

# SHOPPERS DRUG MART CORPORATION

## Consolidated Statements of Earnings

(unaudited)

(in thousands of dollars except per share amounts)

	13 Weeks Ended January 3, 2009	12 Weeks Ended December 29, 2007	53 Weeks Ended January 3, 2009	52 Weeks Ended December 29, 2007
<b>Sales</b>	\$ 2,496,799	\$ 2,168,822	\$ 9,422,911	\$ 8,478,382
<b>Operating expenses</b>				
Cost of goods sold and other operating expenses (Note 2)	2,181,389	1,888,377	8,335,038	7,520,033
Amortization	50,477	41,323	205,371	172,075
<b>Operating income</b>	264,933	239,122	882,502	786,274
Interest expense (Note 4)	15,940	14,185	63,952	52,873
<b>Earnings before income taxes</b>	248,993	224,937	818,550	733,401
<b>Income taxes</b> (Note 2)				
Current	64,809	72,286	254,159	249,834
Future	11,133	1,320	(821)	(6,874)
	75,942	73,606	253,338	242,960
<b>Net earnings</b>	\$ 173,051	\$ 151,331	\$ 565,212	\$ 490,441
<b>Net earnings per common share:</b>				
Basic	\$ 0.80	\$ 0.70	\$ 2.60	\$ 2.27
Diluted	\$ 0.80	\$ 0.70	\$ 2.60	\$ 2.26
Weighted average common shares outstanding				
- Basic (millions)	217.1	216.6	217.0	216.1
- Diluted (millions)	217.4	217.4	217.5	217.2
Actual common shares outstanding (millions)	217.3	216.8	217.3	216.8

**SHOPPERS DRUG MART CORPORATION**  
**Consolidated Statements of Retained Earnings**  
(unaudited)  
(in thousands of dollars)

	<b>53 Weeks Ended January 3, 2009</b>	<b>52 Weeks Ended December 29, 2007</b>
<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>	1,207,532
Net earnings	565,212	490,441
Dividends	(186,679)	(138,398)
Premium on share capital purchased for cancellation	(61)	(24)
<b>Retained earnings, end of period</b>	<b>\$ 1,938,023</b>	1,559,551

**Consolidated Statements of Comprehensive Income and Accumulated  
Other Comprehensive (Loss) Income**  
(unaudited)  
(in thousands of dollars)

	<b>13 Weeks Ended January 3, 2009</b>	<b>12 Weeks Ended December 29, 2007</b>	<b>53 Weeks Ended January 3, 2009</b>	<b>52 Weeks Ended December 29, 2007</b>
<b>Net earnings</b>	\$ 173,051	\$ 151,331	\$ 565,212	\$ 490,441
<b>Other comprehensive (loss) income, net of tax</b>				
Change in unrealized gain/loss on interest rate derivatives (net of tax of \$634 and \$1,605 (2007 - \$727 and \$65), respectively)	(1,176)	(1,476)	(3,148)	24
Change in unrealized gain/loss on equity forward derivatives (net of tax of \$93 and \$167 (2007 - \$54 and \$12), respectively)	(186)	(108)	(337)	(23)
Amount of previously unrealized gain/loss recognized in earnings during the period (net of tax of \$143 and \$145 (2007 - \$23 and \$82), respectively)	(200)	(47)	(204)	(160)
<b>Other comprehensive (loss) income</b>	<b>(1,562)</b>	<b>(1,631)</b>	<b>(3,689)</b>	<b>(159)</b>
<b>Comprehensive income</b>	<b>\$ 171,489</b>	<b>\$ 149,700</b>	<b>\$ 561,523</b>	<b>\$ 490,282</b>
<b>Accumulated other comprehensive income, beginning of period</b>			\$ 247	\$ 406
Other comprehensive (loss) income			(3,689)	(159)
<b>Accumulated other comprehensive (loss) income, end of period</b>			<b>\$ (3,442)</b>	<b>\$ 247</b>

