

Management's Responsibility for Financial Statements

Management is responsible for the preparation and presentation of the accompanying consolidated financial statements and all other information in the Annual Report. This responsibility includes the selection and consistent application of appropriate accounting principles and methods in addition to making the judgements and estimates necessary to prepare the consolidated financial statements in accordance with Canadian generally accepted accounting principles. It also includes ensuring that the financial information presented elsewhere in the Annual Report is consistent with the consolidated financial statements.

In fulfilling its responsibilities, management has developed and maintains systems of internal controls. Although no cost-effective system of internal controls will prevent or detect all errors and irregularities, these systems are designed to provide reasonable assurance that resources are safeguarded from material loss or inappropriate use, that transactions are authorized, recorded and reported properly and that financial records are reliable for preparing the consolidated financial statements. Internal auditors, who are employees of the Company, review and evaluate internal controls on management's behalf. The consolidated financial statements have been audited by the independent auditors, Deloitte & Touche LLP, in accordance with generally accepted auditing standards. Their report follows.

The Board of Directors, acting through an Audit Committee which is comprised solely of directors who are not employees of the Company, is responsible for determining that management fulfils its responsibility for financial reporting and internal control. This responsibility is carried out through periodic meetings with senior officers, financial management, internal audit and the independent auditors to discuss audit activities, the adequacy of internal financial controls and financial reporting matters. The Audit Committee has reviewed these consolidated financial statements and the Management's Discussion and Analysis and has recommended their approval by the Board of Directors prior to their inclusion in this Annual Report.



Glenn Murphy

CHAIRMAN AND CHIEF EXECUTIVE OFFICER



George Halatsis

EXECUTIVE VICE-PRESIDENT AND CHIEF FINANCIAL OFFICER

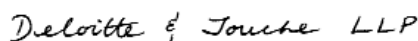
Auditors' Report

To the Shareholders of Shoppers Drug Mart Corporation

We have audited the consolidated balance sheets of Shoppers Drug Mart Corporation as at December 31, 2005 and January 1, 2005 and the consolidated statements of earnings, retained earnings and cash flows for the 52 week periods then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of Shoppers Drug Mart Corporation as at December 31, 2005 and January 1, 2005 and the results of its operations and its cash flows for the 52 week periods then ended, in accordance with Canadian generally accepted accounting principles.



Chartered Accountants

TORONTO, ONTARIO
FEBRUARY 8, 2006

Consolidated Statements of Earnings

52 weeks ended December 31, 2005 and January 1, 2005
(in thousands of dollars, except per share amounts)

	2005	2004
		(Note 2)
Sales	\$ 7,151,115	\$ 6,566,399
Operating expenses		
Cost of goods sold and other operating expenses	6,430,933	5,927,548
Amortization	120,937	102,157
Operating income	599,245	536,694
Interest expense (Note 4)	48,649	60,872
Earnings before income taxes	550,596	475,822
Income taxes (Note 5)		
Current	177,197	160,093
Future	8,905	8,407
	186,102	168,500
Net earnings	\$ 364,494	\$ 307,322
Net earnings per common share (Note 11):		
Basic	\$ 1.72	\$ 1.48
Diluted	\$ 1.69	\$ 1.43

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Retained Earnings

52 weeks ended December 31, 2005 and January 1, 2005
(in thousands of dollars)

	2005	2004
		(Note 2)
Retained earnings, beginning of period as reported	\$ 733,682	\$ 417,940
Impact of the adoption of new accounting standard, Accounting Guideline 15, "Consolidation of Variable Interest Entities" (Note 2)	(71,245)	(62,697)
Retained earnings, as restated	662,437	355,243
Net earnings	364,494	307,322
Premium on share capital purchased for cancellation (Note 11)	(13)	(128)
Dividends	(85,246)	-
Retained earnings, end of period	\$ 941,672	\$ 662,437

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Balance Sheets

As at December 31, 2005 and January 1, 2005
(in thousands of dollars)

