

# SHOPPERS DRUG MART CORPORATION

## Consolidated Statements of Earnings

(unaudited)

(in thousands of dollars except per share amounts)

	16 Weeks Ended		40 Weeks Ended	
	October 4, 2008	October 6, 2007	October 4, 2008	October 6, 2007
<b>Sales</b>	\$ 2,793,005	\$ 2,542,671	\$ 6,926,112	\$ 6,309,560
<b>Operating expenses</b>				
Cost of goods sold and other operating expenses (Note 2)	2,473,584	2,260,187	6,153,649	5,631,656
Amortization	63,799	54,942	154,894	130,752
<b>Operating income</b>	<b>255,622</b>	227,542	<b>617,569</b>	547,152
Interest expense (Note 4)	20,100	15,920	48,012	38,688
<b>Earnings before income taxes</b>	<b>235,522</b>	211,622	<b>569,557</b>	508,464
<b>Income taxes (Note 2)</b>				
Current	84,662	93,369	189,350	177,548
Future	(11,651)	(23,419)	(11,954)	(8,194)
	73,011	69,950	177,396	169,354
<b>Net earnings</b>	<b>\$ 162,511</b>	\$ 141,672	<b>\$ 392,161</b>	\$ 339,110
<b>Net earnings per common share:</b>				
Basic	\$ 0.75	\$ 0.65	\$ 1.81	\$ 1.57
Diluted	\$ 0.75	\$ 0.65	\$ 1.80	\$ 1.56
Weighted average common shares outstanding				
- Basic (millions)	217.1	216.4	216.9	215.9
- Diluted (millions)	217.5	217.3	217.5	217.2
Actual common shares outstanding (millions)	217.1	216.6	217.1	216.6

# SHOPPERS DRUG MART CORPORATION

## Consolidated Statements of Retained Earnings

(unaudited)

(in thousands of dollars)

	40 Weeks Ended	
	October 4, 2008	October 6, 2007
<b>Retained earnings, beginning of period as reported</b>	\$ 1,580,888	\$ 1,225,682
Impact of the adoption of new accounting standard, Handbook Section 3031, Inventories (Note 2)	(21,337)	(18,150)
<b>Retained earnings, beginning of period as restated</b>	<b>1,559,551</b>	<b>1,207,532</b>
Net earnings	392,161	339,110
Dividends	(139,970)	(103,711)
Premium on share capital purchased for cancellation	(30)	(24)
<b>Retained earnings, end of period</b>	<b>\$ 1,811,712</b>	<b>1,442,907</b>

## Consolidated Statements of Comprehensive Income and Accumulated Other Comprehensive (Loss) Income

(unaudited)

(in thousands of dollars)

	16 Weeks Ended		40 Weeks Ended	
	October 4, 2008	October 6, 2007	October 4, 2008	October 6, 2007
<b>Net earnings</b>	\$ 162,511	\$ 141,672	\$ 392,161	\$ 339,110
<b>Other comprehensive (loss) income, net of tax</b>				
Change in unrealized gain/loss on interest rate derivatives (net of tax of \$375 and \$971 (2007 - \$431 and \$792), respectively)	(761)	(875)	(1,972)	1,500
Change in unrealized gain/loss on equity forward derivatives (net of tax of \$296 and \$74 (2007 - \$82 and \$42), respectively)	(602)	163	(151)	85
Amount of previously unrealized gain/loss on equity forward derivatives recognized in earnings during the period (net of tax of \$3 and \$2 (2007 - \$nil and \$59), respectively)	7	2	(4)	(113)
<b>Other comprehensive (loss) income</b>	<b>(1,356)</b>	<b>(710)</b>	<b>(2,127)</b>	<b>1,472</b>
<b>Comprehensive income</b>	<b>\$ 161,155</b>	<b>\$ 140,962</b>	<b>\$ 390,034</b>	<b>\$ 340,582</b>
<b>Accumulated other comprehensive income, beginning of period</b>			\$ 247	\$ 406
Other comprehensive (loss) income			(2,127)	1,472
<b>Accumulated other comprehensive (loss) income, end of period</b>			<b>\$ (1,880)</b>	<b>\$ 1,878</b>

# SHOPPERS DRUG MART CORPORATION

## Consolidated Balance Sheets

(unaudited)  
(in thousands of dollars)