# SHOPPERS DRUG MART CORPORATION

## Consolidated Balance Sheets

(unaudited)

(in thousands of dollars)

	January 3, 2009	December 29, 2007
<b>Assets</b>		
Current		
Cash	\$ 36,567	\$ 27,588
Accounts receivable	448,476	372,306
Inventory (Note 2)	1,743,253	1,545,599
Income taxes recoverable	8,835	-
Future income taxes (Note 2)	83,279	69,952
Prepaid expenses and deposits	64,054	134,692
	<b>2,384,464</b>	<b>2,150,137</b>
Property and equipment	1,442,135	1,126,513
Deferred costs	47,213	32,966
Goodwill	2,427,239	2,245,441
Other intangible assets	97,813	57,930
Other assets	20,442	8,990
<b>Total assets</b>	<b>\$ 6,419,306</b>	<b>\$ 5,621,977</b>
<b>Liabilities</b>		
Current		
Bank indebtedness	\$ 240,844	\$ 225,152
Commercial paper (Note 7)	339,957	543,847
Short-term debt	197,845	-
Accounts payable and accrued liabilities	1,018,505	990,545
Income taxes payable (Note 2)	-	65,100
Dividends payable	46,709	34,686
Current portion of long-term debt	-	298,990
	<b>1,843,860</b>	<b>2,158,320</b>
Long-term debt (Note 7)	647,250	-
Other long-term liabilities	303,117	244,657
Future income taxes	46,988	30,171
	<b>2,841,215</b>	<b>2,433,148</b>
Associate interest	118,678	113,119
<b>Shareholders' equity</b>		
Share capital	1,514,207	1,506,020
Contributed surplus	10,625	9,892
Accumulated other comprehensive (loss) income	(3,442)	247
Retained earnings (Note 2)	1,938,023	1,559,551
	<b>1,934,581</b>	<b>1,559,798</b>
	<b>3,459,413</b>	<b>3,075,710</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 6,419,306</b>	<b>\$ 5,621,977</b>

# SHOPPERS DRUG MART CORPORATION

## Consolidated Statements of Cash Flows

(unaudited)

(in thousands of dollars)

