customer product choice expectations and demands for convenience – particularly given rising demand for health and wellness products that complement our fresh food focus.

Commitment to the Environment

Better use of recycled materials, increased availability of re-usable grocery bags and the introduction of more efficient bagging techniques at the checkout – these are some of the ways that we have been balancing the needs of our customers with our goals for social and environmental responsibility in our stores across Canada.

SMART Retailing

Reduced product waste, improved inventory control, enhanced customer service – these are just some of the benefits of SMART Retailing, our continuous improvement program which engages employees in every department to operate our stores with greater efficiency. By year-end, the first phase of SMART Retailing had been implemented in 675 stores.

A Sobeys *express* on Roncesvalles Avenue in Toronto has brought the Sobeys food experience to an urban environment.

Staying fresh:

Our focus on food is constant, as is our commitment to adapting to the changing needs and lifestyles of our customers.

our imperatives

As we move forward, we do so with the confidence that we are focused on initiatives that will continue to drive our success. But one thing is not changing. We remain absolutely committed to our food-focused strategy and to our stated intention to build sustainable worth for all of our stakeholders: our customers, our employees and franchise affiliates, our suppliers and our shareholders.

In the year ahead, we will continue to advance three core imperatives:

1. Maintain our unwavering commitment to focus on food: to out-food, out-fresh, out-service and out-market those who choose to compete with us for a greater share of Canadian consumers' food requirements.

Our clear and steady focus on food, driven by our fresh expertise, supported by superior customer service in the right format stores for every market we serve is a constant that engages our people, company-wide. We will continue, through fiscal 2007 and beyond, to develop a number of initiatives which will fuel and accelerate our growth and differentiation.

We are pleased with the progress we have made with our product and service expertise, but by no means are we fully satisfied. We are constantly refreshing our offerings and we continue to encourage innovation, utilizing our new Culinary Centres in Toronto and Halifax. In the year ahead, our *Compliments balance-équilibre* line, evaluated by the Heart and Stroke Foundation of Canada's registered dietitians and bearing the Health Check™ symbol, will connect with discerning customers, as will our new *Compliments Organics* line.

At the same time, we are continuing to adjust our existing formats – to ensure we have the right store for each market and the right offerings for the changing tastes of our customers. In Québec, we will be expanding our organic and natural food,

Laval IGA extra
Aide-Gourmet, Audrey Lafleur

supplements and health and wellness offering through Rachelle-Béry food stores, while rolling out Rachelle-Béry health boutiques inside existing IGA stores. In Western Canada, we are implementing more intense merchandising configurations – more shelves and displays above eye-level – to allow for more product choice per square foot. We are proceeding with urban formats for the Sobeys banner, including Sobeys *express*, which provide a fresh fill-in grocery shopping experience in more flexibly-sized, non-traditional locations. This approach is helping us penetrate under-served urban markets such as Toronto.

Sobeys' urban fresh fill-in store at Queen's Quay in Toronto

2. Improve our cost base and productivity.

We have made significant system-wide progress with our business process optimization, supply chain and systems initiatives, with major investment in Ontario over the past two years. This has been a significant undertaking, and will contribute to bottom line growth when fully implemented. We will complete the Ontario work in fiscal 2007 and we have begun similar activities for our Western region with completion scheduled for early fiscal 2008.

At the store level, SMART Retailing, our back-to-basics continuous improvement initiative, has delivered significant savings through reduced shrink and increased efficiency. While improving the bottom line, we have channeled a major portion of these savings to sustain our competitive price position and our sales growth momentum.

We have much further to go: in Western Canada in the past year, we piloted the second phase of SMART Retailing – our Peer-to-Peer Management program – which is focused on improving operational effectiveness through the sharing of best practices. Response has been very positive, and we are currently rolling this program out across our store network. Over the next three years, we will focus more on each store as a distinct business unit, and introduce the third phase of SMART Retailing, which is designed to sustain continuous improvement in processes, productivity and efficiency for every employee and every department.

Our Culinary Centres in Toronto and Halifax have become focal points for innovation and excellence – providing outstanding support to *Compliments* product development.

Compliments Culinary Centre Managing Director Winnie Chiu with Chef James Smith

3. Invest in and develop our people, as we nurture a superior service and high-performance culture.

Achieving operational excellence requires disciplined execution. Our success depends on the engagement and development of our people.

Our people throughout the organization have risen to the challenge and performed superbly. A strong service culture, where people take pride in operational excellence and satisfying customer expectations, continues to grow.

Nadine Pageau at the IGA extra (Langelier), Saint-Léonard, Québec

To support efforts in the store and behind the scenes, we have been improving and developing our Human Resources competencies and programs. Leadership programs have been strengthened and we are accelerating our focus on training and support at the store level.

Isabel Carcacia provides expert health and wellness advice at a Rachelle-Béry boutique in Laval, Québec.

> A strong culture of service, where people take pride in operational excellence and satisfying customer expectations, continues to grow.

Our most compelling initiative in this respect has been GO SERVICE – a customer service improvement program that has been developed and launched in our Québec stores. Within this program, we have set clear goals: to deliver the best customer service in the food business in the medium term, and the best in all retailing over the longer term. It is a measured, customer satisfaction program, tailored for each store department that includes guidelines for every employee, and feedback mechanisms monitoring employee engagement and shopper satisfaction. It is practical, well received and properly supported. We are very excited with the prospects for GO SERVICE.

Our strategies are working because of the dedication and commitment of employees throughout our organization and of all our franchise affiliates who have grasped the opportunity to drive performance by focusing on food. Successful strategies require superior execution, and superior execution requires motivated and talented people. I thank everyone throughout our Company who contributed to our solid progress this past year.

We have the financial resources to sustain the necessary investment in our stores, our infrastructure, and our people. We know that the path to leadership in the grocery business is a marathon, not a sprint, with many stages, milestones and challenges along the way. We will stay focused while building upon the success that we have been proud to achieve thus far.

Bill McEwan,
President & Chief Executive Officer

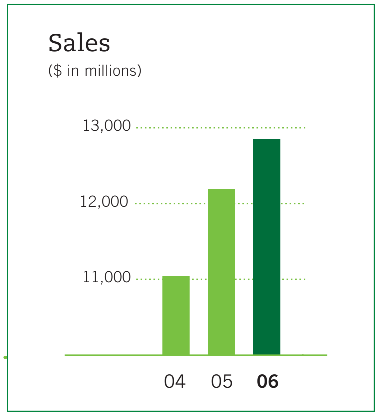
keeping score

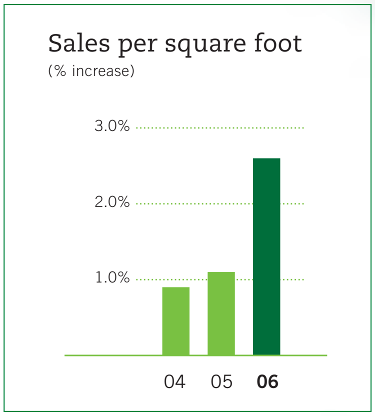
At Sobeys Inc., we have made investments and launched initiatives that will have an enduring and growing impact. We have not fixated on short-term results and are not distracted by quarter-to-quarter fluctuations. It is our measured progress over the past three to four years and continued improvement and growth along the continuum that counts.

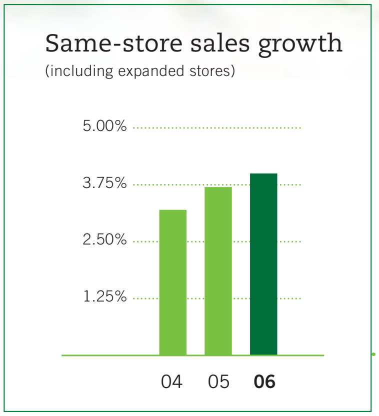
Where we have focused our efforts, resources and investments first – our growth is most encouraging. Upgraded stores are achieving higher sales per square foot, SMART Retailing has dramatically reduced our shrink and waste, and our average customer basket size has grown on the strength of our improved competitive pricing and promotional programs.

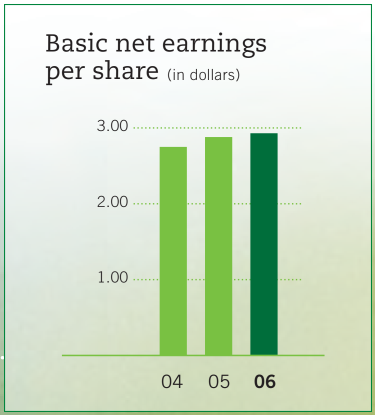
Store renovations:
In Kitchener, Store Manager Jim Koch reviews site plans and drawings with the site foreman.

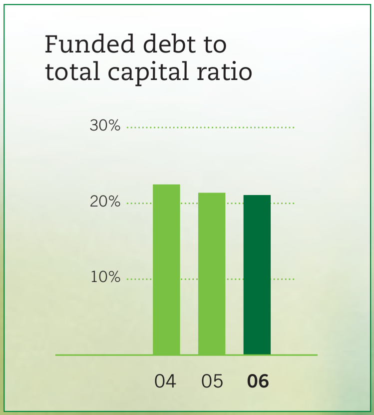
We invest, we manage and we measure – benchmarking our performance is essential to our success.

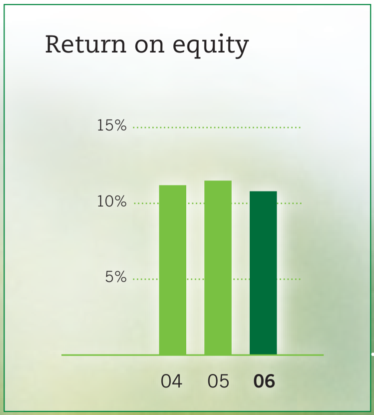


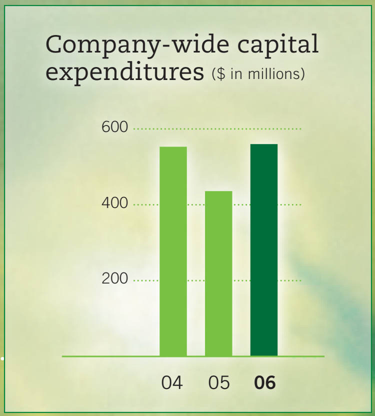


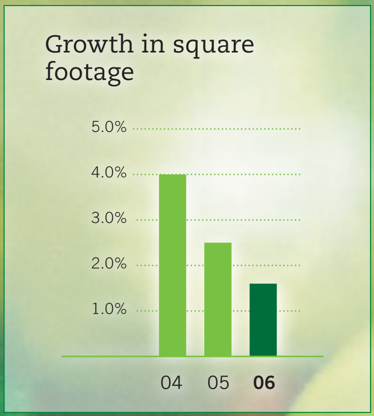












* Excludes Lawtons, Les Marchés Tradition, Marché Bonichoix and Cash & Carry

our community

Focus on our values and Value Champions

Throughout our history, the success and leadership of Sobeys has always been deeply rooted in our participation in communities where we operate. "Proudly serve our communities" is one of our core values.

Today, our network extends to more than 800 communities from coast to coast in Canada and we endeavour to connect with and proudly serve all of them. We support a number of nationwide initiatives that promote the well-being of families and children, including health, wellness, education and scholarship programs. However, the major focus remains on local communities – where employees and franchisees live, work and generously give their time and talents to their communities. Many of these local initiatives and fundraising efforts engage our customers and forge enduring relationships.

At the corporate and regional level in fiscal 2006, we supported hundreds of charities across Canada – with significant contributions to the United Way, provincial cancer societies, health programs, hospitals, and children's recreational programs. Among the noteworthy initiatives across Canada during the year:

- **Food Banks:** Our stores across Canada are major contributors to food banks, as are our customers, who generously contribute to food bank drives to help neighbours in need. In the Fill'er Up program in New Brunswick, Sobeys stores raised over $42,000 in food and donations – and three months worth of food for Food Depot Alimentaire Inc., which supplies 19 food banks, two food kitchens, two shelters, a mobile pantry and a mobile food kitchen in the Moncton area.
- **Food for Thought:** In P.E.I., Sobeys supports the Food For Thought program which provides nutritious snacks to hungry children in 26 elementary schools. When the program lost its major sponsor last year, Sobeys stepped in to keep the program alive.

To celebrate our values and the employees who exemplify them, we honour Value Champions – employees who bring our core values to life everyday, on the job and in their communities.

Ontario Value Champion > Frank Ritacca
Store Manager, Sobeys Brampton, Brampton, Ontario

Frank Ritacca helped raise awareness and funds for Spinal Muscular Atrophy (the childhood version of Lou Gehrig's Disease) – with a special barbecue last May, at his store and two other Sobeys stores in Brampton. With the enthusiastic assistance of Sobeys staff and the support of customers, this special event raised funds which will go directly to research to find a cure for this devastating disease.

A team of Atlantic Canada Value Champions >
Debbie Fraser *Store Manager, Sobeys Clayton Park, Halifax, Nova Scotia*
Greville Nifort *Store Manager Trainee, Sobeys Bedford, Bedford, Nova Scotia*

When Canada's Navy responded to Hurricane Katrina last summer and decided to send three ships with relief supplies, they needed to rapidly source thousands of packages of diapers, baby wipes, mosquito repellent and sun block – in the middle of Labour Day weekend. The Navy turned to Debbie Fraser, well known as the driving force behind Sobeys' involvement in Department of National Defence Family Days in Halifax. Debbie, in turn, enlisted the assistance of Greville Nifort, who is always at the forefront of community activities. With their leadership, Sobeys' store and distribution employees from across Atlantic Canada pulled together and got the job done – helping bring relief to thousands.

- **Easter Seals Paper Egg Campaign:** Staff in Western Canada and Ontario stores enthusiastically sold Easter Seals paper eggs – raising close to $200,000 in fiscal 2006, supporting Easter Seals' programs for children with disabilities and special needs.
- **Heartfelt Rewards:** IGA franchisees and staff in Québec have been long-time supporters of the Montreal Heart Institute Foundation, and have raised $3.8 million over the past 20 years. In fiscal 2006, our IGA team raised $480,000 with the second annual Heartfelt Reward Contest – inviting customers to donate $2 for chances to win AIR MILES™ reward prizes.

Québec Value Champion > René-Paul Coly

Grocery Manager, IGA extra, Saint-Romuald, Québec

In the community of Saint-Romuald, Québec, René-Paul Coly is well known as a champion of community building, taking an active hand as a volunteer for numerous organizations over the years. René-Paul is currently Vice-President for La Société de Saint-Vincent-de-Paul, a major charitable organization in Québec. He assesses the needs of potential clients of the Société, and helps them get the assistance they require. As well, he is responsible for fundraising campaigns and the Société's food and clothing banks – bringing relief to people in need.

Ontario Value Champion > Angeline Tham

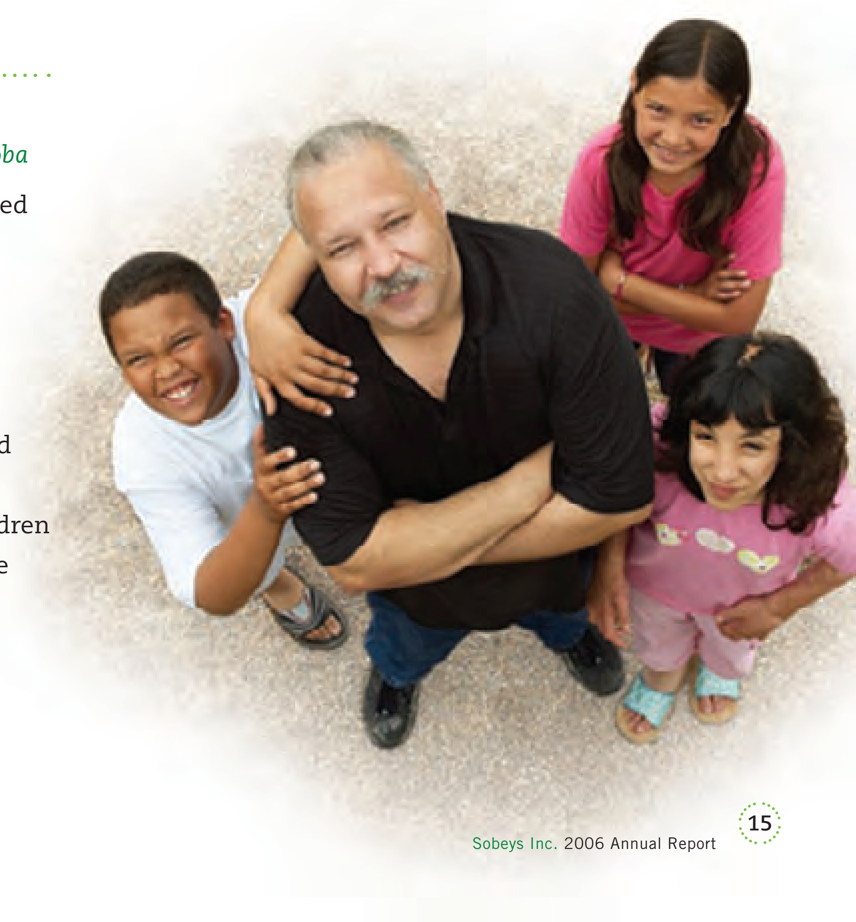
Office Manager, Airway Centre, Mississauga, Ontario

Angeline Tham has been recognized by her peers for the extra miles she goes on behalf of Ontarians, tirelessly volunteering her time and talents to help others. Angeline takes a leadership role in providing training through the St. John Ambulance organization. From first aid courses to infant and child car seat installation, Angeline has helped thousands of Ontarians lead safer lives. She also plays a vital role in educating her peers at work, often providing one-on-one training during her lunch hours or after work.