	October 4, 2008	October 6, 2007	December 29, 2007
<b>Assets</b>			
Current			
Cash	\$ 49,817	\$ 17,477	\$ 27,588
Accounts receivable	399,254	325,034	372,306
Inventory (Note 2)	1,590,062	1,402,477	1,545,599
Income taxes recoverable	18,064	-	-
Future income taxes (Note 2)	82,211	67,619	69,952
Prepaid expenses and deposits	94,926	131,735	134,692
	<b>2,234,334</b>	<b>1,944,342</b>	<b>2,150,137</b>
Property and equipment	1,289,443	1,030,783	1,126,513
Deferred costs	38,497	28,423	32,966
Goodwill	2,400,898	2,229,945	2,245,441
Other intangible assets	84,457	55,726	57,930
Other assets	20,480	11,243	8,990
<b>Total assets</b>	<b>\$ 6,068,109</b>	<b>\$ 5,300,462</b>	<b>\$ 5,621,977</b>
<b>Liabilities</b>			
Current			
Bank indebtedness	\$ 259,394	\$ 246,909	\$ 225,152
Commercial paper (Note 7)	343,847	537,201	543,847
Accounts payable and accrued liabilities	913,392	761,285	990,545
Income taxes payable (Note 2)	-	106,260	65,100
Dividends payable	46,677	34,656	34,686
Current portion of long-term debt	299,986	-	298,990
	<b>1,863,296</b>	<b>1,686,311</b>	<b>2,158,320</b>
Long-term debt (Note 7)	447,069	298,872	-
Other long-term liabilities	289,098	229,020	244,657
Future income taxes	34,006	26,704	30,171
	<b>2,633,469</b>	<b>2,240,907</b>	<b>2,433,148</b>
Associate interest	102,614	102,588	113,119
<b>Shareholders' equity</b>			
Share capital	1,511,412	1,502,145	1,506,020
Contributed surplus	10,782	10,037	9,892
Accumulated other comprehensive (loss) income	(1,880)	1,878	247
Retained earnings (Note 2)	1,811,712	1,442,907	1,559,551
	<b>1,809,832</b>	<b>1,444,785</b>	<b>1,559,798</b>
	<b>3,332,026</b>	<b>2,956,967</b>	<b>3,075,710</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 6,068,109</b>	<b>\$ 5,300,462</b>	<b>\$ 5,621,977</b>

# SHOPPERS DRUG MART CORPORATION

## Consolidated Statements of Cash Flows

(unaudited)

(in thousands of dollars)

	16 Weeks Ended		40 Weeks Ended	
	October 4, 2008	October 6, 2007	October 4, 2008	October 6, 2007
<b>Operating activities</b>				
Net earnings (Note 2)	\$ 162,511	\$ 141,672	\$ 392,161	\$ 339,110
Items not affecting cash				
Amortization	68,137	56,750	164,809	136,486
Future income taxes (Note 2)	(11,651)	(23,419)	(11,954)	(8,194)
Loss on disposal of property and equipment	1,203	2,420	3,183	4,372
Stock-based compensation	516	1,049	1,312	2,963
	<b>220,716</b>	<b>178,472</b>	<b>549,511</b>	<b>474,737</b>
Net change in non-cash working capital balances (Notes 2 and 3)	(67,168)	(27,448)	(244,596)	(147,691)
Increase in other long-term liabilities	18,667	19,944	35,951	32,237
Store opening costs	(7,402)	(7,307)	(17,714)	(14,249)
Cash flows from operating activities	<b>164,813</b>	<b>163,661</b>	<b>323,152</b>	<b>345,034</b>
<b>Investing activities</b>				
Purchase of property and equipment	(161,298)	(137,541)	(317,128)	(248,826)
Proceeds from disposition of property and equipment	10,422	6,705	18,594	6,794
Business acquisition –HealthAccess and Information Healthcare Marketing Corp. (Note 3)	(88,498)	-	(88,498)	-
Other business acquisitions (Note 3)	(21,745)	(110,268)	(109,207)	(121,074)
Deposits	20,639	(66,683)	59,718	(74,815)
Other assets	(2,555)	(7)	(12,250)	(1,046)
Cash flows used in investing activities	<b>(243,035)</b>	<b>(307,794)</b>	<b>(448,771)</b>	<b>(438,967)</b>
<b>Financing activities</b>				
Bank indebtedness, net	(1,047)	20,498	34,242	112,422
Commercial paper, net (Note 7)	95,000	64,324	(199,350)	34,199
Issuance of long-term debt (Note 7)	-	-	450,000	-
Financing costs incurred	-	(20)	(3,500)	(20)
Associate interest	(271)	(4,164)	(10,505)	(14,061)
Proceeds from shares issued for stock options exercised	601	3,628	4,756	10,591
Repayment of share purchase loans	6	29	219	295
Repurchase of share capital	(35)	-	(35)	(29)
Dividends paid	(46,667)	(34,588)	(127,979)	(94,852)
Cash flows from financing activities	<b>47,587</b>	<b>49,707</b>	<b>147,848</b>	<b>48,545</b>
<b>(Decrease) increase in cash</b>	<b>(30,635)</b>	<b>(94,426)</b>	<b>22,229</b>	<b>(45,388)</b>
<b>Cash, beginning of period</b>	<b>80,452</b>	<b>111,903</b>	<b>27,588</b>	<b>62,865</b>
<b>Cash, end of period</b>	<b>\$ 49,817</b>	<b>\$ 17,477</b>	<b>\$ 49,817</b>	<b>\$ 17,477</b>
<b>Supplemental cash flow information</b>				
Interest paid	\$ 8,405	\$ 10,295	\$ 37,669	\$ 32,721
Income taxes paid	\$ 104,129	\$ 56,797	\$ 271,464	\$ 165,087