	13 Weeks Ended January 3, 2009	12 Weeks Ended December 29, 2007	53 Weeks Ended January 3, 2009	52 Weeks Ended December 29, 2007
<b>Operating activities</b>				
Net earnings (Note 2)	\$ 173,051	\$ 151,331	\$ 565,212	\$ 490,441
Items not affecting cash				
Amortization	55,146	44,932	219,955	181,418
Future income taxes (Note 2)	11,133	1,320	(821)	(6,874)
Loss (gain) on disposal of property and equipment	253	(207)	3,436	4,165
Stock-based compensation	186	581	1,498	3,544
	<b>239,769</b>	<b>197,957</b>	<b>789,280</b>	<b>672,694</b>
Net change in non-cash working capital balances (Notes 2 and 3)	(80,652)	13,622	(325,248)	(134,069)
Increase in other long-term liabilities	9,658	16,227	45,609	48,464
Store opening costs	(12,938)	(7,782)	(30,652)	(22,031)
Cash flows from operating activities	<b>155,837</b>	<b>220,024</b>	<b>478,989</b>	<b>565,058</b>
<b>Investing activities</b>				
Purchase of property and equipment	(204,537)	(146,700)	(521,665)	(395,526)
Proceeds from disposition of property and equipment	6,096	11,220	24,690	18,014
Business acquisitions (Note 3)	(46,196)	(18,759)	(243,901)	(139,833)
Deposits	28,804	(18,873)	88,522	(93,688)
Other assets	38	(668)	(12,212)	(1,714)
Cash flows used in investing activities	<b>(215,795)</b>	<b>(173,780)</b>	<b>(664,566)</b>	<b>(612,747)</b>
<b>Financing activities</b>				
Bank indebtedness, net	(18,550)	(21,757)	15,692	90,665
Commercial paper, net (Note 7)	(4,000)	6,601	(203,350)	40,800
Issuance of short-term debt (Note 7)	200,000	-	200,000	-
Issuance of Series 2 notes (Note 7)	-	-	450,000	-
Revolving term debt, net (Note 7)	200,000	-	200,000	-
Repayment of Series 1 notes (Note 7)	(300,000)	-	(300,000)	-
Financing costs incurred	(2,550)	-	(6,050)	(20)
Associate interest	16,064	10,531	5,559	(3,530)
Proceeds from shares issued for stock options exercised	2,388	3,119	7,144	13,710
Repayment of share purchase loans	69	30	288	325
Repurchase of share capital	(36)	-	(71)	(29)
Dividends paid	(46,677)	(34,657)	(174,656)	(129,509)
Cash flows (used in) from financing activities	<b>46,708</b>	<b>(36,133)</b>	<b>194,556</b>	<b>12,412</b>
<b>(Decrease) increase in cash</b>	<b>(13,250)</b>	<b>10,111</b>	<b>8,979</b>	<b>(35,277)</b>
<b>Cash, beginning of period</b>	<b>49,817</b>	<b>17,477</b>	<b>27,588</b>	<b>62,865</b>
<b>Cash, end of period</b>	<b>\$ 36,567</b>	<b>\$ 27,588</b>	<b>\$ 36,567</b>	<b>\$ 27,588</b>
<b>Supplemental cash flow information</b>				
Interest paid	\$ 26,224	\$ 17,875	\$ 63,893	\$ 50,596
Income taxes paid	\$ 55,720	\$ 115,306	\$ 327,184	\$ 280,393

# **SHOPPERS DRUG MART CORPORATION**

## **Notes to the Consolidated Financial Statements**

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

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### **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 until June 10, 2008, when the arrangement with the Trust was terminated. See Notes 7 and 8 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. See Note 10 for the resulting disclosures from implementation.

# SHOPPERS DRUG MART CORPORATION

## Notes to the Consolidated Financial Statements

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

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### 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. See Note 9 for the resulting disclosures from implementation.

#### 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 12 and 52 weeks ended December 29, 2007 reflect an increase in cost of goods sold and other operating expenses and a decrease in operating income of \$2,943 and \$3,742, respectively, and a decrease in net earnings of \$2,328 and \$3,187, respectively, resulting in a decrease of \$0.01 and \$0.01 in basic and diluted net earnings per share for the 12 and 52 weeks ended December 29, 2007, respectively.

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 was a decrease in inventory of \$31,925, an increase in future income tax asset of \$9,863 and a decrease in income taxes payable of \$725.

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 13 and 53 weeks ended January 3, 2009 was \$1,558,194 and \$5,944,249 (2007 - \$1,360,842 and \$5,406,555), 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

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

#### Going concern

In June 2007, the CICA issued amendments to Section 1400, “General Standards of Financial Statement Presentation”, to include requirements to assess and disclose an entity’s ability to continue as a going concern. The new amendments are effective for interim and annual financial statements for fiscal years beginning on or after January 1, 2008. The Company applied the amendments to Section 1400 at the beginning of its current fiscal year. The implementation did not have an impact on the Company’s results of operations, financial position or disclosures.

#### 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

##### 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; specifically deleting the guidance permitting the deferral of costs. 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 in conjunction with Section 3064, “Goodwill and Intangible Assets”.

##### 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 objective of the new standard is to eliminate the practice of deferring costs that do not meet the definition and recognition criteria of 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.