- **Multiple Sclerosis Bike Tour:** A team of 17 Southern Alberta IGA and Sobeys franchisees, managers, and Sobeys West employees participates annually in a 75 km bike rally over a grueling course. In fiscal 2006, the team organized an in-store fundraising campaign and raised more than $119,000.
- **Kids Help Phone:** Sobeys employees are long-time supporters of Kids Help Phone, Canada's only professional, anonymous, and bilingual 24-hour help line and online counselling service for youth. In fiscal 2006, Sobeys National and Ontario employees helped raise over $1.2 million through support of the *Being There for Kids Dinner,* while employees in nine Atlantic locations participated in the annual *Aliant Walk for Kids* and raised $70,000 – up more than 40 percent from the previous year.
- **Boys & Girls Club:** Sobeys Golf Tournament for Ontario stores and vendors raised more than $50,000 for the Boys and Girls Club of Canada, which provides a safe, supportive place for children and youth.
- **'Cook for the Cure':** In Ontario, Foodland and IGA employees and customers participated in 'Cook for the Cure' for the second consecutive year, raising close to $170,000 in support of the Canadian Cancer Society.

Western Canada Value Champion > Larry Swenarchuk,
Foreman, Winnipeg Distribution Centre, Winnipeg, Manitoba

In Western Canada, Sobeys employees have recognized the extraordinary personal commitment and contribution that Larry Swenarchuk has made to children with special needs and disabilities. While raising their own children, Larry and his wife Donna have fostered dozens of special needs children – and are currently caring for two girls and a boy who could be called "miracle children". The Swenarchuks have been saving for several years to take their foster children to Walt Disney World next winter – a trip of a lifetime for the children.



our governance

Message from the Chairman

The performance of Sobeys Inc. in the past year was solid on all fronts: for our employees, for the communities we are part of, for our customers and our shareholders.

Management, led by President and Chief Executive Officer, Bill McEwan, maintained their focus on the Company's long-term strategy and goals – that of setting Sobeys apart with an unrelenting focus on food and being Canada's premier food retailer and brand. Throughout the Company, there is a confidence in our strategy given the momentum achieved to date and the numerous opportunities that lie ahead.

From a single grocery store in Stellarton, Nova Scotia in 1907, Sobeys Inc. today operates a national grocery business, with approximately 1,300 stores from coast to coast, 75,000 corporate and franchise employees, and millions of customers. As we approach our 100th anniversary, your Company's growth has never been more dynamic. We have achieved record revenues in what continues to be an extremely competitive food retail environment and, at the end of fiscal 2006, the Company had achieved its eighth straight quarter of industry leading same-store sales performance, a key indication that our food-focused offering is appealing to consumers across Canada.

DONALD R. SOBEY
New Glasgow, Nova Scotia
Director since 1998.
Chair Emeritus (11)
Empire Company Limited

CHRISTINE CROSS (1) (9)
Thundridge, Hertfordshire, United Kingdom
Director since 2003.
President,
Christine Cross Ltd.

BILL McEWAN
New Glasgow, Nova Scotia
Director since 2000.
President and Chief Executive Officer,
Sobeys Inc.

DAVID F. SOBEY
New Glasgow, Nova Scotia
Director since 1998.
Chairman Emeritus (11)
Sobeys Inc.

MALEN NG (2) (9)
Toronto, Ontario
Director since 2001.
Chief Financial Officer,
Workplace Safety and Insurance Board of Ontario

The growth and progress realized so far is no accident, but the result of good management and dedicated employees, combined with the strong stewardship and oversight provided by an active, experienced and independent Board of Directors which includes key members of the majority shareholder Sobey family. This combination and our dedication to good governance, independent oversight and consulting and advising management have served our shareholders well.

Corporate citizenship and social responsibility remain critical components of Sobeys' long-term goals. Throughout the Company, we see outstanding examples of our employees upholding our core values including *Proudly Serve our Communities*. From the leadership in philanthropy that has always characterized the Sobey family to the individual efforts of outstanding employees, such as the Value Champions who are recognized and celebrated in this report, these efforts reflect well on all of us, and I am proud of my association with this Company.

As we approach our centenary, there will be many occasions to look back on the remarkable legacy of Sobeys – but even more cause to look forward.

PETER C. GODSOE
Toronto, Ontario
Director since 2004.
Former Chairman and
Chief Executive Officer,
The Bank of Nova Scotia.
Chairman, Sobeys Inc.

PAUL D. SOBEY [3] [5]
New Glasgow, Nova Scotia
Director since 1998.
President and Chief
Executive Officer,
Empire Company Limited

ROBERT P. DEXTER [3] [5] [7]
Halifax, Nova Scotia
Director since 1998.
Chair and Chief
Executive Officer, Maritime
Travel Inc., and Chair,
Empire Company Limited

DAVID LESLIE [1] [9]
Toronto, Ontario
Director since 2005.
Former Chairman and
Chief Executive Officer,
Ernst & Young LLP

(1) Audit Committee Member
(2) Audit Committee Chair
(3) Human Resources Committee Member
(4) Human Resources Committee Chair
(5) Corporate Governance Committee Member
(6) Corporate Governance Committee Chair
(7) Nominating Committee Member
(8) Nominating Committee Chair
(9) Oversight Committee Member
(10) Oversight Committee Chair
(11) Honourary Title, for Life

On behalf of the Board, I want to thank Sobeys' management and employees as well as our franchise affiliates and their employees for their collective dedication to serving the needs of all of our customers, and for the important role they play in increasing shareholder value. I must also thank my Board colleagues for their active and informed participation and their wise counsel. Their hard work is much appreciated.

As we approach our centenary, there will be many occasions to look back fondly on the remarkable legacy of Sobeys, however I fully expect there will be even more cause to look forward. That has been the key to a century of growth and value – always looking forward and always making progress.

Peter C. Godsoe
Chairman of the Board

MEL RHINELANDER (4)
Milwaukee, Wisconsin, USA
Director since 2004.
President and
Chief Executive Officer,
Extendicare Inc.

JOHN L. BRAGG (3) (6) (8)
Collingwood, Nova Scotia
Director since 1998.
Chairman, President and
Co-Chief Executive Officer,
Oxford Frozen Foods Ltd.

FRANK C. SOBEY (10)
Stellarton, Nova Scotia
Director since 2001.
Chairman, Crombie REIT

MARCEL CÔTÉ (3) (5) (7)
Montreal, Québec
Director since 1998.
Senior Partner, Secor Inc.

JOHN R. SOBEY (1) (5) (7)
Stellarton, Nova Scotia
Director since 1998.
Corporate Director

our governance focus

The Board of Directors and management of Sobeys are committed to strong corporate governance in the interest of all stakeholders.

The Board of Directors and management of Sobeys believe that strong corporate governance is integral to the effective management of the Company and to our ability to build sustainable worth for our customers, business partners, employees and investors. We believe that the foundation of good governance must include an experienced and independent Board of Directors, codes of business conduct that hold directors, officers and employees to account and a comprehensive disclosure policy that ensures transparency.

Our approach to corporate governance is aligned with the Corporate Governance Guidelines set out in NP 58-201 adopted by Canadian securities regulators, and in keeping with our commitment to the highest standards of corporate governance, we will continue to monitor and develop our governance practices.

Board Committees

Much of the work of the Board is done through its five committees, which hold regular quarterly meetings and meet more frequently as necessary. The committee chairs provide comprehensive reports on the activities of their committees at each quarterly Board meeting, and make recommendations to the Board in their respective areas of responsibility.

The Audit Committee reviews and assesses financial reporting practices and procedures, including internal accounting controls and the appointment of external auditors; reviews and approves quarterly and annual financial statements and related financial communications prior to public disclosure; and reviews and assesses the Company's risk management policies and practices, including in the area of ethical business conduct.

The Corporate Governance Committee develops, monitors and ensures compliance with Sobeys' corporate governance policies; annually reviews and assesses the performance and effectiveness of the Board, its committees and individual directors; recommends the composition of the Board's committees; and recommends compensation for directors.

The Nominating Committee monitors the composition of the Board for skill and expertise, and identifies, evaluates and recommends suitable candidates for election or appointment as directors of the Company.

The Human Resources Committee reviews management training and development programs; undertakes CEO succession planning and monitors other succession planning; ensures Sobeys' compliance with occupational health and safety standards; and recommends compensation for executive management.

The Oversight Committee reviews all matters related to business process optimization and information technology, including assessments, governance models, strategies, planning and risk management processes, and monitors all related projects.

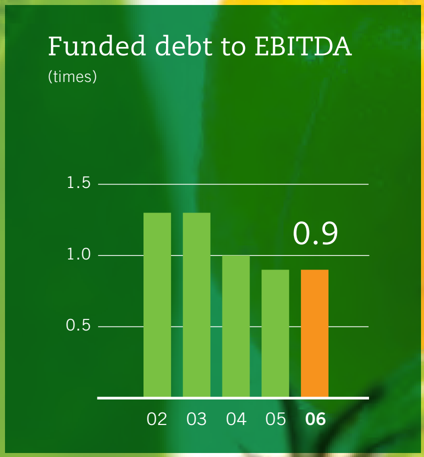
A comprehensive review of our corporate governance policies and practices can be found in our Information Circular and on our website at www.sobeys.com.

Table of Contents

focus on food

management's discussion and analysis

our performance at-a-glance



The following Management's Discussion & Analysis ("MD&A") for Sobeys Inc. ("Sobeys" or "the Company") should be read in conjunction with the Company's audited annual consolidated financial statements and the accompanying notes for the 52-weeks ended May 6, 2006, as compared to the 53-weeks ended May 7, 2005. Additional information about the Company, including the Company's Annual Information Form, can be found on SEDAR at www.sedar.com.

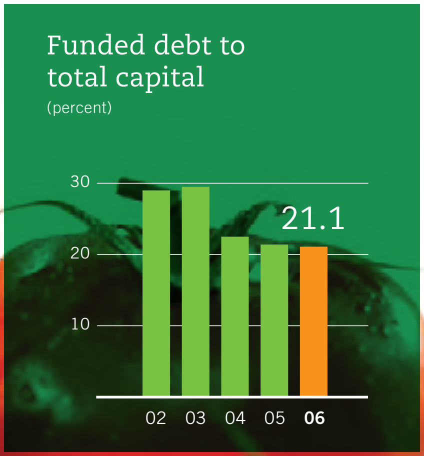
The consolidated financial statements and the accompanying notes have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and are reported in Canadian dollars.

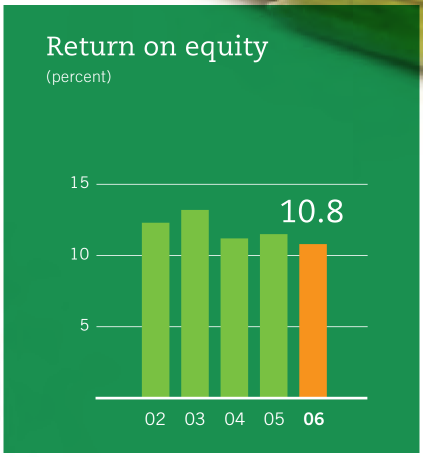
In the fourth quarter of fiscal 2005, the Company adopted Accounting Guideline 15 "Consolidation of Variable Interest Entities" ("AcG-15"). These consolidated financial statements include the accounts of Sobeys Inc. and its subsidiaries and variable interest entities ("VIEs") which the Company is required to consolidate. Please review the section entitled "AcG-15, Consolidation of Variable Interest Entities" included in this MD&A for more information.

This discussion contains forward-looking statements which reflect management's expectations regarding the Company's objectives, plans, goals, strategies, future growth, results of operations, performance and business prospects and opportunities. Forward-looking statements are typically identified by words or phrases such as "anticipates", "expects", "believes", "estimates", "intends" and other similar expressions. These statements are based on Sobeys management's assumptions and beliefs in light of the information currently available to them. These forward-looking statements are subject to uncertainties and other factors that could cause actual results to differ materially from such statements. These uncertainties and risks are discussed in the Company's materials filed with the Canadian securities regulatory authorities from time to time, including in the Risk Management section of this MD&A.

When relying on forward-looking statements to make decisions, the Company cautions readers not to place undue reliance on these statements, as a number of important factors could cause actual results to differ materially from any estimates or intentions expressed in such forward-looking statements. The Company does not undertake to update any forward-looking statements that may be made from time to time by or on behalf of the Company.

Our strategy for growing sales and earnings reflects our commitment to building a healthy and sustainable retail food business and infrastructure for the long term.





Management's analysis of operations

Sobeys and its subsidiaries conduct business in four retail food regions: Sobeys West, Sobeys Ontario, Sobeys Québec, and Sobeys Atlantic.

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 retail food store formats deployed by the Company to satisfy its customers' principal shopping requirements are the full service, fresh service, convenience service, community service and price service formats. The Company remains focused on improving the product, service and merchandising offerings within each format by realigning and renovating its current store base, while continuing to build new stores. The Company's four major banners – Sobeys, IGA extra, IGA and Price Chopper – are the primary focus of these food format development efforts.

During the year, the Company opened, replaced, expanded, renovated, acquired and/or converted the banners in 83 stores (2005 – 98). In fiscal 2006, the Company continued to execute against a number of initiatives in support of its food-focused strategy including productivity initiatives and business process, supply chain and system upgrades.

In fiscal 2006, the Company continued the roll-out of the Sobeys banner in Western Canada with the introduction of two new Sobeys stores and one rebannered store in Alberta. The addition of the Alberta stores brings the total Sobeys banner stores in Western Canada to 74.

Compliments, Sobeys new private label brand, was launched in fiscal 2005, to contribute to growth of company-wide sales and profitability and earn a greater share of customers' food and grocery shopping requirements. The *Compliments* brand consists of three quality tiers: Value, Selection and Sensations. In addition, the Company introduced two sub-brands during fiscal 2006, *Compliments Organics* and *Compliments balance-équilibre*, an organic and healthy line of products respectively. At the end of fiscal 2006, the Company has launched approximately 3,700 *Compliments* products.

The Company remains focused on productivity and business process optimization initiatives, designed to achieve efficiencies and improve its cost structure. A key productivity focus in fiscal 2006 was the continued roll-out of the first phase of the Company's SMART Retailing initiative. The first phase of SMART Retailing focused on continuous improvement processes that have resulted in improved labour productivity in the handling of back-shop inventories and shelf stocking, reduction in back room inventories and shrink reduction in produce, bakery, and meat departments. The Company completed the first phase of SMART Retailing during the year with the program implemented in 675 stores. The second phase of SMART Retailing began during fiscal 2006 and has been implemented in 425 stores to date. The second phase of SMART Retailing is focused on the implementation of a comprehensive store performance management process (Peer-to-Peer) supported by tools to assist in the measurement of the Company's progress against targets and expectations. Phase two continues to support the ongoing implementation of SMART Retailing and focuses on customer satisfaction, sales growth and margin improvements. The third phase will see the extension of the process and productivity improvements across the store.

During fiscal 2006 the Company also made significant progress in the implementation of system-wide business process optimization initiatives that are designed to reduce complexity and improve processes throughout the Company. To this end, Sobeys continued the roll-out of its common point-of-sale ("POS") system. This common POS system provides improved customer information and enhanced customer service at store check-outs, and is a key enabler of other business process optimization initiatives currently underway.

The Company also completed the roll-out of a new scale networking system, which improved accuracy and productivity and enabled full compliance with the nutritional labeling requirements that came into effect on December 12, 2005.

As discussed in the fiscal 2005 MD&A, system and process complexities in the Ontario business negatively impacted earnings in that region. In fiscal 2006, Sobeys began its business process and information systems transformation plan for the Company by focusing on the significant opportunity to upgrade information processing and decision support capabilities and improve efficiencies in the Ontario region. The system and processes that are being implemented were developed over several years and are currently employed in the Company's Atlantic Region. The Ontario roll-out will standardize and streamline the "back shop" in support of the Company's food focused strategy. This move will allow Sobeys to leverage technology investments, improve efficiencies and lower costs over the long term. Costs associated with this initiative totalled $0.19 per share in fiscal 2006. A similar transformation plan was initiated for the Western region in the fourth quarter of fiscal 2006. The anticipated costs for both these initiatives in fiscal 2007 will be $0.27 to $0.32 per share.

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 are set out below.

	52 weeks ended May 6, 2006	53 weeks ended May 7, 2005
Same store sales growth	**4.0%**	3.7%
Sales growth	**5.4%**	10.3%
Basic earnings per share growth	**1.7%**	12.6%
Return on equity	**10.8%**	11.5%
Funded debt to total capital	**21.1%**	21.4%
Funded debt to EBITDA	**0.9x**	0.9x
Company-wide capital expenditures (in millions)	**$ 560**	$ 436

Results of fiscal 2006 operations

Summary table of consolidated financial results

(in millions, except per share data)	52 weeks ended May 6, 2006	% of sales	53 weeks ended May 7, 2005	% of sales	52 weeks ended May 1, 2004 (restated)	% of sales
Sales	$ 12,853.3	100.00%	$ 12,189.4	100.00%	$ 11,046.8	100.00%
Gain on sale of assets	–	0.00%	–	0.00%	14.6	0.13%
Earnings, before interest, income taxes and minority interest	331.6	2.58%	322.6	2.65%	294.3	2.66%
Interest expense	34.9	0.27%	37.9	0.31%	43.2	0.39%
Income taxes	100.1	0.78%	98.0	0.80%	84.6	0.77%
Minority interest	7.2	0.06%	–	0.00%	–	0.00%
Net earnings	189.4	1.47%	186.7	1.53%	166.5	1.51%
Cash flows from operating activities	$ 495.3	3.85%	$ 438.0	3.59%	$ 364.6	3.30%
Dividends	$ 0.545		$ 0.50		$ 0.44	
Weighted average number of shares outstanding, basic	64.7		64.9		65.3	
Weighted average number of shares outstanding, diluted	65.4		65.5		65.9	
Per share, basic:						
Cash flows from operating activities	$ 7.66		$ 6.75		$ 5.58	
Net earnings	$ 2.93		$ 2.88		$ 2.55	
Per share, diluted:						
Cash flows from operating activities	$ 7.57		$ 6.69		$ 5.53	
Net earnings	$ 2.90		$ 2.85		$ 2.53	

Fiscal 2004 has been restated to reflect retroactive adjustments related to lease accounting and EIC-144.
Please see sections entitled "Lease Accounting" and "EIC-144".