# SHOPPERS DRUG MART CORPORATION

## Notes to the Consolidated Financial Statements

(unaudited)  
(in thousands of dollars except per share amounts)

---

### 1. BASIS OF PRESENTATION

The unaudited interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”) and follow the same accounting policies and methods of application with those used in the preparation of the audited annual consolidated financial statements for the 52 week period ended December 29, 2007, except as described in Note 2, Changes in Accounting Policies. These financial statements do not contain all disclosures required by Canadian GAAP for annual financial statements and, accordingly, should be read in conjunction with the most recently prepared annual consolidated financial statements and the accompanying notes included in the Company’s 2007 Annual Report.

The consolidated financial statements of the Company include the accounts of Shoppers Drug Mart Corporation, its subsidiaries and entities considered to be variable interest entities, as defined by the Canadian Institute of Chartered Accountants (“CICA”) Accounting Guideline 15, “Consolidation of Variable Interest Entities” (“AcG-15”). Under AcG-15, the Company has consolidated the Associate-owned stores.

The individual Associate-owned stores that comprise the Company’s store network are variable interest entities and the Company is the primary beneficiary. As such, the Associate-owned stores are subject to consolidation by the Company. The Associate-owned stores remain separate legal entities and consolidation of the Associate-owned stores has no impact on the underlying risks facing the Company.

The Company had an arrangement with an independent trust (the “Trust”) to provide loans to Associates to facilitate their purchase of inventory and fund their working capital requirements. The Trust’s activities were financed through the issuance of short-term asset backed notes to third party investors. The Trust was a variable interest entity and the Company was the primary beneficiary. As such, the Trust was subject to consolidation by the Company. The results of operations of the Trust have been included in the Company’s consolidated results of operations up until June 10, 2008, when the Trust was terminated. See Notes 7 and 8 below for further discussion related to the Trust.

### 2. CHANGE IN ACCOUNTING POLICIES

#### Adoption of New Accounting Standards

##### Capital disclosures

In 2006, the CICA issued a new accounting standard concerning Capital Disclosures (“Section 1535”), which requires the disclosure of both quantitative and qualitative information that enables users of financial statements to evaluate the entity’s objectives, policies and processes for managing capital. The standard also requires an entity to disclose if it has complied with any capital requirements and, if it has not complied, the consequences of such non-compliance. The standard is effective for interim and annual financial statements for fiscal years beginning on or after October 1, 2007. The Company applied the new accounting standard at the beginning of its current fiscal year and its implementation did not have an impact on the Company’s results of operations or financial position; the resulting disclosures from implementation are presented below.

# SHOPPERS DRUG MART CORPORATION

## Notes to the Consolidated Financial Statements

(unaudited)  
(in thousands of dollars except per share amounts)

---

### 2. CHANGE IN ACCOUNTING POLICIES (continued)

#### Capital Management

The Company's primary objectives when managing capital are to profitably grow its business while maintaining adequate financing flexibility to fund attractive new investment opportunities and other unanticipated requirements or opportunities that may arise. Profitable growth is defined as earnings growth commensurate with the additional capital being invested in the business in order that the Company earns an attractive rate of return on that capital. The primary investments undertaken by the Company to drive profitable growth include additions to the selling square footage of its store network via the construction of new, relocated and expanded stores, including related leasehold improvements and fixtures, the purchase of sites for future store construction, as well as through the acquisition of independent drug stores or their prescription files. In addition, the Company makes capital investments in information technology and its distribution capabilities to support an expanding store network. The Company also provides working capital to its Associates via loans and/or loan guarantees. The Company largely relies on its cash flow from operations to fund its capital investment program and dividend distributions to its shareholders. This cash flow is supplemented, when necessary, through the borrowing of additional debt. No changes were made to these objectives during the period.