# SHOPPERS DRUG MART CORPORATION

## Notes to the Consolidated Financial Statements

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

#### Business combinations

In January 2009, the CICA issued new accounting standards concerning Business Combinations (“Section 1582”), Non-controlling Interests (“Section 1602”) and Consolidated Financial Statements (“Section 1601”), which is based on the IASB’s International Financial Reporting Standard 3, “Business Combinations”. The new standards replace the existing guidance on business combinations and consolidated financial statements. The objective of the new standards is to harmonize Canadian accounting for business combinations with the international and U.S. accounting standards. The new standards are to be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011, with earlier application permitted. Assets and liabilities that arose from business combinations whose acquisition dates preceded the application of the new standards shall not be adjusted upon application of these new standards. The Non-controlling Interests standard should be applied retrospectively except for certain items.

The Company is assessing whether it will apply the new accounting standards at the beginning of its 2011 fiscal year or elect to early adopt the new accounting standards at the beginning of its 2010 fiscal year in order to minimize the amount of restatement when the Company adopts International Financial Reporting Standards (“IFRS”). The impact of the new standards on the Company’s results of operations, financial position and disclosures will be assessed as part of the Company’s IFRS transition project.

#### Financial assets and financial liabilities

The EIC issued a new Abstract on January 20, 2009 concerning the measurement of financial assets and financial liabilities (“EIC-173 – Credit Risk and the Fair Value of Financial Assets and Financial Liabilities”). There has been diversity in practice as to whether an entity’s own credit risk and the credit risk of the counterparty are taken into account in determining the fair value of financial instruments. The Committee reached a consensus that these risks should be taken into account in the measurement of financial assets and financial liabilities. The Abstract is effective for all financial assets and financial liabilities measured at fair value in interim and annual financial statements issued for periods ending on or after the date of issuance of the Abstract with retrospective application without restatement of prior periods. The Company will be applying the new Abstract at the beginning of its 2009 fiscal year.

The Company is currently assessing the impact of the Abstract on the measurement of its financial assets and financial liabilities; however, the Company does not expect the implementation to have a significant impact on the Company’s results of operations, financial position and disclosures.

# SHOPPERS DRUG MART CORPORATION

## Notes to the Consolidated Financial Statements

(unaudited)

(in thousands of dollars except per share amounts)

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### 3. ACQUISITIONS

#### 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, Ontario, operates as Shoppers Drug Mart Specialty Health Network Inc. and provides comprehensive patient support services for specialty pharmaceutical needs. The assets acquired are composed primarily of goodwill, intangible assets and leasehold improvements at two locations. The operations of the acquired assets and business 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 \$88,690 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 preliminary cost of the acquisition was allocated to the net assets on the basis of their fair values as follows:

Net working capital	\$	3,886
Property and equipment		488
Goodwill		84,316
Purchase price	\$	88,690

#### 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 \$77,464. This amount includes \$387 of legal fees related to the acquisition recorded in the Company's 2008 fiscal year. The cost of the acquisition was allocated to the net assets on the basis of their fair values as follows:

Net working capital	\$	10,078
Property and equipment		1,337
Goodwill		53,949
Prescription files <sup>(1)</sup>		12,100
Purchase price	\$	77,464

<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.

# 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 13 and 53 weeks ended January 3, 2009, 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 \$45,617 and \$154,824 (2007 - \$18,759 and \$62,756), 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 components of the Company's interest expense are as follows:

	<b>13 Weeks Ended January 3, 2009</b>	12 Weeks Ended December 29, 2007	<b>53 Weeks Ended January 3, 2009</b>	52 Weeks Ended December 29, 2007
Interest on bank indebtedness	\$ 2,266	\$ 2,904	\$ 10,584	\$ 10,887
Interest on commercial paper	3,809	8,389	23,689	27,797
Interest on short-term debt	2,292	-	2,292	-
Interest on long-term debt	7,573	2,892	27,387	14,189
	<b>\$ 15,940</b>	\$ 14,185	<b>\$ 63,952</b>	\$ 52,873

### 5. EMPLOYEE FUTURE BENEFITS

The net benefit expense included in the results for the 12 and 53 weeks ended January 3, 2009 for benefits provided under pension plans was \$1,355 and \$5,874 (2007 - \$1,041 and \$6,154), respectively, and for benefits provided under other benefit plans was \$632 and \$709 (2007 - \$594 and \$671), 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 13 and 53 weeks ended January 3, 2009 and a reduction in net earnings of \$2 and \$176 for the 12 and 52 weeks ended December 29, 2007. Basic and diluted earnings per share would have remained unchanged for the 13 and 53 weeks ended January 3, 2009 and for the 12 and 52 weeks ended December 29, 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)  
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### 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.