The following is a review of Sobeys' performance for the 52-week period ended May 6, 2006 compared to the 53 week period ended May 7, 2005. The performance review takes into consideration the impact of the additional week of operations in fiscal 2005.

Sales

The following table illustrates fiscal 2006 sales growth after eliminating the impact of VIE consolidation and the additional week of sales in fiscal 2005:

($ in millions)	Reported sales fiscal 2006	Reported growth over fiscal 2005	VIE impact fiscal 2006	Adjusted sales fiscal 2006	Reported sales fiscal 2005	53rd week impact	VIE impact fiscal 2005	Adjusted sales fiscal 2005	Adjusted growth over fiscal 2005
Fiscal 2006	12,853	5.4%	587	12,266	12,189	241	137	11,811	3.9%

In fiscal 2006, Sobeys achieved sales of $12.85 billion, an increase of $664 million or 5.4 percent over fiscal 2005.

Fiscal 2006 contained 52 weeks of operations compared to 53 weeks in fiscal 2005. Also impacting sales growth in fiscal 2006 and the fourth quarter of fiscal 2005 was the consolidation of VIEs, which accounted for approximately $587 million in fiscal 2006 and $137 million in fiscal 2005. Adjusting for the 53rd week of operations and VIEs the Company had sales growth of $455 million or 3.9 percent over fiscal 2005.

Sales growth was also driven by the Company's continued implementation of sales and merchandising initiatives across the country, coupled with the increased retail selling square footage resulting from the development of new stores and an ongoing program to enlarge and renovate existing store assets.

Store square footage increased by 1.6 percent in fiscal 2006 as a result of the opening of 56 new or replacement stores and the expansion of 18 stores, net of 76 stores closed.

Sobeys same-store sales – sales from stores in the same locations in both reporting periods – increased by 4.0 percent.

Sales growth was impacted by a year-over-year decline of approximately $134.5 million in company-wide tobacco sales. Excluding this decline in the tobacco business, sales growth would have been 5.0 percent rather than the 3.9 percent reported above.

Inflation was approximately 1.5% for the year, with variances by region.

The Company expects sales growth to continue in fiscal 2007 as a result of the on-going capital investment in its retail store network, and continued offering, merchandising and service improvements across the country.

Earnings before interest, income taxes, depreciation and amortization

Fiscal 2006 earnings before interest, income taxes, depreciation and amortization ("EBITDA") increased $29.2 million or 5.9 percent to $528.2 million from $499.0 million reported in fiscal 2005. EBITDA as a percentage of sales increased to 4.11 percent from 4.09 percent last year. Excluding VIEs, EBITDA as a percent of sales was 4.17 percent in fiscal 2006, a 4 basis point increase from fiscal 2005 EBITDA as a percent of sales.

For the 13-weeks and 52-weeks ended May 6, 2006, $5.3 million and $18.6 million, respectively, of pre-tax costs related to the Ontario business process and system initiative were incurred. These costs included the severance, labour, implementation and training costs associated with the Ontario systems implementation as well as the cost of writing off the Commisso's brand-name. As part of the transformation of the Ontario business, the Company is converting 12 Commisso's stores in Ontario to the Sobeys and Price Chopper banners. These conversions began in fiscal 2006 and will continue throughout the first half of fiscal 2007. Excluding these costs and the impact of VIEs, EBITDA increased 6.2 percent over fiscal 2005 and EBITDA as a percent of sales would have been 4.31 percent, an 18 basis point improvement over fiscal 2005.

Contributing to increased EBITDA was the growth in sales and an increase in gross margin, as a result of improved productivity initiatives and changes in mix, compared to the prior year.

Earnings before interest, income taxes, depreciation, amortization and rent

Fiscal 2006 earnings before interest, income taxes, depreciation and amortization and rent ("EBITDAR") was $863.2 million compared to $774.9 million in fiscal 2005. The Company leases a substantial portion of its store network. Therefore, to arrive at a measure of operating performance excluding the impact of capital, gross rent expense of $335.0 million in fiscal 2006 and $275.9 million in fiscal 2005 is added to EBITDA to arrive at EBITDAR. EBITDAR as a percent of sales in fiscal 2006 was 6.72 percent compared to 6.36 percent in fiscal 2005.

Earnings before interest and income taxes

Earnings before interest and income taxes ("EBIT") increased to $331.6 million in fiscal 2006, a 2.8 percent increase from the prior year, with an EBIT margin of 2.58 percent compared to 2.65 percent in fiscal 2005. Included in fiscal 2006 EBIT was a $20.2 million increase in depreciation and amortization expense ($196.6 million current year compared to $176.4 million last year), reflecting the Company's continued capital investments. Also included in EBIT are the Ontario business process and system initiative costs outlined above. Adjusting for the Ontario business process and system initiative costs and the impact of VIEs, EBIT would total $338.8 million representing an EBIT margin of 2.76 percent. The 53rd week of operations in fiscal 2005 favourably impacted EBIT by approximately $6.1 million or 2.1 percentage points but had no impact on EBIT margin in the prior year.

The Company 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, reduce costs and improve margins over time.

Interest expense

Interest expense declined $3.0 million, in fiscal 2006, to $34.9 million from $37.9 million reported last year, due to lower long-term borrowing levels. Interest coverage, which is EBIT divided by interest expense, improved to 9.5 times compared to 8.5 times last year.

The majority of the Company's debt is long term and at fixed rates, accordingly there is limited exposure to interest rate volatility. The Company is exposed to interest rate risk when arranging new debt.

Income taxes

The annual effective tax rate decreased to 33.7 percent from 34.4 percent last year. The decrease in the effective tax rate for the year was the result of adjustments to future statutory rates applied to timing differences of future tax balances and a reduction in federal capital taxes.

Net earnings

Fiscal 2006 basic net earnings per share totalled $2.93 ($189.4 million), an increase of 1.7 percent compared to the $2.88 per share ($186.7 million) recorded during fiscal 2005. Net earnings for fiscal 2005 were favourably impacted by approximately $3.5 million or $0.05 per share as a result of the 53rd week of operations in the prior year.

Net earnings for the year ended May 6, 2006 included increased depreciation and amortization expense, and Ontario business process and system initiative costs referred to above.

The consolidation of VIEs resulted in a $0.3 million increase in net earnings for the 52-week period ended May 6, 2006 and a $0.6 million decrease in net earnings for the prior fiscal year. The Ontario business process and system initiative costs reduced basic earnings per share by $0.19 for the 52 weeks of fiscal 2006.

Excluding the Ontario process and system costs and the impact of VIEs, fiscal 2006 basic earnings per share would have been $3.11 compared to basic earnings per share of $2.84 in the prior year excluding the impact of VIEs and the 53rd week of operations. This would represent a 9.5 percent increase in basic earnings per share year-over-year.

Results of fourth quarter fiscal 2006 operations

The following is a summary of selected consolidated financial information from the Company's unaudited interim consolidated financial statements for the 13- and 14-weeks ended May 6, 2006 and May 7, 2005, respectively.

Summary table of consolidated financial results for the fourth quarter

(in millions, except per share data)	13 weeks ended May 6, 2006	% of sales	14 weeks ended May 7, 2005	% of sales
Sales	**$ 3,162.6**	**100.00%**	$ 3,294.7	100.00%
EBIT	**85.2**	**2.69%**	84.6	2.57%
Interest expense	**7.9**	**0.25%**	10.7	0.32%
Income taxes	**24.1**	**0.76%**	25.8	0.78%
Net earnings	**49.7**	**1.57%**	48.1	1.46%
Cash flows from operating activities	**$ 299.3**	**9.46%**	$ 236.7	7.18%
Weighted average number of shares outstanding, basic	**64.7**		64.7	
Net earnings per share, basic	**$ 0.77**		$ 0.74	
Weighted average number of shares outstanding, diluted	**65.4**		65.3	
Net earnings per share, diluted	**$ 0.76**		$ 0.74	
Dividends	**$ 0.140**		$ 0.125	

The following is a review of Sobeys' performance for the 13-week period ended May 6, 2006 compared to the 14-week period ended May 7, 2005.

Sales

The following table illustrates fourth quarter of fiscal 2006 sales after eliminating the impact of the additional week of sales included in the fourth quarter of fiscal 2005 (VIEs were consolidated in both the fourth quarter of fiscal 2005 and 2006):

($ in millions)	Reported sales fiscal 2006	Reported decline over fiscal 2005	Reported sales fiscal 2005	53rd week impact	Adjusted sales fiscal 2005	Adjusted growth over fiscal 2005
Fourth quarter	3,163	(4.0%)	3,295	241	3,054	3.6%

Sales decreased $132.1 million or 4.0 percent compared to the fourth quarter of fiscal 2005. The fourth quarter of fiscal 2006 contained 13 weeks of operations compared to 14 weeks in fiscal 2005 and this additional week accounted for approximately $241 million or 7.3 percentage points of the prior year reported sales. Adjusting for the additional week, sales growth was 3.6 percent over the fourth quarter of the prior year.

Same-store sales increased 3.9 percent during the fourth quarter of fiscal 2006. The growth in retail sales was a direct result of the continued implementation of sales and merchandising initiatives across the Company, and the Company's ongoing financial commitment to upgrade and renovate existing store assets. Same-store sales growth outpaced overall Company sales growth as there was little growth in the Company's wholesale sales to independent customers in the fourth quarter this year compared to the fourth quarter last year. Tobacco sales have decreased in the current quarter and the disposition of the Company's cash and carry business in Ontario and Québec in the quarter also had a negative impact on sales. Excluding the impact of the tobacco decline and the impact of the cash and carry disposition, sales growth would have been 6.1 percent on a comparable 13 week basis.

Earnings before interest, income taxes, depreciation and amortization

EBITDA for the quarter ended May 6, 2006 was $136.7 million; an increase of 2.7 percent or $3.6 million versus the $133.1 million recorded in the same quarter last year. EBITDA as a percentage of sales increased to 4.32 percent from 4.04 percent when compared to fourth quarter fiscal 2005 results. The Company experienced a modest increase in gross margin percentage, compared to the same quarter last year, as a result of the continued implementation of enhanced merchandising programs and store productivity initiatives.

Earnings before interest, income taxes, depreciation, amortization and rent

EBITDAR for the fourth quarter of fiscal 2006 grew by $16.3 million to $221.0 million from $204.7 million in the fourth quarter of fiscal 2005. EBITDAR as a percent of sales was 6.99 percent compared to 6.21 percent in the fourth quarter of fiscal 2005.

Earnings before interest and income taxes

EBIT for the fourth quarter increased $0.6 million or 0.7 percent to $85.2 million. The 14th week of operations in the fourth quarter of fiscal 2005 favourably impacted EBIT by approximately $6.1 million. EBIT margin, which is EBIT divided by sales, for the fourth quarter increased to 2.69 percent from 2.57 percent in the same quarter last year.

Interest expense

Interest expense in the fourth quarter decreased $2.8 million to $7.9 million compared to $10.7 million during the same time period last year. Interest coverage for the fourth quarter improved to 10.8 times, compared to 7.9 times for the same quarter last year due to the decrease in interest expense and the increase in EBIT.

Income taxes

The Company's effective income tax rate for the fourth quarter was 31.2 percent compared to 34.9 percent in quarter four of fiscal 2005. The decrease in the effective tax rate for the quarter was the result of adjustments to the statutory rates applied to timing differences of future tax balances and a reduction in federal capital taxes.

Net earnings

Fourth quarter fiscal 2006 basic net earnings per share totalled $0.77 ($49.7 million), an increase of 4.1 percent compared to the $0.74 per share ($48.1 million) recorded in the same quarter of fiscal 2005. Net earnings for the fourth quarter of fiscal 2005 were favourably impacted by approximately $3.5 million or $0.05 per share for the 14th week of operations. Fiscal 2006 fourth quarter net earnings also included $0.05 per share of costs for the Ontario system and process initiatives. Excluding the Ontario system and process costs as well as the 14th week of operations in the fourth quarter of the prior year, basic earnings per share would have been $0.82 in the fourth quarter of fiscal 2006 compared to $0.69 in the fourth quarter of fiscal 2005, representing growth of 18.8 percent.

Financial information by quarter

(in millions, except per share data)	Q4 (13 weeks) May 6, 2006	Q3 (13 weeks) Feb 4, 2006	Q2 (13 weeks) Nov 5, 2005	Q1 (13 weeks) Aug 6, 2005	Q4 (14 weeks) May 7, 2005	Q3 (13 weeks) Jan 29, 2005	Q2 (13 weeks) Oct 30, 2004	Q1 (13 weeks) July 31, 2004
Operations								
Sales	$ 3,162.6	$ 3,171.9	$ 3,218.4	$ 3,300.4	$ 3,294.7	$ 2,917.0	$ 2,966.7	$ 3,011.0
EBITDA	136.7	128.6	132.8	130.1	133.1	119.1	123.9	122.9
EBIT	85.2	78.6	84.1	83.7	84.6	76.2	81.2	80.6
Net earnings	$ 49.7	$ 45.7	$ 45.8	$ 48.2	$ 48.1	$ 44.8	$ 47.2	$ 46.6
Per share information, basic								
EBIT	$ 1.32	$ 1.21	$ 1.30	$ 1.29	$ 1.31	$ 1.18	$ 1.25	$ 1.23
Net earnings	$ 0.77	$ 0.71	$ 0.71	$ 0.74	$ 0.74	$ 0.69	$ 0.73	$ 0.71
Weighted average number of shares, basic	64.7	64.8	64.8	64.7	64.7	64.6	65.0	65.3
Per share information, diluted								
EBIT	$ 1.30	$ 1.20	$ 1.29	$ 1.28	$ 1.30	$ 1.17	$ 1.24	$ 1.22
Net earnings	$ 0.76	$ 0.70	$ 0.70	$ 0.74	$ 0.74	$ 0.69	$ 0.72	$ 0.71
Weighted average number of shares, diluted	65.4	65.4	65.4	65.3	65.3	65.3	65.7	65.9
EBITDA as a percent of sales	4.32%	4.05%	4.13%	3.94%	4.04%	4.08%	4.18%	4.08%
EBIT as a percent of sales	2.69%	2.48%	2.61%	2.54%	2.57%	2.61%	2.74%	2.68%

All quarters prior to the fourth quarter of fiscal 2005 have been restated to reflect the retroactive adjustment related to lease accounting. Please see the section entitled "Lease Accounting".

Financial condition

The Company's financial condition at May 6, 2006 continued to strengthen as indicated in the following table:

Capital structure and key financial condition measures

($ in millions)	May 6, 2006	May 7, 2005	May 1, 2004 (Restated)
Shareholders' equity	$ 1,834.3	$ 1,682.1	$ 1,561.3
Total long-term debt[1]	$ 490.0	$ 457.8	$ 453.1
Funded debt to total capital	21.1%	21.4%	22.5%
Adjusted debt to total capital[3]	45.5%	48.1%	42.9%
Funded debt to EBITDA	0.9x	0.9x	1.0x
EBITDA to interest expense	15.1x	13.2x	10.3x
Current assets to current liabilities	1.00x	0.86x	0.83x
Total assets	$ 3,738.6	$ 3,445.8	$ 3,278.9
Long-term debt[2]	$ 465.0	$ 262.9	$ 420.0

(1) Includes current portion of long-term debt.

(2) Excludes current portion of long-term debt.

(3) Adjusted debt includes capitalization of lease obligations based on six times net annual lease payments (gross lease payments net of expected sub-lease income).

Fiscal 2004 has been restated to reflect retroactive adjustments related to lease accounting and EIC-144. Please see the sections entitled "Lease Accounting" and "EIC-144".

The ratio of funded debt to total capital improved to 21.1 percent from the 21.4 percent reported for the same period last fiscal year, as a result of the growth in retained earnings.

The Company also monitors adjusted debt to total capital, where net annual lease payments are capitalized at six times annual lease payments, and this capitalized lease obligation is then added to funded debt. Adjusted debt to capital at year end was 45.5 percent versus 48.1 percent last year.

The Company's long-term debt is comprised of $118.6 million due within the next five years, and $371.4 million with longer maturities, for a total of $490.0 million (2005 – $457.8 million). The fair value of the Company's long-term debt is estimated to be $517.7 million. Long-term debt maturities in fiscal 2007 and 2008 amount to $48.6 million. Cash generated from operations will finance these maturities. Management monitors debt markets with a view to replacing maturing debt with longer-term maturities.

The ratio of funded debt to EBITDA remained consistent with the level at last fiscal year end, reflecting the growth in EBITDA.

Improvement in the EBITDA to interest expense coverage ratio (15.1 times versus 13.2 times at May 7, 2005) resulted from an improvement in the trailing 12-month EBITDA ($528.2 million compared to $499.0 million for the 12-months ended May 7, 2005) coupled with a 7.9 percent decline in trailing 12-month interest expense ($34.9 million compared to $37.9 million for the 12-months ended May 7, 2005).

Current assets to current liabilities increased to 1.00 times from 0.86 times in the same period last year. The change in the current ratio reflects working capital changes which are described in the liquidity and capital resources section which follows.

Sobeys' liquidity position remained strong at May 6, 2006, with only 10.1 percent utilization (utilized for letters of credit) of the authorized $300 million revolving bank lines. At May 6, 2006, the Company had cash and cash equivalents totalling $332.1 million compared to $272.8 million at May 7, 2005 including $166.9 million in short-term commercial paper as of May 6, 2006.

On October 21, 2005, the Company filed a short-form base shelf prospectus providing for the issuance of up to $500 million in unsecured Medium Term Notes ("MTN") over the next two years. On October 28, 2005, the Company issued $175 million Series D MTN with a maturity date of October 29, 2035 (30 years) and an interest rate of 6.06 percent. The proceeds from this issuance were used to repay the Sobeys' Series A MTN which matured on November 1, 2005 and carried a rate of 7.60 percent. Through a bond forward, the Company had locked in the rate on the underlying government of Canada 15-year yield for refinancing $100 million of the November 2005 Series A MTN maturity. The settlement of this bond forward resulted in a $4.4 million addition to deferred costs which is being amortized to interest expense over the 30-year term of the related MTN.