The Company considers its total capitalization to be bank indebtedness, commercial paper, long-term debt (including the current portion thereof) and shareholders' equity, net of cash. The Company also gives consideration to its obligations under operating leases when assessing its total capitalization. The Company manages its capital structure with a view to maintaining investment grade credit ratings from two credit rating agencies. In order to maintain its desired capital structure, the Company may adjust the level of dividends paid to shareholders, issue additional equity, repurchase shares for cancellation or issue or repay indebtedness. The Company has certain debt covenants and is in compliance with those covenants.

The Company monitors its capital structure principally through measuring its net debt to shareholders' equity and net debt to total capitalization ratios, and ensures its ability to service its debt and meet other fixed obligations by tracking its interest and other fixed charges coverage ratios.

The following table provides a summary of certain information with respect to the Company's capital structure and financial position at the end of the periods indicated.

**SHOPPERS DRUG MART CORPORATION**  
**Notes to the Consolidated Financial Statements**  
(unaudited)  
(in thousands of dollars except per share amounts)

**2. CHANGES IN ACCOUNTING POLICIES (continued)**

	October 4, 2008	October 6, 2007	December 29, 2007
Cash	\$ (49,817)	\$ (17,477)	\$ (27,588)
Bank indebtedness	259,394	246,909	225,152
Commercial paper	343,847	537,201	543,847
Current portion of long-term debt	299,986	-	298,990
Long-term debt	447,069	298,872	-
Net debt	1,300,479	1,065,505	1,040,401
Shareholders' equity	3,332,026	2,956,967	3,075,710
Total capitalization	\$ 4,632,505	\$ 4,022,472	\$ 4,116,111
Net debt:Shareholders' equity	0.39:1	0.36:1	0.34:1
Net debt:Total capitalization	0.28:1	0.26:1	0.25:1
EBITDA:Cash interest expense <sup>(1)(2)</sup>	17.23:1	18.93:1	18.37:1

<sup>(1)</sup> For purposes of calculating the ratios, EBITDA is comprised of EBITDA for each of the 52 week periods then ended. EBITDA (earnings before interest, taxes, depreciation and amortization) is a non-GAAP financial measure. Non-GAAP financial measures do not have standardized meanings prescribed by GAAP and therefore may not be comparable to similar measures presented by other reporting issuers.

<sup>(2)</sup> Cash interest expense is also a non-GAAP measure and is comprised of interest expense for each of the 52 week periods then ended and excludes the amortization of deferred financing costs.

As measured by the ratios set out above, the Company maintained its desired capital structure and financial position during the period.

The following table provides a summary of the Company's credit ratings at October 4, 2008:

	Standard & Poor's	Dominion Bond Rating Service
Corporate credit rating	BBB+	-
Senior unsecured debt	BBB+	A (low)
Commercial paper	-	R-1 (low)

There were no changes to any of the Company's credit ratings during the 16 and 40 weeks ended October 4, 2008.

**SHOPPERS DRUG MART CORPORATION**  
**Notes to the Consolidated Financial Statements**  
(unaudited)  
(in thousands of dollars except per share amounts)

---

**2. CHANGES IN ACCOUNTING POLICIES (continued)**

**Financial instruments**

The Company adopted two new accounting standards concerning financial instruments: CICA Handbook Section 3862 “Financial Instruments – Disclosures” (“Section 3862”) and CICA Handbook Section 3863 “Financial Instruments – Presentation” (“Section 3863”). These standards were issued in December 2006 and replaced Section 3861, “Financial Instruments - Disclosure and Presentation”. The new disclosure standard increased the emphasis on the risk associated with financial instruments and how those risks are managed. The new presentation standard carried forward the former presentation requirements under the replaced Section 3861. The standards are effective for interim and annual financial statements for fiscal years beginning on or after October 1, 2007. The Company applied the new accounting standards at the beginning of its current fiscal year and its implementation did not have an impact on the Company’s results of operations or financial position; the resulting disclosures from implementation are presented below and in the Company’s Management’s Discussion and Analysis for the 16 and 40 week periods ended October 4, 2008.

In accordance with Section 3855, *Financial Instruments – Recognition and Measurement*, financial instruments are classified into one of the following five categories: held for trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets, or other financial liabilities. The classification determines the accounting treatment of the instrument. The classification is determined by the Company when the financial instrument is initially recorded, based on the underlying purpose of the instrument.