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.

On October 17, 2008, the Company entered into a senior, unsecured 364-day bank credit facility in the amount of up to \$200,000; available for a single drawdown. On October 23, 2008, the Company fully utilized this facility to refinance a portion of its \$300,000 medium-term notes that were maturing. This facility bears interest at a floating interest rate based on the prime rate. The debt has been recognized net of the costs of issuance and is valued at amortized cost.

On October 24, 2008, the \$300,000 of Series 1 notes was repaid in full, along with all accrued and unpaid interest owing on the final semi-annual interest payment. The Company financed the repayment with funds from the drawdown of \$200,000 of the senior, unsecured 364-day bank credit facility and \$100,000 from the revolving term facility.

On December 19, 2008, the Company amended the senior, unsecured 364-day bank credit facility to increase the funds available to \$300,000. The additional \$100,000 is available for a single drawdown. Should the Company issue any medium-term notes during the term of the facility, the facility must be repaid in the lesser of: the amount of the medium-term notes issued or the outstanding balance of the facility.

As at January 3, 2009, an additional \$349,889 (2007 - \$61,212) of the \$800,000 revolving term facility was utilized as follows: \$8,889 (2007 - \$61,212) relating to letters of credit and trade finance guarantees and \$341,000 (2007 - \$45,000) relating to commercial paper issued by the Company.

# SHOPPERS DRUG MART CORPORATION

## Notes to the Consolidated Financial Statements

(unaudited)

(in thousands of dollars except per share amounts)

### 7. DEBT REFINANCING (continued)

Subsequent to year end, on January 20, 2009, The Company issued \$500,000 of medium-term notes in two series and the outstanding amount on the senior, unsecured 364-day bank credit facility was repaid and the facility was terminated. See Note 11 for a description of the issuance.

### 8. FINANCING TRUST

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

### 9. FINANCIAL INSTRUMENTS

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
Short-term debt	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 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)  
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### 9. FINANCIAL INSTRUMENTS (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 loss; 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

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### 9. FINANCIAL INSTRUMENTS (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. During the current fiscal year, 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 ranged from 4.03% to 4.18%. Agreements covering \$150,000 of notional principal amount matured in December 2008. The remaining agreements mature as follows: \$50,000 with a fixed rate payable of 4.11% in December 2009 and \$50,000 with a fixed rate payable of 4.18% in December 2010, with reset terms of one month. The Company recorded a net gain of \$332 as interest expense on commercial paper related to the agreements that matured in December 2008.

Based on market values of the interest rate derivative agreements at January 3, 2009, the Company recognized a liability of \$4,647, of which \$1,566 is presented in accounts payable and accrued liabilities and \$3,081 is presented in other long-term liabilities. Based on market values of the interest rate derivative agreements at December 29, 2007, the Company recognized an asset of \$428 in other assets. During the 13 and 12 weeks ended January 3, 2009 and December 29, 2007, the Company assessed that the interest rate derivatives were an effective hedge for the floating interest rates on the associated commercial paper debt. Market values were determined based on information received from the Company's counterparties to these agreements.

During the 13 weeks ended January 3, 2009, an amount previously recorded in accumulated other comprehensive loss of \$186 (2007 – \$nil) was recognized in earnings. During the 53 weeks ended January 3, 2009, an amount previously recorded in accumulated other comprehensive income of \$186 (2007 - \$nil) was recognized in earnings.