Liquidity and capital resources

The table below highlights major cash flow components for the 13- and 52-weeks ended May 6, 2006 compared to the 14- and 53-weeks ended May 7, 2005.

Major cash flow components

($ in millions)	**13 weeks ended May 6, 2006**	14 weeks ended May 7, 2005	**52 weeks ended May 6, 2006**	53 weeks ended May 7, 2005
Net earnings	**$ 49.7**	$ 48.1	**$ 189.4**	$ 186.7
Items not affecting cash	**87.9**	75.6	**260.4**	235.7
	137.6	123.7	**449.8**	422.4
Net change in non-cash working capital	**161.7**	113.0	**45.5**	15.6
Cash flows from operating activities	**299.3**	236.7	**495.3**	438.0
Cash flows used in investing activities	**(113.1)**	(113.3)	**(409.6)**	(295.7)
Cash flows used in financing activities	**(6.3)**	(5.8)	**(26.4)**	(67.0)
Initial impact of VIEs	**–**	32.9	**–**	32.9
Increase in cash and cash equivalents	**$ 179.9**	$ 150.5	**$ 59.3**	$ 108.2

Operating activities

Cash flows from operating activities amounted to $299.3 million in the fourth quarter of fiscal 2006 compared to $236.7 million in the comparable period last year. This increase of $62.6 million was due to increased net earnings of $1.6 million, an increase in items not affecting cash of $12.3 million and an increase in non-cash working capital of $48.7 million, from a positive $113.0 million in fiscal 2005 to a positive $161.7 million in fiscal 2006.

Cash flows from operating activities on an annual basis were $495.3 million compared to $438.0 million in the comparable period last year. This increase of $57.3 million was the result of a $2.7 million improvement in net earnings, a $29.9 million improvement in non-cash working capital and a $24.7 million increase in items not affecting cash.

The following table presents non-cash working capital changes as compared to the third quarter of fiscal 2006 and last fiscal year.

Non-cash working capital (including VIEs)

($ in millions)	Including VIEs as of May 6, 2006	Including VIEs as of February 4, 2006	Quarter increase (decrease) in cash flows including VIEs	Including VIEs as of May 7, 2005	Year-to-date increase (decrease) in cash flows
Receivables	$ 208.2	$ 219.0	$ 10.8	$ 199.8	$ (8.4)
Inventories	626.8	652.5	25.7	588.6	(38.2)
Prepaid expenses	45.9	44.2	(1.7)	43.4	(2.5)
Income taxes receivable	5.8	19.4	13.6	21.9	16.1
Accounts payable and accrued liabilities	(1,158.8)	(1,048.5)	110.3	(1,083.3)	75.5
Impact of business acqusitions on working capital	(3.0)	–	3.0	–	3.0
Total	$ (275.1)	$ (113.4)	$ 161.7	$ (229.6)	$ 45.5

Receivables decreased $10.8 million, inventory levels decreased $25.7 million and accounts payable and accrued liabilities increased $110.3 million compared to the third quarter of fiscal 2006. The decrease in accounts receivable during the quarter is reflective of the collection of supplier revenue that was outstanding at the end of the third quarter. The increase in accounts payable and accrued liabilities was consistent with the prior year and can be attributed to a combination of higher trade payables and accrued liabilities such as construction costs and employee incentives. The decrease in inventory levels is consistent with inventory level trends in prior years.

Compared to May 7, 2005 accounts receivable increased $8.4 million, inventories increased $38.2 million and accounts payable and accrued liabilities increased $75.5 million. The increase in inventory and the corresponding increase in trade accounts payable reflects higher inventory levels required to support the Company's expanded store network and growing sales.

Investing activities

Cash used in investing activities of $113.1 million in the fourth quarter was $0.2 million lower than in the fourth quarter of last fiscal year. The decrease in cash used in investing activities was the result of a decrease in property and equipment purchases of $10.1 million, a decrease in deferred cost additions of $8.9 million, partially offset by an increase in restricted cash of $14.7 million when compared to the fourth quarter of fiscal 2005.

Company-wide capital investment includes on-balance sheet capital expenditures, all known capital investments by franchise affiliates and capital investments by third-party landlords. Company-wide capital investment totalled $560 million in fiscal 2006, an increase of $124 million from $436 million in the previous year. The Company remains committed to growing and improving its store network. During the quarter, 12 corporate and franchised stores were opened or replaced compared to 13 corporate and franchised stores opened or replaced during the fourth quarter of last year. An additional 4 stores were expanded during the quarter compared to 7 in the same time period last year. There were 4 stores rebannered in the current quarter compared to 16 for the same quarter last year.

On an annual basis, 56 corporate and franchised stores were opened or replaced this fiscal year compared to 41 corporate and franchised stores opened or replaced last year. An additional 18 stores were expanded in the year compared to 19 stores last year and 9 stores were rebannered this year compared to 36 last year.

Net retail store square footage increased during the fourth quarter by 1,341 square feet (405,108 square feet opened, less 403,767 square feet closed). Net retail store additions for the year totalled 322,484 square feet (1,341,601 square feet opened less 1,019,117 square feet closed). At May 6, 2006, Sobeys' square footage totalled 25.4 million square feet, a 1.6 percent increase over May 7, 2005.

The Company continues to focus on growth through a combination of new store openings, renovations, replacements and enlargements and, where appropriate, through strategic acquisitions. It is expected that there will be a significant increase in capital expenditures for fiscal 2007. This will include a continued focus on the retail store network along with increased spending on landbanked sites and logistics infrastructure. During fiscal 2007, the Company plans to open, expand, or renovate approximately 90 corporate and franchise affiliate stores across Canada, increasing square footage by approximately four percent.

Financing activities

Financing activities during the fourth quarter used $6.3 million of cash compared to $5.8 million of cash used in the comparable period of fiscal 2005.

Financing activities year-to-date reduced cash by $26.4 million compared to a $67.0 million cash decrease for the same period last year. The Company repaid, on maturity, the $175 million Series A MTN with the proceeds from the issuance of new Series D MTN. This resulted in a corresponding increase in issuance of long-term debt and debt repayments of $175.0 million. During fiscal 2005, the Company repurchased 708,700 common shares as part of a normal course issuer bid, and also purchased 32,305 shares from employees. The purchase price for these share repurchases was $23.1 million. The Company completed no repurchases in fiscal 2006. The Company's share capital was comprised of the following at fiscal year-end, on May 6, 2006:

	Number of shares
Authorized	
Preferred shares, par value of $25 each, issuable in series	471,000,000
Preferred shares, without par value, issuable in series	500,000,000
Common shares, without par value	498,682,931
Issued	
Common shares, without par value	65,426,282

As of June 28, 2006, the Company had common shares outstanding of 65,426,282.

Accounting policy changes

Accounting standards implemented during fiscal 2006 and 2005

EIC-144, Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor ("EIC-144")

In January 2004, the CICA issued a new accounting standard, EIC-144 titled "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor". EIC-144 provides that cash consideration received from a vendor is presumed to be a reduction in the prices of the vendor's products or services and should, therefore, be characterized as a reduction in cost of sales and related inventory when recognized in the customer's income statement and balance sheet. If the consideration is a payment for assets or services delivered to the vendor, the cash consideration should be characterized as revenue or other income. If it is a reimbursement of costs incurred to sell the vendor's products, the cash consideration should be characterized as a reduction of that cost, provided certain conditions are met. EIC-144 requires retroactive application to all financial statements for annual and interim periods ending after August 15, 2004. The Company adopted EIC-144 in the 2005 fiscal year, adjusting for it retroactively, with restatement of comparative periods.

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. Due to the retroactive implementation of EIC-144, the timing of recognition of certain vendor allowances has changed, resulting in the Company recording a decrease in opening retained earnings for fiscal 2005 of $5.9 million (net of income taxes receivable of $3.4 million), and a decrease in inventory of $9.3 million. The implementation of EIC-144 did not result in a material change in the annual net earnings for fiscal 2006 or fiscal 2005 or in fiscal 2006 or fiscal 2005 quarterly net earnings.

During fiscal 2006 the Company adopted the amendment to EIC-144 issued in January 2005. The amendment requires disclosure of the amount of vendor allowances that have been recognized in income but for which the full requirements for entitlement have not yet been met. Certain allowances from vendors are contingent on the Company achieving minimum purchase levels. The Company recognizes these allowances in income in accordance with EIC-144 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 6, 2006, the Company has recognized $3.5 million of allowances in income where it is probable that the minimum purchase level will be met and the amount of the allowance can be estimated.

AcG-15, Consolidation of Variable Interest Entities

Effective for the fourth quarter ended May 7, 2005, the Company was required to implement Accounting Guideline 15 "Consolidation of Variable Interest Entities" ("AcG-15") issued by the CICA. AcG-15 required the Company to consolidate certain entities that are deemed to be subject to control of the Company on a basis other than through ownership of a voting interest in the entity.

Variable interest entities are defined under AcG-15 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 VIE's expected losses and its expected residual returns.

The Company implemented AcG-15 during the fourth quarter ended May 7, 2005, retroactively without restatement of prior periods. Entities that have been identified as meeting the characteristics of a VIE were consolidated in the Company's results effective for the fourth quarter of fiscal 2005.

The Company has identified the following entities as VIEs:

Franchise Affiliates

The Company has identified 300 (2005 – 287) franchise affiliates 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. The terms of the agreement with this entity require the Company to consolidate its results with those of the Company pursuant to AcG-15.

The Company has consolidated the results of these franchise affiliates and the entity providing warehouse and distribution services effective for the fourth quarter of fiscal 2005.

Balance sheet as at May 6, 2006

($ in millions)	Consolidated balance sheet as at May 6, 2006 before AcG-15 impact	Impact of the implementation of AcG-15	Consolidated balance sheet as at May 6, 2006 after AcG-15 impact
Assets			
Current			
Cash and cash equivalents	$ 292.8	$ 39.3	$ 332.1
Receivables	251.7	(43.5)	208.2
Inventories	503.9	122.9	626.8
Prepaid expenses	40.8	5.1	45.9
Mortgages, loans and other receivables	14.6	1.3	15.9
Income taxes receivable	8.0	(2.2)	5.8
	1,111.8	122.9	1,234.7
Mortgages, loans and other receivables	163.7	(95.3)	68.4
Other assets	171.4	8.6	180.0
Property and equipment	1,580.8	31.4	1,612.2
Assets held for realization	8.5	–	8.5
Intangibles	21.5	–	21.5
Goodwill	613.3	–	613.3
	$ 3,671.0	$ 67.6	$ 3,738.6
Liabilities			
Current			
Accounts payable and accrued liabilities	$ 1,136.6	$ 22.2	$ 1,158.8
Future tax liabilities	46.1	–	46.1
Long-term debt due within one year	23.9	1.1	25.0
	1,206.6	23.3	1,229.9
Long-term debt	448.3	16.7	465.0
Long-term lease obligation	16.6	4.2	20.8
Employee future benefit obligation	96.0	–	96.0
Future tax liabilities	45.4	(1.3)	44.1
Deferred revenue	3.3	–	3.3
Minority interest	0.2	45.0	45.2
	1,816.4	87.9	1,904.3
Shareholders' equity			
Capital stock	904.8	–	904.8
Contributed surplus	0.9	–	0.9
Retained earnings	948.9	(20.3)	928.6
	1,854.6	(20.3)	1,834.3
	$ 3,671.0	$ 67.6	$ 3,738.6

The impact of implementation of AcG-15 on the consolidated balance sheet of the Company can be explained as follows:

- Accounts receivable and long-term notes receivable due from the franchise affiliates were eliminated upon consolidation. Cash, inventories, fixed assets, accounts payable and debt financing of the fixed assets has been consolidated.
- A charge of $14.5 million was recorded to opening retained earnings for the fourth quarter of fiscal 2005 to reflect:
  1. The reduction of inventory values of the franchise affiliates that include charges from the Company for distribution costs and vendor allowances that are not recognized by the Company until final sale to customers.
  2. Goodwill that is carried on the accounts of stores determined to be VIEs has been assessed as being impaired with no fair market value, and, as such, has been eliminated.
- Based on a change in management's estimation process, it has been determined that a charge of $5.7 million to retained earnings was required in the second quarter of 2006 to reflect additional minority interest in the VIEs. Additional adjustments of $0.2 million to retained earnings are reflective of changes in the number of VIE entities required to be consolidated.
- Minority interest represents the equity in the VIEs held by the common shareholder.

Statement of earnings for 52-weeks ended May 6, 2006:

(in millions, except per share data)	Consolidated statement of earnings for 52-weeks ended May 6, 2006 before AcG-15 impact	Impact of the imple-mentation of AcG-15	Consolidated statement of earnings for 52-weeks ended May 6, 2006 after AcG-15 impact
Sales	$ 12,266.1	$ 587.2	$ 12,853.3
Operating expenses			
Cost of sales, selling and administrative expenses	11,755.1	570.0	12,325.1
Depreciation	187.0	5.8	192.8
Amortization of intangibles	3.8	–	3.8
Earnings before interest, income taxes and minority interest	320.2	11.4	331.6
Interest expense			
Long-term debt	32.5	1.1	33.6
Short-term debt	1.3	–	1.3
	33.8	1.1	34.9
Earnings before income taxes and minority interest	286.4	10.3	296.7
Income taxes	97.3	2.8	100.1
Net earnings before minority interest	189.1	7.5	196.6
Minority interest	–	7.2	7.2
Net earnings	$ 189.1	$ 0.3	$ 189.4
Net earnings per share basic	$ 2.92	$ 0.01	$ 2.93
Net earnings per share diluted	$ 2.89	$ 0.01	$ 2.90
Basic weighted average number of common shares outstanding, in millions	64.7		64.7
Diluted weighted average number of common shares outstanding, in millions	65.4		65.4

The impact of implementation of AcG-15 on the consolidated income statement of the Company can be explained as follows:

Franchise affiliate retail sales are recorded and sales from the Company's distribution centres and cost of goods sold to the franchise affiliate have been eliminated. The impact on all other financial statement line items including net earnings is immaterial.

CICA Section 1100, Generally Accepted Accounting Principles

During fiscal 2004, the Canadian Institute of Chartered Accountants ("CICA") introduced handbook section 1100 which discusses primary sources of GAAP, what to do when a matter is not dealt with explicitly in the sources of GAAP and identifies other sources to be consulted when a matter is not addressed within the sources of GAAP. The Company has adopted this section prospectively effective May 2, 2004, without restatement and as a result, the Company now records multi-year real estate lease expense on a straight-line basis. Additional real estate lease expense of $5.0 million was recorded in fiscal 2006 as a result of this policy change.

Lease Accounting

On February 7, 2005, the Office of the Chief Accountant of the U.S. Securities and Exchange Commission ("SEC") issued a clarification in respect of accounting for various components of property leases and leasehold improvements on which U.S. and Canadian accounting governing bodies had been largely silent. As a result of the SEC clarification, in fiscal 2005, the Company has adopted the following two accounting policies. Lease inducements received as a reimbursement for leasehold improvement costs are amortized over the term of the lease and lease expense related to a store fixturing period is expensed during the fixturing period. A store fixturing period varies by store but is generally considered to be one month prior to the store opening. The Company adopted this guideline retroactively with restatement in fiscal 2005.

The Company reviewed its practices related to lease accounting and determined that adjustments were required to align to the recent clarification of lease accounting guidelines. The first adjustment relates to lease allowances and incentives. Historically, the Company classified lease allowances as a reduction of the related capital assets, which effectively reduced the depreciation expense over the expected life of the asset. The guideline clarification suggests these lease allowances should be recorded as a deferred credit and amortized as a reduction of lease expense over the term of the lease. The second adjustment relates to rent expense to be recorded during a store's fixturing period. The Company is often granted a fixturing period during which rent is not charged. The fixturing period is generally considered to be one month prior to the store opening. Historically, when the Company was granted a fixturing period rent expense was not recorded as none was being charged and the store was not yet open. The clarification of the accounting guidance however requires that the fixturing period be considered a free-rent period that should be included in the term of the lease. Since lease expense must be recognized on a straight-line basis over the lease term an appropriate portion of the straight-line expense must be recorded for the fixturing period. The third adjustment relates to the capitalization of long-term leases. An evaluation was completed in the fourth quarter of fiscal 2005 and certain long-term leases were identified as capital leases. These changes have been accounted for on a retroactive basis with restatement resulting with the following net impact on the comparative statements for the period ended May 6, 2006.

- As at May 7, 2005, a reduction to retained earnings of $8.3 million.
- A reduction in net earnings for the 53-week period ended May 7, 2005, of $0.2 million from $186.9 million to $186.7 million, and a nil reduction in basic and diluted earnings per share.
- As at May 7, 2005, an increase to capital assets, future taxes, long-term debt and long-term lease obligation of $8.1 million, $4.8 million, $9.1 million and $12.3 million, respectively.

These lease accounting adjustments did not have any material impact on the Company's fiscal 2006 net earnings, historical or future revenues, cash flows or lease payments.

EIC-150, Determining Whether an Arrangement Contains a Lease ("EIC-150")

EIC-150 addresses arrangements comprising a transaction or a series of transactions that do not take the legal form of a lease but convey a right to use a tangible asset in return for a payment or a series of payments. EIC-150 provides guidance for determining whether these types of arrangements contain a lease within the scope of handbook section 3065, "Leases", and should be accounted for accordingly. The assessment should be based on whether the fulfillment of the arrangement is dependent on the use of specific tangible assets and whether the arrangement conveys the right to control the use of the tangible assets. This assessment should be made at the inception of the arrangement and only reassessed if certain conditions are met. EIC-150 is effective for arrangements entered into or modified during the fourth quarter of fiscal 2005 and did not have any impact during fiscal 2005 or 2006. The Company will continue to monitor whether EIC-150 is applicable to transactions undertaken by the Company.