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

<b>Financial Asset / Liability</b>	<b>Category</b>	<b>Measurement</b>
Cash	Held for trading	Fair value
Accounts receivable	Loans and receivables	Amortized cost
Deposits <sup>(1)</sup>	Loans and receivables	Amortized cost
Long-term receivables <sup>(2)</sup>	Loans and receivables	Amortized cost
Bank indebtedness	Held for trading	Fair value
Commercial paper	Other financial liabilities	Amortized cost
Accounts payable	Other financial liabilities	Amortized cost
Long-term debt	Other financial liabilities	Amortized cost
Other long-term liabilities	Other financial liabilities	Amortized cost
<b>Derivatives</b>	<b>Classification</b>	<b>Measurement</b>
Interest rate derivatives <sup>(3)</sup>	Effective cash flow hedge	Fair value
Equity forward derivatives <sup>(3)</sup>	(4)	Fair value

Notes:

- (1) The carrying value of deposits is included in prepaid expenses and deposits in the consolidated balance sheets.
- (2) The carrying value of long-term receivables is included in other assets in the consolidated balance sheets.
- (3) The carrying values of the Company’s derivatives are included in accounts receivable, other assets, accounts payable and accrued liabilities and other long-term liabilities in the consolidated balance sheets.
- (4) The portion of the equity forward derivative agreements relating to the earned long-term incentive plan units is considered a derivative financial instrument. See Note 12 to the Company’s 2007 annual consolidated financial statements for a further discussion of the long-term incentive plan.

# SHOPPERS DRUG MART CORPORATION

## Notes to the Consolidated Financial Statements

(unaudited)  
(in thousands of dollars except per share amounts)

---

### 2. CHANGES IN ACCOUNTING POLICIES (continued)

Financial instruments measured at amortized cost are initially recognized at fair value and then subsequently at amortized cost with gains and losses recognized in earnings in the period in which the gain or loss occurs. Changes in fair value of financial instruments classified as held for trading are recorded in net earnings in the period of change. Changes in the fair value of the Company's derivative instruments designated as effective cash flow hedges are recognized in other comprehensive income; changes in derivative instruments not designated as effective hedges are recognized in net earnings in the period of the change.

#### Transaction costs

The Company has adopted the policy of adding transaction costs to financial assets and liabilities classified as other than "held for trading".

#### Derivative financial instruments and hedge accounting

The Company uses interest rate derivatives to manage its exposure to fluctuations in interest rates related to the Company's commercial paper. The income or expense arising from the use of these instruments is included in interest expense for the year.

The Company uses cash-settled equity forward agreements to limit its exposure to future price changes in the Company's share price for share unit awards under the Company's long-term incentive plan ("LTIP"). The income or expense arising from the use of these instruments is included in other operating expenses for the year. See Note 12 of the Company's 2007 annual consolidated financial statements for further discussion of the LTIP.

The Company formally identifies, designates and documents all relationships between hedging instruments and hedged items, as well as its risk assessment objective and strategy for undertaking various hedge transactions. The Company assesses, both at the hedge's inception and on an ongoing basis including on re-designation, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. When such derivative instruments cease to exist or be effective as hedges, or when designation of a hedging relationship is terminated, any associated deferred gains or losses are recognized in net earnings in the same period as the corresponding gains or losses associated with the hedged item. When a hedged item ceases to exist, any associated deferred gains or losses are recognized in net earnings in the period the hedged item ceases to exist. Changes in the fair value of the Company's derivatives are non-cash transactions and are therefore not recognized in the consolidated statement of cash flows.

The Company does not have any significant embedded features in contractual arrangements that require separate presentation from the related host contract.

# SHOPPERS DRUG MART CORPORATION

## Notes to the Consolidated Financial Statements

(unaudited)  
(in thousands of dollars except per share amounts)

---

### 2. CHANGES IN ACCOUNTING POLICIES (continued)

#### Interest rate derivatives

In December 2005, the Company entered into interest rate derivative agreements converting an aggregate notional principal amount of \$250,000 of floating rate commercial paper debt issued by the Trust into fixed rate debt. The commercial paper issued by the Trust has been replaced with commercial paper issued directly by the Company. The fixed rates payable by the Company under the derivative agreements range from 4.03% to 4.18%. These agreements mature as follows: \$150,000 in December 2008, \$50,000 in December 2009 and \$50,000 in December 2010 with reset terms from one to three months.

Based on market values of the interest rate derivative agreements at October 4, 2008, the Company has recognized a liability of \$2,516, of which \$200 is presented in accounts payable and accrued liabilities and \$2,316 is presented in other long-term liabilities. Based on market values of the interest rate derivative agreements at October 6, 2007, the Company recognized an asset of \$2,630 in other assets. Market values were determined based on information received from the Company's counterparties to these agreements.