#### Equity forward derivatives

Based on market values of the equity forward agreements at January 3, 2009, the Company recognized a liability of \$2,093, of which \$1,006 is presented in accounts payable and accrued liabilities and \$1,087 is presented in other long-term liabilities. Based on market values of equity forward agreements at December 29, 2007, the Company recognized an asset of \$332 in other assets. During the 13 and 12 weeks ended January 3, 2009 and December 29, 2007, the Company assessed that the percentage of the equity forward derivatives related to unearned units under the LTIP were an effective hedge for the common share price of the unearned units. Market values were determined based on information received from the Company's counterparties to these agreements.

During the 13 weeks ended January 3, 2009, an amount previously recorded in accumulated other comprehensive loss of \$14 (2007 – \$47) was recognized in earnings. During the 53 weeks ended January 3, 2009, an amount previously recorded in accumulated other comprehensive income of \$18 (2007 - \$160) was recognized in earnings.

# SHOPPERS DRUG MART CORPORATION

## Notes to the Consolidated Financial Statements

(unaudited)  
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### 9. FINANCIAL INSTRUMENTS (continued)

#### 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 below:

#### Interest rate risk

Interest rate risk is the risk that fair value or future cash flows associated with the Company's financial assets or liabilities will fluctuate due to changes in market interest rates.

The Company, including its Associate-owned store network, is exposed to fluctuations in interest rates by virtue of its borrowings under its bank credit facilities, commercial paper program and financing programs available to its Associates. Increases or decreases in interest rates will positively or negatively impact the financial performance of the Company.

The Company uses interest rate derivatives to manage this exposure and monitors market conditions and the impact of interest rate fluctuations on its fixed and floating rate debt instruments on an ongoing basis. The Company has entered into interest rate derivative agreements converting an aggregate notional principal amount of \$250,000 of floating rate commercial paper debt into fixed rate debt. The fixed rates payable by the Company under the derivative agreements ranged from 4.03% to 4.18%. Agreements covering \$150,000 of notional principal amount matured in December 2008. The remaining agreements mature as follows: \$50,000 with a fixed rate payable of 4.11% in December 2009 and \$50,000 with a fixed rate payable of 4.18% in December 2010, with reset terms of one month.

Furthermore, the Company may be exposed to losses should any counterparty to its derivative agreements fail to fulfill its obligations. The Company has sought to minimize counterparty risk by transacting with counterparties that are large financial institutions. As at January 3, 2009, there is no net exposure (2007 - \$428), as the interest rate derivative agreements are in a liability position.

# SHOPPERS DRUG MART CORPORATION

## Notes to the Consolidated Financial Statements

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### 9. FINANCIAL INSTRUMENTS (continued)

As at January 3, 2009 the Company had \$904,830 of unhedged floating rate debt. During the 13 and 53 weeks ended January 3, 2009, the Company's average outstanding unhedged floating rate debt was \$837,401 and \$484,973, respectively. Had interest rates been higher or lower by 50 basis points during the 13 and 53 weeks ended January 3, 2009, net earnings would have decreased or increased, respectively, by approximately \$726 and \$1,701, respectively, as a result of the Company's exposure to interest rate fluctuations on its unhedged floating rate debt.

#### **Credit risk**

Credit risk is the risk that the Company's counterparties will fail to meet their financial obligations to the Company causing a financial loss.

Accounts receivable arise primarily in respect of prescription sales billed to governments and third-party drug plans and, as a result, collection risk is low. There is no concentration of balances with debtors in the remaining accounts receivable. The Company does not consider its exposure to credit risk to be material.

#### **Liquidity risk**

Liquidity risk is the risk that the Company will be unable to meet its obligations relating to its financial liabilities.