EIC-154, Accounting for Pre-Existing Relationships Between the Parties of the Business Combination (“EIC-154”)

EIC-154 issued on May 31, 2005, requires that a business combination occurring after May 31, 2005, between parties that have a pre-existing relationship be evaluated to determine if a settlement of the pre-existing contract has occurred which would require separate accounting from the business combination. The settlement of the pre-existing contract should be measured at the settlement amount as defined within the standard. In addition, EIC-154 requires that certain reacquired rights, including the rights to the acquirer’s trade name under a franchise agreement, be recognized as an intangible asset separate from goodwill.

The Company has determined that its acquisitions of franchised, associated and independent stores could be within the scope of EIC-154. The adoption of EIC-154 by the Company on a prospective basis did not impact net earnings and the Company will continue to monitor whether EIC-154 is applicable to transactions undertaken by the Company.

AcG-13, Hedging Relationships

Accounting guideline 13, “Hedging Relationships” (“AcG-13”), came into effect during fiscal 2005. This guideline addresses the identification, designation, documentation and effectiveness of hedging relationships for the purpose of applying hedge accounting and provides guidance with respect to the discontinuance of hedge accounting. The Company has applied this guideline prospectively. Upon application of this guideline, if documentation and effectiveness requirements are met, gains and losses on derivative financial instruments used to hedge exposure to foreign exchange, and interest rates are deferred and recognized in earnings in the same period the related hedged risk is realized. Amounts received or paid related to instruments used to hedge foreign exchange, including any gains and losses, are recognized in the cost of purchases. Amounts received or paid, including any gains and losses on instruments used to hedge interest rate risks are recognized over the term of the hedged item in interest expense. The derivatives are not recorded on the balance sheet.

CICA Section 3110, Asset Retirement Obligations

During fiscal 2005, CICA Handbook Section 3110, “Asset Retirement Obligations”, was adopted. This section establishes standards for the recognition, measurement, and disclosure of legal obligations associated with the costs to retire long-lived assets. A liability associated with the retirement of long-lived assets is recorded in the period in which the legal asset is capitalized as part of the related asset and depreciated over its useful life. Subsequent to the initial measurement of the asset retirement obligation, the obligation is adjusted to reflect the passage of time and changes in the estimated future costs underlying the obligation. There has been no impact on the Company from the retroactive adoption of this section.

EIC-159, Accounting for Conditional Asset Retirement Obligations

This abstract provides guidance on when a conditional asset retirement obligation should be recognized in accordance with CICA 3110, Asset Retirement Obligations. The abstract is to be applied on a retroactive basis effective in the fourth quarter of fiscal 2006. The abstract requires an entity to recognize a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. A conditional asset retirement obligation refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and/or method of settlement.

There was no effect on the Company of adopting this guideline and the Company will continue to monitor whether EIC-159 is applicable to future transactions.

Future accounting standards

EIC-156, Accounting for Consideration by a Vendor to a Customer (Including a Reseller of the Vendor's Products) ("EIC-156")

Issued in September 2005, EIC-156 addresses cash consideration, including a sales incentive, given by a vendor to a customer. This consideration is presumed to be a reduction of the selling price of the vendor's products and should therefore be classified as a reduction of sales in the vendor's income statement. These recommendations are effective for all interim and annual financial statements for fiscal years beginning on or after January 1, 2006. The Company is currently assessing the impact of these recommendations and will implement them in the first quarter of fiscal 2007.

The following standards are effective for interim and annual financial statements for fiscal years beginning on or after October 1, 2006. The Company is currently assessing the impact of these recommendations.

CICA Section 3855, Financial Instruments – Recognition and Measurement

CICA Section 3855 "Financial Instruments – Recognition and Measurement" establishes standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. All financial instruments must be classified into defined categories. This classification will determine how each instrument is measured and how gains and losses are recognized. In addition, the recommendations define derivatives and embedded derivatives which meet certain criteria.

CICA Section 3865, Hedges

CICA Section 3865 "Hedges" will replace AcG-13, "Hedging Relationships" and the guidance formerly in CICA Section 1650, "Foreign Currency Translation." The recommendations of this section are optional and are only required if the entity is applying hedge accounting. This section establishes standards for the accounting treatment of qualifying hedge relationships and the necessary disclosures.

CICA Section 1530, Comprehensive Income

CICA Section 1530, "Comprehensive Income" introduces a statement of comprehensive income in the full set of interim and annual financial statements. Comprehensive income will temporarily present certain gains and losses outside net income.

CICA Section 3070, Deferred Charges

CICA Section 3070 "Deferred Charges" will be withdrawn with the introduction of CICA Sections 3855, 3865, and 1530 as discussed above.

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. Management continually evaluates the estimates and assumptions it uses. 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 benefit obligations.

Significant assumptions used to calculate the pension and employee future benefit obligations 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 10 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 rate is determined on April 30th of every year. For fiscal 2006, the discount rate used for calculation of pension and other benefit plan expense was 5.5 percent (fiscal 2005 – 5.5 percent pension benefit plan; 5.75 percent other benefit plans). The expected long-term rate of return on plan assets for pension benefit plans for fiscal 2006 was 7.0 percent (2005 was 7.0 percent). The expected growth rate in health care costs is 10.0 percent for fiscal 2006 (fiscal 2005 – 10.0 percent). The cumulative growth rate to 2012 is expected to be 6.0 percent. The expected future growth rate is evaluated on an annual basis. The table below outlines the sensitivity of the fiscal 2006 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 impact on the accrued benefit obligations or benefit plan expenses.

($ in thousands)	Pension plans Benefit obligations	Pension plans Benefit cost[1]	Other benefit plans Benefit obligations	Other benefit plans Benefit cost[1]
Expected long term rate of return on plan assets		7.0%		
Impact of: 1% increase		$ (2,644)		
Impact of: 1% decrease		$ 2,644		
Discount Rate	5.5%	5.5%	5.5%	5.5%
Impact of: 1% increase	$ (29,806)	$ 290	$ (16,643)	$ (836)
Impact of: 1% decrease	$ 33,591	$ (643)	$ 20,106	$ 954
Growth rate of health care costs[2]			10.0%	10.0%
Impact of: 1% increase			$ 17,103	$ 1,996
Impact of: 1% decrease			$ (13,959)	$ (1,550)

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

(2) Gradually decreasing to 6.0% in 2012 and remaining at that level thereafter.

The Company has also assumed that a pending merger of pension plans will be completed. If this merger is not completed, the valuation of the transitional pension asset included in other assets on the balance sheet may need to be re-evaluated.

Goodwill and long-lived assets

Goodwill is not amortized and is assessed for impairment at the reporting unit level. This is done, at a minimum, annually. 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. A charge or credit to income tax expense may result in cash payments or receipts.

Valuation of inventories

Certain retail store inventories are stated at the lower of cost and estimated net realizable value less normal gross profit margin. Significant estimation or judgment is required in the determination of (i) inventories counted and adjusted to cost and (ii) estimated inventory reductions due to spoilage, shrinkage and allowances, occurring between the last physical inventory count and the balance sheet date.

Inventory shrinkage, which is calculated as a percentage of sales, 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, both inventories and operating income may be impacted.

Changes or differences in 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.

Disclosure controls

Sobeys' management, with the participation of the CEO and CFO, has reviewed and evaluated the Company's disclosure controls and procedures (as that term is defined in MI 52-109) as of May 6, 2006. Based on that evaluation the CEO and CFO have concluded that the design and operation of the system of disclosure controls and procedures was effective.

Related-party transactions

The Company leases certain real property from related parties, at formula determined rates that in management's opinion approximate fair market value over the life of the leases. The rates are determined based primarily on the financing of the actual costs incurred at the time of construction of the leased properties. The aggregate net payments under these leases amounted to approximately $54.2 million (2005 – $56.8 million). The Company was charged expenses of $1.3 million (2005 – $0.3 million) by related parties.

At May 6, 2006, current receivables of $6.5 million (2005 – $0) and mortgage receivables of $0 (2005 – $1.8 million) were owed from related parties. In the current year, the Company sold real property to related parties, at an amount equal to fair market value in management's opinion with proceeds of $4.7 million and no resulting gain. The Company purchased real property from related parties for $1.4 million, an amount equal to fair market value in management's opinion.

Related-party transactions are with the parent company, Empire Company Limited and any of its subsidiaries or related parties. Empire Company Limited is the majority shareholder of Sobeys Inc., holding 70.3 percent of Sobeys Inc. common shares.

Guarantees and commitments

The following illustrates the Company's significant contractual obligations.

Contractual obligations

($ in millions)	2007	2008	2009	2010	2011	Thereafter	Total
Long-term debt	$ 16.3	$ 16.4	$ 18.5	$ 23.0	$ 13.2	$ 353.4	$ 440.8
Capital lease obligations	8.7	7.2	6.6	6.0	2.7	18.0	49.2
Operating leases	244.9	219.7	197.7	182.7	166.2	1,543.8	2,555.0
Contractual obligations	$ 269.9	$ 243.3	$ 222.8	$ 211.7	$ 182.1	$ 1,915.2	$ 3,045.0

Operating leases, net of expected lease income received by the Company, are as follows:

($ in millions)	2007	2008	2009	2010	2011	Thereafter	Total
	$ 173.1	$ 155.4	$ 140.6	$ 131.7	$ 121.1	$ 1,252.0	$ 1,973.9

Sobey Leased Properties Limited

The Company has undertaken to fund any obligations which Sobey Leased Properties Limited (a wholly-owned subsidiary of Empire Company Limited) is unable or fails to meet until all of its debentures have been paid in full in accordance with their terms. Any deficiency payment made by the Company will be by purchase of fully-paid, non-assessable five percent redeemable, non-voting preference shares of that company. The aggregated outstanding principal amount of these debentures as at May 6, 2006, is $32.6 million (2005 – $36.6 million). Sobey Leased Properties Limited's principal business relates to leasing real estate locations to Sobeys Capital Incorporated (a subsidiary of Sobeys Inc.) and its subsidiary companies.

The equity holder in Sobey Leased Properties Limited ("SLP"), Empire Company Limited, retains full ability to make all decisions respecting SLP with respect to the operations of its business. The current lease between Sobeys Capital Incorporated and its subsidiary companies and SLP is at an amount in management's opinion which approximates market value, and is reflective of market rates at the time the lease was entered into. SLP does not have a guaranteed return to Empire Company Limited, and SLP retains full ownership of the leased property at the expiration of the leases.

Franchise Affiliates

The Company has guaranteed certain bank loans contracted by franchise affiliates. As at May 6, 2006, these loans amounted to approximately $1.3 million (2005 – $2.4 million).

The Company has guaranteed certain equipment leases of its franchise affiliates. Under the terms of the guarantee should a franchise affiliate be unable to fulfill their lease obligation the Company would be required to fund the difference of the lease commitments up to a maximum of $100.0 million on a cumulative basis. The Company approves each of the contracts.

The aggregate, annual, minimum rent payable under the guaranteed equipment leases for fiscal 2007 is approximately $21.1 million. The guaranteed lease commitments over the next five fiscal years are:

($ in millions)	Guaranteed lease commitments
2007	$ 21.1
2008	23.2
2009	18.9
2010	15.9
2011	11.1
Thereafter	9.8

Other

At May 6, 2006, the Company was contingently liable for letters of credit issued in the aggregate amount of $30.2 million (2005 – $26.2 million).

Upon entering into the lease of its new Mississauga distribution centre in March 2000, Sobeys Capital Incorporated 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 14 years with an aggregate obligation of $43.3 million (2005 – $46.2 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.

Contingencies

On June 21, 2005, the Company received a notice of reassessment from Canada Revenue Agency ("CRA") for fiscal years 1999 and 2000 related to Lumsden Brothers Limited (a wholesale subsidiary of the Company) and the Goods and Service Tax ("GST"). The reassessment relates 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, the Company filed a Notice of Objection with CRA. Accordingly, the Company has not recorded in its statement of earnings any of the tax, interest or penalties in the notice of reassessment. The Company has deposited with CRA funds to cover the total tax, interest and penalties in the reassessment and has recorded this amount as a long-term receivable from CRA pending resolution of the matter.

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

Risk management

Sobeys is exposed to a number of risks in the normal course of business that have the potential to affect operating performance. During fiscal 2006 the Company adopted an annual enterprise risk management assessment which is overseen by the Company's Leadership Committee and reported to the Board and Committees of the Board.

Competitive

The Company maintains a strong national presence in the Canadian retail food and food distribution industry through regionally managed operations. The most significant risk to the Company is the potential for reduced revenues and profit margins as a result of increased competition. To mitigate this risk, the Company's strategy is to be geographically diversified with the benefits of national scale, to be customer and market-driven, to be focused on superior execution, and to have efficient, cost-effective operations. The Company 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. The Company approaches the market with five distinct formats, sizes, and banners, to meet anticipated needs of its customers in order to enhance profitability by region and target market.

Financial

Sobeys has 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 to manage the volatility of borrowing costs. Financial instruments are not used for speculative purposes. The majority of Company debt is at fixed rates, accordingly, there is a limited exposure to interest rate risk.

Interest rate risk

Interest rate risk is the potential for financial loss arising from changes in interest rates. The Company's long-term debt is at a fixed interest rate, and therefore, the Company's exposure to interest rate cash flow risk during the term of the debt is minimal.

Insurance

Sobeys is self-insured on a limited basis with respect to certain operational risks and also purchases excess insurance coverage from financially stable third-party insurance companies. In addition to maintaining comprehensive loss prevention programs, Sobeys maintains management programs to mitigate the financial impact of operational risks.

Human resources

The Company is exposed to the risk of labour disruption in its operations. Labour disruptions pose a moderate operational risk, as the Company operates an integrated network of 21 distribution centres across the country. The Company has good relations with its employees and unions and does not anticipate any material labour disruptions in fiscal 2007. However, Sobeys has stated that it will accept the short-term costs of a labour disruption to support a steadfast 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 better serve its customers. The ability of Sobeys to properly develop and retain its employees could affect the Company's future performance.

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 event and natural hazard is the risk of a pandemic. The Company is working with industry and government sources to develop a pandemic preparedness plan.

Responsibility for business continuity planning has been assigned to a member of the Leadership Committee.

Environmental, health and safety

The Company is continually enhancing its programs in the 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.

Sobeys has 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 its stores, distribution centres and offices. These policies and programs are reviewed regularly by the Human Resources Committee of the Board.

Foreign operations

Sobeys does not have any material risks associated with foreign operations. Sobeys' foreign operations are limited to a small number of produce brokerage offices based in the United States.

Foreign currency

The Company conducts the majority of its business in Canadian dollars and its foreign exchange risk is limited to currency fluctuations between the Canadian and U.S. dollar. U.S. dollar purchases of product represent approximately three percent of the Company's total annual purchases. The Company has processes in place to use forward contracts with high quality counterparties to fix the exchange rate on some of its expected requirements for U.S. dollars for periods of not more than 30 days.

Food safety

The Company 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 the Company's private label products, in relation to the production, packaging and design of products.

A large majority of the Company's sales are generated from food products and the Company 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 the Company's 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's insurance program. In addition, the Company has food safety procedures and programs, which address safe food handling and preparation standards. The Company employs best practices for storage and distribution of food products.

Technology

The Company is committed to improving its 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 that must be mitigated by disciplined change management and governance processes. The Company has a business process optimization team staffed with knowledgeable internal and external resources who are responsible for implementing the various initiatives. Sobeys' Board of Directors also created an Oversight Committee to ensure an appropriate governance structure over these change initiatives is in place and this committee receives regular reports from the Company's management.

Real estate

The Company utilizes a robust capital allocation process which is focused on obtaining the most attractive real estate locations for its stores, with direct Company ownership being an important, but not overriding, consideration. The Company 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 the Company's ability to purchase high potential 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 Sobeys. 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.

Operations

The success of Sobeys is closely tied to the performance of its retail stores. Franchise affiliates operate approximately 58 percent of these retail stores. The Company relies on franchise affiliates and corporate store management to successfully execute retail programs and strategies.

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

Supply chain

The Company is exposed to potential supply chain disruptions that could result in shortages of merchandise in its retail store network. The Company 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.

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.

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 which 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.

Outlook

The Company will continue to invest in a manner consistent with its expressed intention to build a healthy and sustainable retail business and infrastructure for the long term.

The disposition of the Company's cash and carry business in Ontario and Québec, as indicated above, will negatively impact sales growth by approximately $200 million in fiscal 2007 compared to fiscal 2006. The Company also expects to experience continued declines in Company-wide tobacco sales during fiscal 2007.

In fiscal 2007, Sobeys will advance its business process, supply chain and information systems transformation plan for the Company by focusing on the significant opportunity to upgrade information processing and decision support capabilities and improve efficiencies in its Ontario and Western regions. The system and processes that are being implemented have been developed over several years and are currently employed in the Company's Atlantic Region. The Ontario and Western initiatives will simplify, standardize and streamline the "back shop," in support of the Company's food-focused strategy. This move will leverage technology investments, improve efficiency and lower costs over the long term.

The approach taken for this set of initiatives was guided and informed by the Company's previous experience. The complexity of this comprehensive set of initiatives, which impacts every aspect of the business, requires that a significant investment be made to manage the risk of implementation but also to prepare employees to secure and sustain the benefits of more efficient processes and systems after they have been implemented. The necessary re-training of thousands of employees in Ontario has just begun and will continue through the first six months of fiscal 2007. The implementation costs as well as training costs for thousands of employees in the Western region will be completely incurred during fiscal 2007. The total anticipated cost of the Ontario and Western initiatives is expected to approximate $0.27 to $0.32 per share in fiscal 2007.

Non-GAAP measures

There are measures included in this Management's Discussion and Analysis 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 measuring financial performance.

- EBIT is calculated as net earnings before minority interest plus interest expense and income taxes.
- EBITDA is calculated as EBIT plus depreciation and intangible amortization.
- EBITDAR is calculated as EBITDA plus gross rent expense.