#### Equity forward derivatives

Based on market values of the equity forward agreements at October 4, 2008, the Company has recognized a net liability of \$670, of which \$152 is presented in accounts receivable and \$822 is presented in other long-term liabilities. Based on market values of the equity forward agreements at October 6, 2007, the Company recognized an asset of \$1,051 in other assets. Market values were determined based on information received from the Company's counterparties to these agreements.

During the 16 weeks ended October 4, 2008, net losses of \$7 (2007 – \$2) were reclassified from accumulated other comprehensive (loss) income to earnings. During the 40 weeks ended October 4, 2008, net gains of \$4 (2007 – \$113) were reclassified from accumulated other comprehensive (loss) income to earnings.

#### Fair value of financial instruments

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

The fair values of long-term receivables, long-term liabilities and long-term debt approximate their carrying values given the current market rates associated with these instruments.

The interest rate and equity forward derivatives are recognized at fair value, which is determined based on current market rates and on information received from the Company's counterparties to these agreements.

#### Financial risk management objectives and policies

In the normal course of business, the Company is exposed to financial risks that have the potential to negatively impact its financial performance. The Company may use derivative financial instruments to manage certain of these risks. The Company does not use derivative financial instruments for trading or speculative purposes. These risks are discussed in more detail under the section entitled "Risks and Risk Management – Financial Instruments" on pages 16 -17 of the Company's Management Discussion and Analysis for the 16 and 40 weeks ended October 4, 2008.

**SHOPPERS DRUG MART CORPORATION**  
**Notes to the Consolidated Financial Statements**  
(unaudited)  
(in thousands of dollars except per share amounts)

---

**2. CHANGES IN ACCOUNTING POLICIES (continued)**

**Inventories**

The CICA issued a new accounting standard concerning Inventories (“Section 3031”), in June 2007, which is based on the International Accounting Standards Board’s (“IASB”) International Accounting Standard 2 and replaced Section 3030, “Inventories”. The new standard provides guidance on the determination of the cost of inventory and the subsequent recognition of inventory as an expense, as well as requiring additional associated disclosures. The new standard also allows for the reversal of any write-downs previously recognized. The standard is effective for interim and annual financial statements for fiscal years beginning on or after January 1, 2008. The Company applied the new accounting standard retrospectively at the beginning of its current fiscal year, with restatement of prior periods.

The results for the 16 and 40 weeks ended October 6, 2007 reflect an increase in cost of goods sold and other operating expenses and a decrease in operating income of \$1,176 and \$799, respectively, and a decrease in net earnings of \$902 and \$859, respectively, with basic and diluted net earnings per share remaining unchanged. The impact for year ended December 29, 2007 is an increase in cost of goods sold and other operating expenses and a decrease in operating income of \$3,742 and a decrease in net earnings of \$3,187, resulting in a decrease of \$0.01 in basic and diluted net earnings per share.

The implementation of the new standard has resulted in a reduction to 2008 and 2007 opening retained earnings of \$21,337 and \$18,150, respectively. The impact on balances as at December 29, 2007 and October 6, 2007 was a decrease in inventory of \$31,925 and \$28,984, respectively, an increase in future income tax asset of \$9,863 and \$9,463, respectively, and a decrease in income taxes payable of \$725 and \$512, respectively.

Inventory is comprised of merchandise inventory and is valued at the lower of cost and estimated net realizable value, with cost being determined on the first-in, first-out basis. Cost includes all direct expenditures and other appropriate costs incurred in bringing inventory to its present location and condition. The Company classifies rebates and other consideration received from a vendor as a reduction to the cost of inventory unless the rebate clearly relates to the reimbursement of a specific expense.

The cost of inventory recognized as an expense and included in cost of goods sold and other operating expenses for the 16 and 40 weeks ended October 4, 2008 was \$1,758,232 and \$4,386,055 (2007 - \$1,622,654 and \$4,045,713), respectively. During the period, there were no significant write-downs of inventory as a result of net realizable value being lower than cost and no inventory write-downs recognized in previous years were reversed.

# SHOPPERS DRUG MART CORPORATION

## Notes to the Consolidated Financial Statements

(unaudited)  
(in thousands of dollars except per share amounts)

---

### 2. CHANGES IN ACCOUNTING POLICIES (continued)

#### **Financial instruments - determining whether a contract is routinely denominated as a single currency**

In January 2008, the Emerging Issues Committee (“EIC”) issued EIC-169, “Determining Whether a Contract is Routinely Denominated as a Single Currency”, which provides additional guidance on the interpretation of the term “routinely denominated” in CICA Handbook Section 3855, “Financial Instruments - Recognition and Measurement”. The new guidance is effective for interim and annual financial statements issued on or after March 15, 2008. The Company applied the new guidance retrospectively at the beginning of its 2008 fiscal year. The implementation did not have a significant impact on the Company’s results of operations, financial position or disclosures.