The Company prepares cash flow budgets and forecasts to ensure that it has sufficient funds through operations, access to bank facilities and access to debt and capital markets to meet its financial obligations, capital investment program and fund new investment opportunities or other unanticipated requirements as they arise. The Company manages its liquidity risk as it relates to financial liabilities by monitoring its cash flow from operating activities to meet its short-term financial liability obligations and planning for the repayment of its long-term financial liability obligations through cash flow from operating activities and/or the issuance of new debt.

The contractual maturities of the Company's financial liabilities as at January 3, 2009 are as follows:

**SHOPPERS DRUG MART CORPORATION**  
**Notes to the Consolidated Financial Statements**  
(unaudited)  
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**9. FINANCIAL INSTRUMENTS (continued)**

\$000's	Payments due in the next 90 days	Payments due between 90 days and less than a year	Payments due between 1 year and less than 2 years	Payments due after 2 years	Total
Bank indebtedness	\$ 240,844	\$ -	\$ -	\$ -	\$ 240,844
Commercial paper	341,000	-	-	-	341,000
Short-term debt	-	200,000	-	-	200,000
Accounts payable	964,059	18,876	-	-	982,935
Medium-term note	-	-	-	450,000	450,000
Revolving term facility	-	-	-	200,000	200,000
Other long-term liabilities	48,806	-	12,573	11,157	72,536
<b>Total</b>	<b>\$ 1,594,709</b>	<b>\$ 218,876</b>	<b>\$ 12,573</b>	<b>\$ 661,157</b>	<b>\$ 2,487,315</b>

There is no difference between the carrying value of bank indebtedness and the amount the Company is required to pay. The accounts payable and other long-term liabilities amounts exclude certain liabilities that are not considered financial liabilities.

**10. 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, short-term debt, 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.

**SHOPPERS DRUG MART CORPORATION**  
**Notes to the Consolidated Financial Statements**  
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**10. CAPITAL MANAGEMENT (continued)**

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.

	<b>January 3, 2009</b>	December 29, 2007
Cash	\$ (36,567)	\$ (27,588)
Bank indebtedness	240,844	225,152
Commercial paper	339,957	543,847
Short-term debt	197,845	-
Current portion of long-term debt	-	298,990
Long-term debt	647,250	-
Net debt	1,389,329	1,040,401
Shareholders' equity	3,459,413	3,075,710
Total capitalization	\$ 4,848,742	\$ 4,116,111
Net debt:Shareholders' equity	0.40:1	0.34:1
Net debt:Total capitalization	0.29:1	0.25:1
EBITDA:Cash interest expense <sup>(1)(2)</sup>	17.45:1	18.37:1

<sup>(1)</sup> For purposes of calculating the ratios, EBITDA is comprised of EBITDA for the 53 week and 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 the 53 week and 52 week periods then ended and exclude 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 January 3, 2009:

**SHOPPERS DRUG MART CORPORATION**  
**Notes to the Consolidated Financial Statements**  
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**10. CAPITAL MANAGEMENT (continued)**

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

There were no changes to the Company's credit ratings during the 13 and 53 weeks ended January 3, 2009.

**11. SUBSEQUENT EVENT**

On January 20, 2009, the Company issued \$250,000 of three-year medium-term notes maturing January 20, 2012, which bear interest at a fixed rate of 4.80% (the "Series 3 notes") and \$250,000 of five-year medium-term notes maturing January 20, 2014, which bear interest at a fixed rate of 5.19% (the "Series 4 notes"). The Series 3 notes and the Series 4 notes were issued pursuant to the Prospectus, as supplemented by pricing supplements dated January 14, 2009.

The net proceeds from the issuance of the Series 3 notes and the Series 4 notes were used to refinance existing indebtedness, including repayment of all amounts outstanding under the Company's senior unsecured 364-day bank credit facility. The Company's senior unsecured 364-day bank credit facility was terminated on January 20, 2009.

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

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

53 Weeks Ended January 3, 2009

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Earnings coverage on long-term debt obligations

31.54 times

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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.