($ in millions)	**13 weeks ended May 6, 2006**	14 weeks ended May 7, 2005	**52 weeks ended May 6, 2006**	53 weeks ended May 7, 2005
EBIT	**$ 85.2**	$ 84.6	**$ 331.6**	$ 322.6
Depreciation	**50.8**	47.7	**192.8**	174.5
Amortization of intangibles	**0.7**	0.8	**3.8**	1.9
EBITDA	**136.7**	133.1	**528.2**	499.0
Gross rent	**84.3**	71.6	**335.0**	275.9
EBITDAR	**$ 221.0**	$ 204.7	**$ 863.2**	$ 774.9

- Funded debt is all interest-bearing debt, which includes bank loans, bankers' acceptances and long-term debt.
- Adjusted debt is funded debt plus the capitalized value of net operating lease payments, which is calculated as six times net annual operating lease payments.
- Total capital is funded debt plus shareholders' equity.

($ in millions)	**May 6, 2006**	May 7, 2005	May 1, 2004
Long-term debt due within one year	**$ 25.0**	$ 194.9	$ 33.1
Long-term debt	**465.0**	262.9	420.0
Funded debt	**490.0**	457.8	453.1
Total shareholders' equity	**1,834.3**	1,682.1	1,561.3
Total capital	**$ 2,324.3**	$ 2,139.9	$ 2,014.4

- Company-wide capital investment includes on-balance sheet capital expenditures, all known capital investments by franchise affiliates and capital investments by third-party landlords.
- Same-store sales are sales from stores in the same locations in both reporting periods.

June 28, 2006

Nova Scotia, Canada

Management's 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 appropriate Canadian generally accepted accounting principles and reflect management's best estimates and judgments. 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, which is comprised solely of directors who are unrelated to, and independent of, the Company, meets regularly with financial management and external auditors to satisfy itself as to the reliability and integrity of financial information. The Audit Committee reports its findings to the Board of Directors for consideration in approving the annual consolidated financial statements to be issued to the shareholders. The external auditors have full and free access to the Audit Committee.

Bill McEwan
President &
Chief Executive Officer
June 28, 2006

J. Bruce Terry
Executive Vice President &
Chief Financial Officer
June 28, 2006

Auditors' report

To the Shareholders of Sobeys Inc.

We have audited the consolidated balance sheets of Sobeys Inc. as at May 6, 2006 and May 7, 2005, and the consolidated statements of retained earnings, earnings, and cash flows for the 52 and 53 week fiscal years then ended, respectively. 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 6, 2006 and May 7, 2005, and the results of its operations and its cash flows for the fiscal years then ended in accordance with Canadian generally accepted accounting principles.

Grant Thornton LLP

Grant Thornton LLP
Chartered Accountants
New Glasgow, Canada
June 12, 2006

Consolidated balance sheets

(in millions)	May 6, 2006	May 7, 2005
Assets		
Current		
Cash and cash equivalents	$ 332.1	$ 272.8
Receivables	208.2	199.8
Inventories	626.8	588.6
Prepaid expenses	45.9	43.4
Mortgages, loans and other receivables	15.9	15.5
Income taxes receivable	5.8	21.9
	1,234.7	1,142.0
Mortgages, loans and other receivables (Note 2)	68.4	43.4
Other assets (Note 3)	180.0	150.3
Property and equipment (Note 4)	1,612.2	1,461.9
Assets held for realization (Note 1q)	8.5	11.5
Intangibles (less accumulated amortization of $7.2; May 7/05 $4.7)	21.5	24.3
Goodwill	613.3	612.4
	$ 3,738.6	$ 3,445.8
Liabilities		
Current		
Accounts payable and accrued liabilities	$ 1,158.8	$ 1,083.3
Future tax liabilities (Note 7)	46.1	52.4
Long-term debt due within one year	25.0	194.9
	1,229.9	1,330.6
Long-term debt (Note 6)	465.0	262.9
Long-term lease obligation (Note 17)	20.8	12.3
Employee future benefits obligation (Note 14)	96.0	92.2
Future tax liabilities (Note 7)	44.1	33.1
Deferred revenue	3.3	3.0
Minority interest (Note 1t v)	45.2	29.6
	1,904.3	1,763.7
Shareholders' equity		
Capital stock (Note 8)	904.8	901.4
Contributed surplus	0.9	0.4
Retained earnings	928.6	780.3
	1,834.3	1,682.1
	$ 3,738.6	$ 3,445.8

Contingent liabilities (see Note 13)

See accompanying notes to the consolidated financial statements.

Approved on behalf of the Board

Bill McEwan
Director

Peter C. Godsoe
Director

Consolidated statements of retained earnings

Year ended (in millions)	May 6, 2006	May 7, 2005
Retained earnings, beginning of year as previously reported	$ 780.3	$ 667.9
Adjustment due to adoption of accounting standards (Note 1t)	–	(28.7)
Retained earnings, beginning of year as restated	780.3	639.2
Net earnings	189.4	186.7
Adjustment to minority interest (Note 19)	(5.5)	–
	964.2	825.9
Dividends declared and paid	(35.6)	(32.8)
Premium on common shares purchased for cancellation (Note 8)	–	(12.8)
Balance, end of year	$ 928.6	$ 780.3

See accompanying notes to the consolidated financial statements.

Consolidated statements of earnings

(in millions except per share amounts)	52 weeks ended May 6, 2006	53 weeks ended May 7, 2005
Sales	$ 12,853.3	$ 12,189.4
Operating expenses		
Cost of sales, selling and administrative expenses	12,325.1	11,690.4
Depreciation	192.8	174.5
Amortization of intangibles	3.8	1.9
Earnings before interest, income taxes and minority interest	331.6	322.6
Interest expense		
Long-term debt	33.6	35.0
Short-term debt	1.3	2.9
	34.9	37.9
Earnings before income taxes and minority interest	296.7	284.7
Income taxes (Note 7)	100.1	98.0
Net earnings before minority interest	196.6	186.7
Minority interest (Note 1t v)	7.2	–
Net earnings	$ 189.4	$ 186.7
Net earnings per share basic (Note 9)	$ 2.93	$ 2.88
Net earnings per share diluted (Note 9)	$ 2.90	$ 2.85
Basic weighted average number of common shares outstanding, in millions	64.7	64.9
Diluted weighted average number of common shares outstanding, in millions	65.4	65.5

See accompanying notes to the consolidated financial statements.

Consolidated statements of cash flows

(in millions)	**52 weeks ended May 6, 2006**	53 weeks ended May 7, 2005
Operations		
Net earnings	**$ 189.4**	$ 186.7
Items not affecting cash (Note 10)	**260.4**	235.7
	449.8	422.4
Net change in non-cash working capital	**45.5**	15.6
Cash flows from operating activities	**495.3**	438.0
Investment		
Property and equipment purchases	**(332.3)**	(268.5)
Proceeds on disposal of property and equipment	**18.6**	34.9
Mortgages, loans and other receivables	**(25.4)**	(0.3)
Increase in restricted cash	**(14.7)**	–
Increase in deferred costs	**(50.5)**	(49.7)
Business acquisitions, net of cash acquired	**(5.3)**	(12.1)
Cash flows used in investing activities	**(409.6)**	(295.7)
Financing		
Issue of long-term debt	**203.0**	32.3
Repayment of long-term debt	**(199.8)**	(47.3)
Minority interest	**2.9**	–
Increase in share purchase loan	**(2.6)**	(1.3)
Issue of capital stock	**5.7**	5.5
Repurchase of capital stock	**–**	(23.4)
Dividends	**(35.6)**	(32.8)
Cash flows used in financing activities	**(26.4)**	(67.0)
Increase in cash and cash equivalents	**59.3**	75.3
Initial impact of variable interest entities	**–**	32.9
Increase in cash and cash equivalents	**59.3**	108.2
Cash and cash equivalents, beginning of year	**272.8**	164.6
Cash and cash equivalents, end of year	**$ 332.1**	$ 272.8

See accompanying notes to the consolidated financial statements.

Notes to the consolidated financial statements

May 6, 2006 (in millions, except share capital)

1 Summary of significant accounting policies

These consolidated financial statements, have been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP"), and include the accounts of Sobeys Inc. (the Company), all subsidiary companies, 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. All of the Company's subsidiaries are wholly owned. The Company has four operating food distribution regions: Western Canada, Ontario, Québec and Atlantic Canada. These regions have been aggregated into one reportable operating segment as they all share similar economic characteristics.

(a) Depreciation

Property and equipment are recorded at cost.

Depreciation is recorded on a straight line basis over the estimated useful lives of the assets as follows:

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

(b) 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.

(c) Inventories

Warehouse inventories are valued at the lower of cost and net realizable value with cost being determined substantially on a first-in, first-out (FIFO) basis. Retail inventories are valued at the lower of cost and net realizable value. Cost is determined using FIFO or the retail method. The retail method uses the anticipated selling price less normal profit margins, substantially on an average cost basis.

(d) 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. Obligations under capital leases are reduced by rental payments net of imputed interest. All other leases are accounted for as operating leases.

(e) Goodwill

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 subject to an annual impairment review. 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.

(f) Intangibles

Intangibles arise on the purchase of a new business, existing franchises, and the acquisition of pharmacy prescription files. Amortization is on a straight-line basis, over 10 – 15 years.

(g) Revenue recognition

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.

(h) Interest capitalization

Interest related to the period of construction is capitalized as part of the cost of the related property and equipment. The amount of interest capitalized to construction in progress in the current year was $0.5 (May 7, 2005 – $0.1).

(i) Deferred revenue

Deferred revenue consists of long-term supplier purchase agreements, and rental revenue arising from the sale of subsidiaries. Deferred revenue is being taken into income over the term of the related agreements.

(j) Deferred costs

Deferred costs consist of deferred store marketing, deferred financing, transitional pension assets and deferred purchase agreements.

Deferred costs are amortized as follows:

Deferred store marketing	7 years
Deferred financing	over the term of the debt
Deferred purchase agreements	over the term of the purchase agreement

(k) Store opening expenses

Store opening expenses of new stores and store conversions are written off during the first year of operation.

(l) Financial instruments

The Company uses various derivative financial instruments to hedge its exposure to interest rate risks. If documentation and effectiveness requirements are met, gains and losses on these instruments are deferred and recognized in earnings in the same period the related hedged risk is realized (settlement accounting). Amounts received or paid, including any gains and losses on instruments used to hedge interest rate risks are recognized over the term of the hedged item in interest expense. The derivatives are not recorded on the balance sheet.

The Company uses forward contracts to fix the exchange rate on some of its expected requirements for US dollars for periods of not more than 30 days. Amounts received or paid related to instruments used to hedge foreign exchange, including any gains and losses, are recognized in the cost of purchases.

(m) Future income taxes

The difference between the tax basis of assets and liabilities and their carrying value on the balance sheet is used to calculate future tax assets and liabilities. The future tax assets and liabilities have been measured using substantively enacted tax rates that will be in effect when the differences are expected to reverse.

(n) 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 period. 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.

(o) Foreign currency translation

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 foreign currency exchange rate for the period.

(p) Pension benefit plans and other benefit plans

The cost of the Company's pension benefits for defined contribution plans are expensed when the employees are paid. 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 other benefit plans, actuarial gains and losses are recognized immediately. For the Sobeys Supplemental Executive Retirement Plan ("SERP"), the impact of changes in the plan provisions are amortized over five years.

(q) Assets held for realization

Certain land and buildings have been listed for sale and reclassified as "Assets held for realization" 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 and there is no longer an intent to develop for future use. Assets held for realization are valued at the lower of cost and fair value less cost of disposal.

(r) Use of estimates

The preparation of consolidated financial statements, in conformity with Canadian generally accepted accounting principles, requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. These estimates are based on management's best knowledge of current events and actions that the Company may undertake in the future.

(s) Accounting standards adopted during fiscal 2006

i. Vendor allowances

During the first quarter of fiscal 2006 the Company adopted the amendment to EIC-144 issued in January 2005. The amendment requires disclosure of the amount of any vendor allowances that have been recognized in income but for which the full requirements for entitlement have not yet been met (see Note 18).

(t) Accounting standards adopted during fiscal 2005

i. Hedging

Accounting guideline AcG-13, “Hedging Relationships”, came into effect during fiscal 2005. This guideline addresses the identification, designation, documentation and effectiveness of hedging relationships for the purpose of applying hedge accounting and provides guidance with respect to the discontinuance of hedge accounting. The Company adopted this guideline prospectively, and there was no effect on the Company from the adoption of this guideline.

ii. Asset retirement obligations

Beginning in fiscal 2005 CICA Handbook Section 3110, “Asset Retirement Obligations”, was adopted retroactively. This section establishes standards for the recognition, measurement, and disclosure of legal obligations associated with the costs to retire long-lived assets. A liability associated with the retirement of long-lived assets is recorded in the period in which the legal asset is capitalized as part of the related asset and depreciated over its useful life. Subsequent to the initial measurement of the asset retirement obligation, the obligation is adjusted to reflect the passage of time and changes in the estimated future costs underlying the obligation. There has been no impact on the Company from the adoption of this section.

iii. Real estate leases

Effective May 2, 2004, the Company adopted CICA Handbook section 1100, which discusses primary sources of GAAP, what to do when a matter is not dealt with explicitly in the sources of GAAP and identifies other sources to be consulted when a matter is not addressed within the sources of GAAP. This section was adopted prospectively without restatement and as a result the Company has changed its policy to record real estate lease expense on a straight-line basis (see Note 17).

On February 7, 2005, the Office of the Chief Accountant of the U.S. Securities and Exchange Commission (“SEC”) issued a clarification in respect of accounting for various components of property leases and leasehold improvements on which U.S. and Canadian accounting governing bodies had been largely silent. As a result of the SEC clarification the Company has adopted the following two accounting policies. Lease inducements received as a reimbursement for leasehold improvement costs are amortized over the term of the lease. The total 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. The Company has adopted this guideline retroactively with restatement (see Note 17).

iv. Vendor allowances

In January 2004, the CICA issued a new accounting standard, EIC-144 “Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor”. EIC-144 outlines that cash consideration received from a vendor is presumed to be a reduction in the prices of the vendor’s products or services, and should be accounted for as a reduction in cost of sales and related inventory, when recognized in the customer’s income statement and balance sheet. Certain exceptions apply if the consideration is a payment for assets or services delivered to the vendor or for reimbursement of costs incurred to sell the vendor’s products, provided certain conditions are met. The Company adopted EIC-144 in the second quarter of fiscal 2005, adjusting for it retroactively (see Note 18).

v. Variable interest entities

Effective for the fourth quarter ended May 7, 2005, the Company was required to implement Accounting Guideline 15 “Consolidation of Variable Interest Entities” (“AcG-15”) issued by the CICA. AcG-15 requires the Company to consolidate certain entities that are deemed to be subject to control of the Company on a basis other than through ownership of a voting interest in the entity (see Note 19).

vi. Stock-based compensation

The Company has a Share Purchase Loan plan for employees. In accordance with Emerging Issues Committee Abstract 132 these loans, which are granted to employees to purchase common stock, are considered to be stock options and are treated as stock-based compensation and recorded at their fair market value. This application was on a prospective basis beginning in 2005 as it was determined that application on a retroactive basis would not result in a material change (see Note 16).

2 Mortgages, loans and other receivables

	May 6, 2006	May 7, 2005
Loans receivable	$ 66.5	$ 53.6
Mortgages receivable	0.3	2.1
Other	17.5	3.2
	84.3	58.9
Less amount due within one year	15.9	15.5
	$ 68.4	$ 43.4

Loans receivable

Loans receivable represent long-term financing to certain retail associates. These loans 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 receivable approximates fair value based on the variable interest rates charged on the loans and the operating relationship of the associates with the Company.

3 Other assets

	2006 net book value	2005 net book value
Deferred store marketing costs	$ 68.7	$ 68.6
Deferred financing costs	6.2	2.0
Deferred purchase agreements	25.9	15.9
Transitional pension asset	39.1	31.5
Restricted cash	14.7	–
Other	25.4	32.3
Total	$ 180.0	$ 150.3

4 Property and equipment

May 6, 2006	Cost	Accumulated depreciation	Net book value
Land	$ 89.5	$ –	$ 89.5
Land held for development	138.6	–	138.6
Buildings	577.4	135.7	441.7
Equipment and vehicles	1,707.4	1,062.7	644.7
Leasehold improvements	361.0	218.2	142.8
Construction in progress	103.7	–	103.7
Assets under capital leases	78.9	27.7	51.2
	$ 3,056.5	$ 1,444.3	$ 1,612.2

May 7, 2005	Cost	Accumulated depreciation	Net book value
Land	$ 94.5	$ –	$ 94.5
Land held for development	85.4	–	85.4
Buildings	532.0	117.6	414.4
Equipment and vehicles	1,662.7	993.6	669.1
Leasehold improvements	309.7	192.7	117.0
Construction in progress	57.4	–	57.4
Assets under capital leases	47.7	23.6	24.1
	$ 2,789.4	$ 1,327.5	$ 1,461.9

5 Bank loans and bankers' acceptances

Under the terms of a credit agreement entered into between the Company and a banking syndicate arranged by the Bank of Nova Scotia, a revolving term credit facility of $300.0 was established. During the third quarter of the current fiscal year, the expiry date of the revolving unsecured credit facility was extended from June 22, 2006 to December 20, 2010. All indebtedness and obligations under the agreement shall be payable in full on December 20, 2010.

Interest payable on this facility fluctuates with changes in the prime interest rate.

6 Long-term debt

	May 6, 2006	May 7, 2005
First mortgage loans, average interest rate 9.5%, due 2008 – 2021	$ 25.8	$ 23.9
Medium Term Notes, interest rate 7.6%, due November 1, 2005	–	175.0
Medium Term Notes, interest rate 6.1%, due October 29, 2035	175.0	–
Medium Term Notes, interest rate 7.2%, due February 26, 2018	100.0	100.0
Sinking fund debentures, average interest rate 10.7%, due 2008 – 2013	63.1	68.2
Notes payable and other debt at interest rates fluctuating with the prime rate	76.9	67.5
	440.8	434.6
Capital lease obligations, net of imputed interest	49.2	23.2
	490.0	457.8
Less amount due within one year	25.0	194.9
	$ 465.0	$ 262.9

First mortgage loans are secured by land, buildings, and specific charges on certain assets. Capital lease obligations are secured by the related capital lease asset. Sobeys Group Inc., an indirect subsidiary of Sobeys Inc., has provided the debenture holders with a floating charge over all its assets, subject to permitted encumbrances, a general assignment of book debts, and the assignment of proceeds of insurance policies.