#### **Future Accounting Standards**

##### **Goodwill and intangible assets**

In February 2008, the CICA issued a new accounting standard concerning Goodwill and Intangible Assets (“Section 3064”), which is based on the IASB’s International Accounting Standard 38, *Intangible Assets*. The new section replaced the existing guidance on goodwill and other intangible assets and research and development costs. The new section provides additional guidance on measuring the cost of goodwill and intangible assets. The standard is effective for interim and annual financial statements for fiscal years beginning on or after October 1, 2008. The Company will apply the new accounting standards at the beginning of its 2009 fiscal year. The Company is currently assessing the impact of the new standard on the Company’s results of operations, financial position and disclosures.

##### **Financial statement concepts**

In February 2008, the CICA issued amendments to Section 1000, “Financial Statement Concepts” to clarify the criteria for recognition of an asset and the timing of expense recognition. The new requirements are effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2008. The Company will apply the amendments to Section 1000 at the beginning of its 2009 fiscal year. The implementation of the amendments to Section 1000 will not have an impact the Company’s results of operations, financial position and disclosures because the amendments are clarifications on the application of Section 1000.

# SHOPPERS DRUG MART CORPORATION

## Notes to the Consolidated Financial Statements

(unaudited)

(in thousands of dollars except per share amounts)

---

### 3. ACQUISITIONS

#### Centre d'Escomptes Racine

On September 25, 2007, the Company purchased assets of the seven stores of Centre d'Escomptes Racine, a pharmacy chain in Quebec. The operations of the acquired stores have been included in the Company's results of operations from the date of acquisition.

The total cost of the acquisition in cash, including costs incurred in connection with the acquisition, was \$77,530 and was allocated to the net assets on the basis of their fair values as follows:

Net working capital	\$	9,363
Property and equipment		997
Goodwill		54,273
Prescription files <sup>(1)</sup>		12,100
Future income taxes		797
Purchase price	\$	77,530

<sup>(1)</sup>The carrying value of the Company's prescription files is included in other intangible assets in the consolidated balance sheets.

The net change in non-cash working capital balances reported on the consolidated statements of cash flows does not include working capital balances acquired in connection with the Company's acquisition of Centre d'Escomptes Racine, which is included in investing activities.

#### HealthAccess and Information Healthcare Marketing Corp.

On July 2, 2008, the Company acquired the specialty drug assets of the HealthAccess business of Calea Ltd. and 100% of the shares of Calea Ltd.'s wholly owned subsidiary, Information Healthcare Marketing Corp., which operates a related call centre business. The acquired business is based in Mississauga and will operate as Shoppers Drug Mart Specialty Health Network Inc. and will provide comprehensive patient support services for specialty pharmaceutical needs. The assets acquired are composed of primarily goodwill, intangible assets and leasehold improvements at two locations. The total cost of the acquisition in cash, including costs incurred in connection with the acquisition, was \$88,498 and will be allocated between the assets acquired on the basis of their fair values. The purchase price allocation remains preliminary pending finalization of the valuations of the assets and business acquired.

The operations of the acquired assets and business have been included in the Company's results of operations from the date of acquisition.

# SHOPPERS DRUG MART CORPORATION

## Notes to the Consolidated Financial Statements

(unaudited)

(in thousands of dollars except per share amounts)

---

### 3. ACQUISITIONS (continued)

#### Other business acquisitions

During the 16 and 40 weeks ended October 4, 2008, the Company acquired the assets or shares of a number of pharmacies, each of which is individually immaterial to the Company's total acquisitions. The total cost of acquisitions of \$21,745 and \$109,207 (2007 - \$32,738 and \$43,544), respectively, including costs incurred in connection with the acquisitions, is allocated primarily to goodwill and other intangible assets based on their fair values. Certain purchase price allocations are preliminary and may change. The operations of the acquired pharmacies have been included in the Company's results of operations from the date of acquisition.

### 4. INTEREST EXPENSE

The significant components of the Company's interest expense are as follows:

	16 Weeks Ended		40 Weeks Ended	
	October 4, 2008	October 6, 2007	October 4, 2008	October 6, 2007
Interest on bank indebtedness	\$ 3,467	\$ 3,683	\$ 8,318	\$ 7,983
Interest on commercial paper	4,846	7,854	19,880	19,408
Interest on long-term debt	11,787	4,383	19,814	11,297
	\$ 20,100	\$ 15,920	\$ 48,012	\$ 38,688

### 5. EMPLOYEE FUTURE BENEFITS

The net benefit expense included in the results for the 16 and 40 weeks ended October 4, 2008 for benefits provided under pension plans was \$1,807 and \$4,519 (2007 - \$1,991 and \$5,113), respectively, and for benefits provided under other benefit plans was \$31 and \$77 (2007 - \$31 and \$77), respectively.