On October 21, 2005 the Company filed a short form base shelf prospectus providing for the issuance of up to $500.0 of unsecured Medium Term Notes. On October 28, 2005, the Company issued new Medium Term Notes of $175.0, maturing on October 29, 2035.

On November 1, 2005, Medium Term Notes of $175.0 were repaid according to the terms of the agreement. Sinking fund debenture payments are required on an annual basis. The proportionate share of related debt is retired with these repayments.

During the year the Company increased its capital lease obligation by $29.0 with a similar increase in assets under capital lease.

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

	Long-term debt	Capital leases
2007	$ 16.3	$ 8.7
2008	16.4	7.2
2009	18.5	6.6
2010	23.0	6.0
2011	13.2	2.7
Thereafter	353.4	18.0

Operating leases

The total net, annual, minimum rent payable under the Company's operating leases for fiscal 2007 is approximately $173.1. This reflects a gross lease obligation of $244.9 reduced by expected sub-lease income of $71.8. The net commitments over the next five fiscal years are:

	Net lease obligation	Gross lease obligation
2007	$ 173.1	$ 244.9
2008	155.4	219.7
2009	140.6	197.7
2010	131.7	182.7
2011	121.1	166.2
Thereafter	1,252.0	1,543.8

7 Income taxes

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

	52 weeks May 6, 2006	53 weeks May 7, 2005
Income tax expense according to combined statutory rate of 34.2% (2005 – 33.9%)	**$ 101.6**	$ 96.6
Decrease in income taxes resulting from:		
Rate changes effect on timing differences	**(2.0)**	–
Increase in income taxes resulting from:		
Large corporation tax	**0.5**	1.4
Total income taxes	**$ 100.1**	$ 98.0

May 6, 2006 income tax expense attributable to net income consists of:

	52 weeks May 6, 2006	53 weeks May 7, 2005
Current	**$ 95.4**	$ 76.5
Future	**4.7**	21.5
Total	**$ 100.1**	$ 98.0

The tax effect of temporary differences that give rise to significant portions of the future tax liability are presented below.

	May 6, 2006	May 7, 2005
Employee future benefit obligation	$ 33.6	$ 32.2
Restructuring provisions	5.0	5.3
Pension contributions	(17.4)	(16.0)
Deferred costs	(28.4)	(23.7)
Deferred credits	(54.6)	(57.7)
Goodwill and intangibles	(8.6)	(6.0)
Fixed assets	(33.2)	(23.0)
Other	13.4	3.4
	$ (90.2)	$ (85.5)
Current future tax liabilities	$ (46.1)	$ (52.4)
Non-current future tax liabilities	(44.1)	(33.1)
	$ (90.2)	$ (85.5)

8 Capital stock

	Number of shares	
Authorized	May 6, 2006	May 7, 2005
Preferred shares, par value of $25 each, issuable in series	471,000,000	471,000,000
Preferred shares, without par value, issuable in series	500,000,000	500,000,000
Common shares, without par value	498,682,931	498,682,931

	Number of shares	
Issued and outstanding	May 6, 2006	May 7, 2005
Common shares, without par value	65,426,282	65,280,415

	Capital stock (in millions)	
	May 6, 2006	May 7, 2005
Common shares, without par value	$ 926.7	$ 920.7
Loans receivable from officers and employees under share purchase plan	(21.9)	(19.3)
Total capital stock	$ 904.8	$ 901.4

During the current fiscal year 145,867 (May 7, 2005 – 175,308) common shares of Sobeys Inc. were issued under the Company's share purchase plan to certain officers and employees for $5.7 (May 7, 2005 – $5.5).

Loans receivable from officers and employees of $21.9 (May 7, 2005 – $19.3) under the Company's share purchase plan are classified as a reduction of capital stock. Loan repayments will result in a corresponding increase in capital stock. The individual loans are non-interest bearing, non-recourse, and are secured by the individual's common shares of Sobeys Inc. (combined total 2006 – 652,517; 2005 – 630,378).

During fiscal 2005, the Company cancelled 14,607 common shares in accordance with the plan of arrangement entered into in connection with the acquisition of the outstanding shares of The Oshawa Group Ltd., by the Company. This resulted in a reduction to the common share value of $0.3. The Company also purchased for cancellation 708,700 common shares as part of a normal course issuer bid announced on March 8, 2004. Additionally, common shares of 32,305 were purchased from employees. The purchase price for the shares was $23.1. The excess of the purchase price over the average paid-up value of common shares purchased for cancellation charged to retained earnings in fiscal 2005 was $12.8.

9 Basic and diluted net earnings per share

	52 weeks ended May 6, 2006	53 weeks ended May 7, 2005
Net earnings	**$ 189.4**	$ 186.7
Weighted average common shares outstanding	**64.7**	64.9
Dilutive effect of share purchase loans	**0.7**	0.6
Weighted average common shares outstanding for diluted earnings per share calculation	**65.4**	65.5
Basic net earnings per common share	**$ 2.93**	$ 2.88
Dilutive effect of share purchase loans	**(0.03)**	(0.03)
Diluted net earnings per common share	**$ 2.90**	$ 2.85

10 Supplementary cash flow information

	52 weeks ended May 6, 2006	53 weeks ended May 7, 2005
(a) Items not affecting cash:		
Depreciation	**$ 192.8**	$ 174.5
Future tax provision	**4.7**	21.5
Loss (gain) on disposal of assets	**3.0**	(0.4)
Amortization of intangibles	**3.8**	1.9
Stock-based compensation	**0.8**	0.6
Amortization of deferred items	**35.8**	34.0
Increase (decrease) in long-term lease obligation	**8.5**	(0.2)
Employee future benefit obligation	**3.8**	3.8
Minority interest	**7.2**	–
	$ 260.4	$ 235.7
(b) Cash items		
Interest paid	**$ 31.9**	$ 34.2
Taxes paid	**$ 83.6**	$ 104.2

11 Related party transactions

The Company leased certain real property from related parties during the year at amounts in management's opinion which approximate fair market value. The aggregate net payments under these leases amounted to approximately $54.2 (2005 – $56.8). The Company was charged expenses of $1.3 (2005 – $0.3) by related parties.

At May 6, 2006, current receivables of $6.5 (2005 – $0) and mortgages receivables of $0 (2005 – $1.8) were owing from related parties. In the current year, the Company sold real property to related parties, at an amount equal to fair market value in management's opinion with proceeds of $4.7 and no resulting gain. The Company purchased real property from related parties for $1.4, an amount equal to fair market value in management's opinion.

Related party transactions are with the parent company Empire Company Limited and any of its subsidiaries or related parties. Empire Company Limited is a majority shareholder of Sobeys Inc., holding 70.3% of Sobeys Inc. common shares.

12 Financial instruments

Credit risk

There is no significant concentration of credit risk. The credit risk exposure is considered normal for the business.

Fair value of financial instruments

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

The total fair value of long-term debt is estimated to be $517.7 (2005 – $500.5). The fair value of variable rate long term-debt is assumed to approximate its carrying amount. The fair value of other long-term debt has been estimated by discounting future cash flows at a rate offered for debt of similar maturities and credit quality.

Interest rate risk

Interest rate risk is the potential for financial loss arising from changes in interest rates. The Company's long-term debt is at a fixed interest rate, and therefore, the Company's exposure to interest rate cash flow risk during the term of the debt is minimal.

13 Contingent liabilities

Guarantees and commitments

Sobey Leased Properties Limited

The Company has undertaken to provide cash to meet any obligations which Sobey Leased Properties Limited (a wholly owned subsidiary of Empire Company Limited) is unable or fails to meet until all of its debentures have been paid in full in accordance with their terms. Any deficiency payment made by the Company will be by purchase of fully-paid non-assessable 5% redeemable, non-voting preference shares of that company. The aggregated outstanding principal amounts of these debentures at May 6, 2006 is $32.6 (2005 – $36.6). Sobey Leased Properties Limited's principal business relates to leasing real estate locations to Sobeys Capital Incorporated (a subsidiary of Sobeys Inc.) and its subsidiary companies.

The equity holder in Sobey Leased Properties Limited ("SLP"), Empire Company Limited, retains full ability to make all decisions respecting SLP with respect to the operations of its business. The current lease between Sobeys Capital Incorporated and its subsidiary companies and SLP is at an amount in management's opinion which approximates market value and is reflective of market rates at the time the lease was entered into. SLP does not have a guaranteed return to Empire Company Limited, and SLP retains full ownership of the leased property at expiration of the leases.

Franchise Affiliates

The Company has guaranteed certain bank loans contracted by franchise affiliates. As at May 6, 2006, these loans amounted to approximately $1.3 (2005 – $2.4).

The Company has guaranteed certain equipment leases of its franchise affiliates. Under the terms of the guarantee should a franchise affiliate be unable to fulfill their lease obligation the Company would be required to fund the difference of the lease commitments up to a maximum of $100.0 on a cumulative basis. The Company approves each of the contracts.

The aggregate, annual, minimum rent payable under the guaranteed operating equipment leases for fiscal 2007 is approximately $21.1. The guaranteed lease commitments over the next five fiscal years are:

	Guaranteed lease commitments
2007	$ 21.1
2008	23.2
2009	18.9
2010	15.9
2011	11.1
Thereafter	9.8

Other

At May 6, 2006, the Company was contingently liable for letters of credit issued in the aggregate amount of $30.2 (2005 – $26.2).

Upon entering into the lease of its new Mississauga distribution centre, in March 2000, Sobeys Capital Incorporated guaranteed to the landlord the performance, by SERCA Foodservice Inc., of all its obligations under the lease. The remaining term of the lease is 14 years with an aggregate obligation of $43.3 (2005 – $46.2). 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 Capital Incorporated harmless from any liability it may incur pursuant to its guarantee.

Contingencies

On June 21, 2005 the Company received a notice of reassessment from Canada Revenue Agency ("CRA") for fiscal years 1999 and 2000 related to Lumsden Brothers Limited (a wholesale subsidiary of the Company) 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 sales of tobacco products to status Indians. The total tax, interest and penalties in the reassessment was $13.6. 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, the Company filed a Notice of Objection with CRA. Accordingly, the Company has not recorded in its statement of earnings any of the tax, interest or penalties in the notice of reassessment. The Company has deposited with CRA funds to cover the total tax, interest and penalties in the reassessment and has recorded this amount as a long-term receivable from CRA pending resolution of the matter.

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

14 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.

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 December 31 as an actuarial valuation date, and April 30 as a measurement date for accounting purposes, for its defined benefit pension plans.

	Most recent valuation date	Next required valuation date
Retirement Pension Plan	December 31, 2004	December 31, 2007
Senior Management Pension Plan	December 31, 2004	December 31, 2007

Defined contribution plans

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

	2006	2005
	$ 13.9	$ 11.8

Defined benefit plans

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

	Pension benefit plans 2006	Pension benefit plans 2005	Other benefit plans 2006	Other benefit plans 2005
Accrued benefit obligation				
Balance at beginning of year	$ 262.4	$ 248.0	$ 105.1	$ 108.1
New incidence (post-employment benefits)	–	–	–	0.4
Current service cost	2.3	2.0	2.7	2.3
Interest cost	14.2	14.6	5.9	5.7
Employee contributions	0.4	0.4	–	–
Past service costs	–	0.7	–	–
Benefits paid	(19.8)	(18.3)	(3.7)	(4.3)
Actuarial losses (gains)	5.9	15.0	2.1	(7.1)
Balance at end of year	$ 265.4	$ 262.4	$ 112.1	$ 105.1
Plan assets				
Market value at beginning of year	$ 244.4	$ 223.5	$ –	$ –
Actual return on plan assets	33.0	31.3	–	–
Employer contributions	9.2	7.5	3.7	4.3
Employee contributions	0.4	0.4	–	–
Benefits paid	(19.8)	(18.3)	(3.7)	(4.3)
Market value at end of year	$ 267.2	$ 244.4	$ –	$ –
Funded status				
Surplus (deficit)	$ 1.8	$ (18.0)	$ (112.1)	$ (105.1)
Unamortized past service cost	0.6	0.8	1.1	1.2
Unamortized actuarial losses (gains)	36.7	48.7	15.0	11.7
Accrued benefit asset (liability)	$ 39.1	$ 31.5	$ (96.0)	$ (92.2)
Expense				
Current service cost	$ 2.3	$ 2.0	$ 2.7	$ 2.3
Interest cost	14.2	14.6	5.9	5.7
Actual return on plan assets	(33.0)	(31.3)	–	–
Actuarial losses (gains)	5.9	15.0	2.1	(7.1)
Past service costs	–	0.7	–	–
New incidence (post-employment benefits)	–	–	–	0.4
Expense (income) before adjustments	(10.6)	1.0	10.7	1.3
Expected vs. actual return on plan assets	16.0	16.0	–	–
Recognized vs. actual past service costs	0.2	(0.5)	0.1	0.1
Recognized vs. actuarial losses (gains)	(4.0)	(12.7)	(3.4)	6.7
Net expenses	$ 1.6	$ 3.8	$ 7.4	$ 8.1
Classification of accrued benefit asset (liability)				
Other assets	$ 60.8	$ 55.2	$ –	$ –
Other liabilities	(21.7)	(23.7)	(96.0)	(92.2)
Accrued benefit asset (liability)	$ 39.1	$ 31.5	$ (96.0)	$ (92.2)

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

	Pension benefit plans 2006	Pension benefit plans 2005	**Other benefit plans 2006**	Other benefit plans 2005
Accrued benefit obligation	**$ 17.0**	$ 16.3	**$ 96.0**	$ 92.2

The significant actuarial assumptions adopted in measuring the Company's accrued benefit obligations are as follows (weighted-average assumptions as of May 6, 2006):

	Pension benefit plans 2006	Pension benefit plans 2005	**Other benefit plans 2006**	Other benefit plans 2005
Discount rate	**5.50%**	5.50%	**5.50%**	5.75%
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 10% fiscal 2006 annual rate of increase in the per capita cost of covered health care benefits was assumed. The cumulative rate expectation to 2012 is 6%. The expected average remaining service period of the active employees covered by the pension benefit plans ranges from 11 to 19 years with a weighted average of 11 years at year-end. The expected average remaining service period of the active employees covered by the other benefit plans ranges from 13 to 17 years with a weighted average of 16 years at year-end.

	Pension plans		Other benefit plans	
	Benefit obligations	Benefit cost(1)	Benefit obligations	Benefit cost(1)
Expected long-term rate of return on plan assets		7.00%		
Impact of: 1% increase		$ (2.6)		
Impact of: 1% decrease		$ 2.6		
Discount rate	5.50%	5.50%	5.50%	5.50%
Impact of: 1% increase	$ (29.8)	$ 0.3	$ (16.6)	$ (0.8)
Impact of: 1% decrease	$ 33.6	$ (0.6)	$ 20.1	$ 1.0
Growth rate of health care costs(2)			10.00%	10.00%
Impact of: 1% increase			$ 17.1	$ 2.0
Impact of: 1% decrease			$ (14.0)	$ (1.6)

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

(2) Gradually decreasing to 6.0% in 2012 and remaining at that level thereafter.

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

	2006	2005
Cash and short term investments	**3.34%**	7.06%
Bonds, debentures, fixed income pooled funds and real estate funds	**18.04%**	17.71%
Equities and pooled equities fund	**78.42%**	74.96%
Accrued interest and dividends	**0.20%**	0.27%
Total investments	**100.00%**	100.00%

Within these securities are investments in a related party, Empire Company Limited. The market value of these shares at year-end is as follows:

	2006	% of plan assets	2005	% of plan assets
Empire Company Limited shares	**$ 93.4**	**10.3%**	$ 80.2	10.0%

15 Business acquisitions

The Company acquires franchisee stores and prescription files as part of its normal course of operations. The results of these acquisitions have been included in the consolidated financial results of the Company, and were accounted for through the use of the purchase method. As illustrated in the table below the acquisition of certain franchise stores resulted in the acquisition of intangible assets. The method of amortization of intangibles is on a straight-line basis over 10 – 15 years.

	52 weeks ended May 6, 2006	53 weeks ended May 7, 2005
Franchisees		
Inventory	**$ 3.0**	$ 2.5
Property and equipment	**0.7**	1.1
Intangibles	**–**	6.4
Goodwill	**0.3**	–
Other assets	**0.1**	0.8
Cash consideration	**$ 4.1**	$ 10.8
Prescription files		
Intangibles	**$ 1.2**	$ 0.8
Cash consideration	**$ 1.2**	$ 0.8

16 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 Sobeys Inc. common shares on each directors' 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 a Sobeys Inc. common share at the time of the redemption. At each interim or annual period that the Company prepares its financial statements, it revalues this liability. At May 6, 2006 there were 49,251 (May 7, 2005 – 56,215) DSUs outstanding. During the year, the stock-based compensation expense was $0.7 (2005 – $0.9).

Share purchase loans

The Company has a Share Purchase Loan plan for employees of the Company whereby loans are granted to purchase common stock. These loans have been treated as stock-based compensation in accordance with Emerging Issues Committee Abstract 132. The application was on a prospective basis beginning in fiscal 2005 as it was determined that the application on a retroactive basis would not result in a material change.

The compensation cost relating to the 2006 Share Purchase Loans was determined to be $1.3 (2005 – $1.2) with amortization of the cost over 5 years. The total increase in contributed surplus in relation to the Share Purchase Loan compensation cost for 2006 is $0.8. The contributed surplus balance was reduced by $0.3 in relation to shares issued under the Share Purchase Loan that have been treated as stock-based compensation that became fully vested with the employee during fiscal 2006. Shares become vested when the employees' outstanding loan balance is reduced. The compensation cost was calculated using the Black-Scholes model with the following assumptions:

	2006	2005
Expected life	**5 years**	5 years
Risk-free interest rate	**3.7%**	4.0%
Expected volatility	**21.6%**	22.3%
Dividend yield	**1.4%**	1.6%

17 Real estate leases

Effective May 2, 2004 the Company adopted CICA Handbook section 1100 prospectively, without restatement, and as a result the Company has changed its policy to record real estate lease expense on a straight-line basis. Additional real estate lease expense of $5.0 (May 7, 2005 – $2.7) was recorded in fiscal 2006 as a result of this policy change.

During fiscal 2005 the Company reviewed its practices related to lease accounting and determined that adjustments were required to align to the recent clarification of lease accounting guidelines. The first adjustment related to lease allowances and incentives. Historically the Company classified lease allowances as a reduction of the related capital assets, which effectively reduced the depreciation expense over the expected life of the asset. The guideline clarification suggests these lease allowances should be recorded as a deferred credit and amortized as a reduction of lease expense over the term of the lease. The second adjustment related to rent expense to be recorded during a store's fixturing period. The Company is often granted a fixturing period during which rent is not charged. The fixturing period is generally considered to be one month prior to the store opening. Historically, when the Company was granted a fixturing period rent expense was not recorded as none was being charged and the store was not yet open. The clarification of the accounting guidance however requires that the fixturing period be considered a free-rent period that should be included in the term of the lease. Since lease expense must be recognized on a straight-line basis over the lease term an appropriate portion of the straight-line expense must be recorded for the fixturing period. The third adjustment related to the capitalization of long-term leases. An evaluation was completed in the fourth quarter of fiscal 2005 and certain long-term leases were identified as capital leases. These changes have been accounted for on a retroactive basis with restatement resulting with the following net impact on the comparative statements for the year ended May 6, 2006:

- As at May 7, 2005 a reduction to retained earnings of $8.3.
- A reduction in net earnings for the 53-week period ended May 7, 2005 of $0.2 from $186.9 to $186.7, and a nil reduction in basic and diluted earnings per share.
- As at May 7, 2005 an increase to capital assets, future taxes, long-term debt and long-term lease obligation of $8.1, $4.8, $9.1 and $12.3, respectively.

These lease accounting adjustments did not have any material impact on the Company's fiscal 2006 net earnings, historical or future revenues, cash flows or lease payments.

18 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. Due to the retroactive implementation of EIC-144, the timing of recognition of certain vendor allowances has changed, resulting in the Company recording a decrease in opening retained earnings for fiscal 2005 of $5.9 (net of income tax affect of $3.4), and a decrease to inventory of $9.3. The implementation of EIC-144 did not result in a material change in the annual net earnings for fiscal 2005 or in the current or prior year's quarterly net earnings. The fiscal 2005 full-year impact of this adoption was not material to net earnings.

Certain allowances from vendors are contingent on the Company achieving minimum purchase levels. The Company recognizes these allowances in income in accordance with EIC-144 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 6, 2006 the Company has recognized $3.5 of allowances in income where it is probable that the minimum purchase level will be met and the amount of the allowance can be estimated.

19 Variable interest entities

Variable interest entities are defined under AcG-15 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 VIE's expected losses and its expected residual returns.

The Company has implemented AcG-15 on May 7, 2005 retroactively without restatement of prior periods. Entities that have been identified as meeting the characteristics of a VIE were consolidated in the Company's results effective for the fourth quarter of fiscal 2005.

The Company has identified the following entities as VIEs:

Franchise Affiliates

The Company has identified 300 (May 7, 2005 – 287) 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.

The Company has consolidated the results of these franchise affiliates and the entity providing warehouse and distribution services effective at the fourth quarter of fiscal 2005.

Balance sheet as at May 6, 2006

	Consolidated balance sheet as at May 6, 2006 before AcG-15 impact	Impact of the imple-mentation of AcG-15	Consolidated balance sheet as at May 6, 2006 after AcG-15 impact
Assets			
Current			
Cash and cash equivalents	$ 292.8	$ 39.3	$ 332.1
Receivables	251.7	(43.5)	208.2
Inventories	503.9	122.9	626.8
Prepaid expenses	40.8	5.1	45.9
Mortgages, loans and other receivables	14.6	1.3	15.9
Income taxes receivable	8.0	(2.2)	5.8
	1,111.8	122.9	1,234.7
Mortgages, loans and other receivables	163.7	(95.3)	68.4
Other assets	171.4	8.6	180.0
Property and equipment	1,580.8	31.4	1,612.2
Assets held for realization	8.5	–	8.5
Intangibles	21.5	–	21.5
Goodwill	613.3	–	613.3
	$ 3,671.0	$ 67.6	$ 3,738.6
Liabilities			
Current			
Accounts payable and accrued liabilities	$ 1,136.6	$ 22.2	$ 1,158.8
Future tax liabilities	46.1	–	46.1
Long-term debt due within one year	23.9	1.1	25.0
	1,206.6	23.3	1,229.9
Long-term debt	448.3	16.7	465.0
Long-term lease obligation	16.6	4.2	20.8
Employee future benefits obligation	96.0	–	96.0
Future tax liabilities	45.4	(1.3)	44.1
Deferred revenue	3.3	–	3.3
Minority interest	0.2	45.0	45.2
	1,816.4	87.9	1,904.3
Shareholders' equity			
Capital stock	904.8	–	904.8
Contributed surplus	0.9	–	0.9
Retained earnings	948.9	(20.3)	928.6
	1,854.6	(20.3)	1,834.3
	$ 3,671.0	$ 67.6	$ 3,738.6

The impact of implementation of AcG-15 on the consolidated balance sheet of the Company can be explained as follows:

- Accounts receivable and long-term notes receivable due from the franchise affiliates were eliminated upon consolidation. Cash, inventories, fixed assets, accounts payable and debt financing of the fixed assets have been consolidated.
- A charge of $14.5 was recorded to opening retained earnings for the fourth quarter of fiscal 2005 to reflect:
  1) The reduction of inventory values of the franchise affiliates that include charges from the Company for distribution costs and vendor allowances that are not recognized by the Company until final sale to customers.
  2) Goodwill that is carried on the accounts of stores determined to be VIEs has been assessed as being impaired with no fair market value, and, as such, has been eliminated.
- Based on a change in management's estimation process, it has been determined that a charge of $5.7 to retained earnings was required in the second quarter of 2006 to reflect additional minority interest in the VIEs. Additional adjustments of $0.2 to retained earnings are reflective of changes in the number of VIE entities required to be consolidated.
- Minority interest represents the equity in the VIEs held by the common shareholder.

Statement of earnings for the 52-weeks ended May 6, 2006

	Consolidated statement of earnings for the 52 weeks ended May 6, 2006 before AcG-15 impact	Impact of the imple-mentation of AcG-15	Consolidated statement of earnings for the 52 weeks ended May 6, 2006 after AcG-15 impact
Sales	$ 12,266.1	$ 587.2	$ 12,853.3
Operating expenses			
Cost of sales, selling and administrative expenses	11,755.1	570.0	12,325.1
Depreciation	187.0	5.8	192.8
Amortization of intangibles	3.8	–	3.8
Earnings before interest, income taxes and minority interest	320.2	11.4	331.6
Interest expense			
Long-term debt	32.5	1.1	33.6
Short-term debt	1.3	–	1.3
	33.8	1.1	34.9
Earnings before income taxes and minority interest	286.4	10.3	296.7
Income taxes	97.3	2.8	100.1
Net earnings before minority interest	189.1	7.5	196.6
Minority interest	–	7.2	7.2
Net earnings	$ 189.1	$ 0.3	$ 189.4
Net earnings per share basic	$ 2.92	$ 0.01	$ 2.93
Net earnings per share diluted	$ 2.89	$ 0.01	$ 2.90
Basic weighted average number of common shares outstanding, in millions	64.7		64.7
Diluted weighted average number of common shares outstanding, in millions	65.4		65.4

The impact of implementation of AcG-15 on the consolidated statement of earnings of the Company can be explained as follows:

Franchise affiliate retail sales are recorded and sales from the Company's distribution centres and cost of goods sold to the franchise affiliate have been eliminated. The impact on all other financial statement line items including net earnings is immaterial.

20 Indemnities

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.

21 Comparative figures

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

Glossary of terms

Adjusted debt
Funded debt plus capitalized value of operating lease payments, which is calculated as six times net annual operating lease payments

Adjusted debt to capital
Adjusted debt divided by the sum of adjusted debt and shareholders' equity

Capital expenditure / investment
Payments made for the acquisition of property and equipment

Company-wide capital expenditures
Total investment in property and equipment, which includes investment financed by the Company, third party operating leases, landlords and franchise affiliates

EBITDA
Earnings before interest, taxes, depreciation, amortization and minority interest

EBITDA margin
EBITDA divided by sales

EBITDAR
Earnings before interest, taxes, depreciation, amortization, rent and minority interest

Expanded stores
Stores that undergo construction resulting in square footage increase during the year

Funded debt
All interest bearing debt, which includes bank loans, bankers' acceptances and long-term debt

Hedge
A financial instrument used to manage foreign exchange or interest rate risk by making a transaction which offsets the existing position

Interest coverage
EBITDA divided by interest expense

Letters of credit
Financial instruments issued by a financial institution to guarantee the Company's payments to a third party

Managed working capital
The net amount of accounts receivable and inventories less accounts payable and accrued liabilities

On balance sheet investment
The Company's investment in property and equipment that is recorded on the balance sheet

Operating earnings
Net earnings before net capital gain and other items

Operating income
Earnings before interest, income taxes and minority interest

Operating margin
EBIT divided by sales

Private label
A brand of products that is marketed, distributed and owned by the Company

Renovated stores
Stores that undergo construction, resulting in no increase in square footage

Return on equity
Operating earnings divided by average shareholders' equity

Same-store sales
Sales from stores in the same locations in both reporting periods

Total capital
Funded debt plus shareholders' equity

Variable Interest Entity (VIE)
An entity that does not have sufficient equity at risk to finance its activities without additional subordinated financial support, or where the equity holders lack the overall characteristics of a controlling financial interest

Weighted average number of shares
Number of common shares outstanding adjusted to take into account the time the shares are outstanding in the reporting period

Working capital
Total current assets less total current liabilities

Five-year financial review

Year ended May ($ in millions, except per share data)	**2006**	2005*	2004†	2003†	2002
Operations					
Sales	**$12,853.3**	$ 12,189.4	$ 11,046.8	$ 10,414.5	$ 9,732.5
Gain on sale of assets	**–**	–	14.6	–	–
Cost of sales, selling and administrative expenses	**12,325.1**	11,690.4	10,614.4	9,963.4	9,334.9
Depreciation	**192.8**	174.5	152.2	125.5	101.0
Intangible amortization	**3.8**	1.9	0.5	–	–
Operating income	**331.6**	322.6	294.3	325.6	296.6
Interest expense	**34.9**	37.9	43.2	42.5	57.0
Income taxes (operating activities)	**100.1**	98.0	84.6	105.0	96.5
Minority interest	**7.2**	–	–	–	–
Goodwill charges	**–**	–	–	–	15.4
Earnings from discontinued operations	**–**	–	–	–	14.0
Operating earnings	**189.4**	186.7	166.5	178.1	141.7
Net capital gain and other items	**–**	–	–	–	68.9
Net earnings	**189.4**	186.7	166.5	178.1	210.6
Cash flows from operating activities	**495.3**	438.0	364.6	348.4	494.7
Property and equipment purchases	**332.3**	268.5	316.1	342.3	424.2
Financial position					
Net working capital	**4.8**	(188.6)	(194.8)	(93.1)	(5.6)
Property and equipment	**1,612.2**	1,461.9	1,360.2	1,253.8	1,072.1
Total assets	**3,738.6**	3,445.8	3,278.9	3,195.7	2,875.2
Long-term debt	**490.0**	457.8	453.1	595.8	523.6
Shareholders' equity	**1,834.3**	1,682.1	1,561.3	1,423.6	1,283.3
Per share information					
Operating earnings , diluted	**2.90**	2.85	2.53	2.70	2.15
Net earnings, diluted	**2.90**	2.85	2.53	2.70	3.20
Cash flows from operating activities, diluted	**7.57**	6.69	5.53	5.29	7.48
Dividends	**0.545**	0.50	0.44	0.36	0.24
Weighted average number of common shares outstanding, diluted (millions)	**65.4**	65.5	65.9	65.9	65.9
Closing share price	**38.80**	37.20	28.65	36.75	44.25

* 53 weeks
† restated

Quarterly information

($ in millions, except per share data)	Q4 (13 weeks) May 6, 2006	Q3 (13 weeks) Feb 4, 2006	Q2 (13 weeks) Nov 5, 2005	Q1 (13 weeks) Aug 6, 2005	Q4 (14 weeks) May 7, 2005	Q3 (13 weeks) Jan 29, 2005	Q2 (13 weeks) Oct 30, 2004	Q1 (13 weeks) July 31, 2004
Operations								
Sales	$3,162.6	$3,171.9	$3,218.4	$3,300.4	$ 3,294.7	$ 2,917.0	$ 2,966.7	$ 3,011.0
EBITDA	136.7	128.6	132.8	130.1	133.1	119.1	123.9	122.9
EBIT	85.2	78.6	84.1	83.7	84.6	76.2	81.2	80.6
Net earnings	$ 49.7	$ 45.7	$ 45.8	$ 48.2	$ 48.1	$ 44.8	$ 47.2	$ 46.6
Per share information, basic								
EBIT	$ 1.32	$ 1.21	$ 1.30	$ 1.29	$ 1.31	$ 1.18	$ 1.25	$ 1.23
Net earnings	$ 0.77	$ 0.71	$ 0.71	$ 0.74	$ 0.74	$ 0.69	$ 0.73	$ 0.71
Weighted average number of shares, basic	64.7	64.8	64.8	64.7	64.7	64.6	65.0	65.3
Per share information, diluted								
EBIT	$ 1.30	$ 1.20	$ 1.29	$ 1.28	$ 1.30	$ 1.17	$ 1.24	$ 1.22
Net earnings	$ 0.76	$ 0.70	$ 0.70	$ 0.74	$ 0.74	$ 0.69	$ 0.72	$ 0.71
Weighted average number of shares, diluted	65.4	65.4	65.4	65.3	65.3	65.3	65.7	65.9
EBITDA as percent of sales	4.32%	4.05%	4.13%	3.94%	4.04%	4.08%	4.18%	4.08%
EBIT as percent of sales	2.69%	2.48%	2.61%	2.54%	2.57%	2.61%	2.74%	2.68%

All quarters prior to the fourth quarter of fiscal 2005 have been restated to reflect the retroactive adjustment related to lease accounting. Please see the section entitled "Lease Accounting" in the fiscal 2006 annual MD&A.

Officers

Peter C. Godsoe
Chairman

Bill McEwan
President & Chief Executive Officer

Craig T. Gilpin
President Operations, Sobeys Ontario

J. Gary Kerr
President Operations, Sobeys West

Jason Potter
President Operations, Sobeys Atlantic

Marc Poulin
President Operations, Sobeys Québec

Dennis Folz
Executive Vice President & Chief Human Resources Officer

J. Bruce Terry
Executive Vice President & Chief Financial Officer

François Vimard
Executive Vice President, Supply Chain

Belinda Youngs
Executive Vice President, Corporate Brands

R. Glenn Hynes
Executive Vice President & Chief Development Officer

Karin McCaskill
Senior Vice President, General Counsel & Secretary

Paul A. Jewer
Vice President, Finance & Treasurer

L. Jane McDow
Assistant Secretary

Investor information

Head office
115 King Street
Stellarton, Nova Scotia B0K 1S0
Telephone: (902) 752 8371
Facsimile: (902) 928 1101
Email: investor.relations@sobeys.com

Investor relations
For additional information please write the Company, c/o Paul Jewer, CA, Vice President, Finance & Treasurer

Web address
www.sobeys.com

Shareholders' Annual General Meeting
September 12, 2006, at 10:00 a.m. (ADT)
Aberdeen Cinemas
610 East River Road
New Glasgow, Nova Scotia

Stock exchange listing
Toronto Stock Exchange
Stock Symbol – SBY

Average daily trading volume (TSX)
61,153

Common dividend record and payment dates for fiscal 2007

Record Date	Payment Date
July 14, 2006	July 31, 2006
Oct. 13, 2006*	Oct. 31, 2006*
Jan. 15, 2007*	Jan. 31, 2007*
Apr. 13, 2007*	Apr. 30, 2007*

*subject to approval by Board of Directors

Outstanding shares
As of June 28, 2006
Common shares outstanding 65,426,282

Transfer agent and registrar
CIBC Mellon Trust Company
Investor Correspondence
P.O. Box 7010
Adelaide Street Postal Station
Toronto, Ontario M5C 2W9
Toll free in North America: (800) 387 0825
Email: inquiries@cibcmellon.com
Web address: www.cibcmellon.com

Bankers
Bank of Montreal
Bank of Nova Scotia
Bank of Tokyo Mitsubishi
Canadian Imperial Bank of Commerce
National Bank of Canada
Rabobank
TD Canada Trust

Solicitors
Stewart McKelvey
Halifax, Nova Scotia

Auditors
Grant Thornton, LLP
New Glasgow, Nova Scotia

Investor inquiries
For more information on shareholder services or any other inquiries regarding investor records, including stock transfer, address change, lost certificates, tax forms, contact the Company's transfer agent and registrar.

Shareholders, analysts, and investors should direct their financial inquiries or requests to: Paul Jewer, CA, Vice President, Finance & Treasurer.

Exemplaire français
Vous pouvez obtenir un exemplaire français de ce rapport annuel en écrivant à :
Sobeys Inc.
Relations avec les investisseurs
115, rue King
Stellarton (N-É) B0K 1S0

DESIGN: Craib Design & Communications EDITORIAL SERVICES: Sage Corporate Communications PHOTOGRAPHY: Brian Pieters PRINTING: Grafikom.MIL

From day one, our focus has been great food and exceptional service. As we move into our second century, Sobeys will continue to build on these fundamentals to create Canada's premier food shopping experience.

CORPORATE
www.sobeys.com

CONSUMER
www.sobeys.ca

PRIVATE LABEL
www.compliments.ca