### 6. STOCK-BASED COMPENSATION

The Company uses the fair value method to account for stock options issued after 2002 under its stock option programs. If compensation expense under the fair value method of accounting had been recognized on stock options issued in 2002, the stock options would have been fully expensed by the end of the Company's fiscal 2007 year; and as a result, there would be no impact on the Company's net earnings for the 16 and 40 weeks ended October 4, 2008 and a reduction in net earnings of \$14 and \$174 for the 16 and 40 weeks ended October 6, 2007. Basic and diluted earnings per share would have remained unchanged for the 16 and 40 weeks ended October 4, 2008 and October 6, 2007.

For a description of the Company's stock option programs, see Note 12 to the consolidated financial statements in the Company's 2007 Annual Report.

# SHOPPERS DRUG MART CORPORATION

## Notes to the Consolidated Financial Statements

(unaudited)  
(in thousands of dollars except per share amounts)

---

### 7. DEBT REFINANCING

On April 22, 2008, the Company completed an amendment to its existing bank credit facility which matures in June of 2011, increasing the size of the facility from \$550,000 to \$800,000. In conjunction with this amendment, the Company also increased its commercial paper program from \$300,000 to \$500,000.

On April 23, 2008, the Company issued \$200,000 of commercial paper to purchase loans provided to Associates by the Trust. The purchase of these loans reduced the outstanding Trust loans to Associates from \$499,000 to \$299,000. In conjunction with this reduction, the standby letter of credit provided by the Company to the Trust as a form of credit enhancement was reduced from \$50,000 to \$30,000.

On May 22, 2008, the Company filed with the securities regulators in each of the provinces of Canada, a final short form base shelf prospectus (the "Prospectus") for the issuance of up to \$1 billion of medium-term notes. Subject to the requirements of applicable law, medium-term notes can be issued under the Prospectus for up to 25 months from May 22, 2008, the date of the final receipt. No incremental debt was incurred by the Company as a result of this filing.

On June 2, 2008, the Company issued \$450,000 of five-year medium-term notes (the "Series 2 Notes") under the Prospectus for aggregate net proceeds of \$448,285. The Series 2 Notes mature on June 3, 2013 and bear interest at a fixed rate of 4.99% per annum.

The net proceeds from the issuance of the Series 2 Notes were used to purchase the remaining outstanding Trust loans to Associates, with the balance applied to reduce outstanding commercial paper issued by the Company. In conjunction with the purchase of all remaining Trust loans to Associates, the \$30,000 standby letter of credit was returned to the Company by the Trust and cancelled.

### 8. FINANCING TRUST

As a result of the debt refinancing described in Note 7 above, the Trust was terminated on June 10, 2008.

### 9. SUBSEQUENT EVENT

On October 17, 2008, the Company entered into a new senior unsecured 364-day bank credit facility in the amount of up to \$200,000. This facility was available for a single drawdown to provide for a partial refinancing of the Company's \$300,000 of medium-term notes maturing on October 24, 2008. On October 23, 2008, the Company elected to drawdown all of this facility to refinance a portion of its \$300,000 of maturing medium-term notes. The balance of funds required to complete the refinancing of the \$300,000 of maturing medium-term notes was drawn from funds available under the Company's pre-existing \$800,000 revolving term bank credit facility maturing June 6, 2011. On October 24, 2008, the \$300,000 of medium-term notes was repaid in full, along with all accrued and unpaid interest owing on the final semi-annual interest payment. On a consolidated basis, after giving effect to the repayment of the maturing medium-term notes, the net debt position of the Company remained substantially unchanged as a result of these refinancing activities.

**SHOPPERS DRUG MART CORPORATION**  
**Exhibit to the Consolidated Financial Statements**  
**(unaudited)**

---

**Earnings Coverage Exhibit to the Consolidated Financial Statements**

52 Weeks Ended October 4, 2008

---

Earnings coverage on long-term debt obligations

37.73 times

---

The earnings coverage ratio on long-term debt (including any current portion) is equal to earnings (before interest and income taxes) divided by interest expense on long-term debt (including any current portion). Interest expense excludes any amounts in respect of amortization that were included in interest expense as shown in the consolidated statement of earnings of the Company for the period.