	2005	2004
		(Note 2)
Assets		
Current		
Cash	\$ 24,524	\$ 14,136
Accounts receivable	256,504	237,590
Inventory	1,216,549	1,135,725
Future income taxes (Note 5)	38,316	35,728
Prepaid expenses	29,018	38,941
	1,564,911	1,462,120
Long-term receivables	2,946	3,277
Property and equipment (Note 6)	748,840	617,337
Deferred costs (Note 7)	21,562	21,180
Goodwill	2,019,499	2,000,642
Other intangible assets (Note 8)	17,625	12,850
Total assets	\$ 4,375,383	\$ 4,117,406
Liabilities		
Current		
Bank indebtedness	\$ 163,503	\$ 202,732
Commercial paper (Note 4)	469,850	303,175
Accounts payable and accrued liabilities	697,945	691,270
Income taxes payable	39,860	46,072
Dividends payable	21,343	-
Current portion of long-term debt (Note 9)	-	25,000
	1,392,501	1,268,249
Long-term debt (Note 9)	325,000	554,943
Other long-term liabilities (Note 10)	140,758	96,726
Future income taxes (Note 5)	14,115	1,063
	1,872,374	1,920,981
Associate interest (Note 2)	116,501	110,367
Shareholders' equity		
Share capital (Note 11)	1,441,254	1,421,980
Contributed surplus (Note 11)	3,582	1,641
Retained earnings (Note 2)	941,672	662,437
	2,386,508	2,086,058
Total liabilities and shareholders' equity	\$ 4,375,383	\$ 4,117,406

The accompanying notes are an integral part of these consolidated financial statements.

On behalf of the Board of Directors:



Glenn Murphy
DIRECTOR



David M. Williams
DIRECTOR

Consolidated Statements of Cash Flows

52 weeks ended December 31, 2005 and January 1, 2005
(in thousands of dollars)

	2005	2004
		(Note 2)
Operating activities		
Net earnings	\$ 364,494	\$ 307,322
Items not affecting cash		
Amortization	128,530	110,400
Future income taxes	8,905	8,407
Loss on disposal of property and equipment	4,283	2,400
Stock-based compensation (Note 11)	1,941	1,425
	508,153	429,954
Net change in non-cash working capital balances (Note 12)	(89,352)	(148,011)
Long-term liabilities	44,032	40,280
Store opening costs	(12,258)	(10,841)
Cash flows from operating activities	450,575	311,382
Investing activities		
Purchase of property and equipment	(249,973)	(230,842)
Business acquisitions	(24,540)	(22,513)
Long-term receivables	331	130
Cash flows used in investing activities	(274,182)	(253,225)
Financing activities		
Bank indebtedness, net	(39,229)	(134,783)
Commercial paper, net	166,675	133,175
Repayment of long-term debt (Note 9)	(250,000)	(75,000)
Revolving term debt, net	(4,943)	4,943
Associate interest (Note 2)	6,134	2,555
Shares issued for stock options exercised	17,797	4,057
Repayment of share purchase loans	1,480	6,107
Repurchase of share capital	(16)	(190)
Dividends paid	(63,903)	-
Cash flows used in financing activities	(166,005)	(59,136)
Increase (decrease) in cash	10,388	(979)
Cash, beginning of period	14,136	15,115
Cash, end of period	\$ 24,524	\$ 14,136
Supplemental cash flow information		
Interest paid	\$ 38,829	\$ 57,065
Income taxes paid	\$ 191,232	\$ 142,438

The accompanying notes are an integral part of these consolidated financial statements.

Notes to the Consolidated Financial Statements

December 31, 2005 and January 1, 2005 (in thousand of dollars, except per share data)

1. Basis of Presentation

Shoppers Drug Mart Corporation (“the Company”) is a licensor of approximately 950 Shoppers Drug Mart/Pharmaprix full-service retail drug stores across Canada. The Shoppers Drug Mart/Pharmaprix stores are licensed to Associate-owners (“Associates”). In addition, the Company owns and operates 51 Shoppers Home Health Care stores. Under Accounting Guideline 15, “Consolidation of Variable Interest Entities”, the Company consolidates the Associate-owned stores and the Financing Trust (see Note 2).

The fiscal year of the Company consists of a 52 or 53 week period ending on the Saturday closest to December 31. The Company’s 2005 and 2004 fiscal years consisted of a 52 week period.

2. Change in Accounting Policy

Accounting Guideline 15, Consolidation of Variable Interest Entities

In June 2003, the Canadian Institute of Chartered Accountants (“CICA”) issued Accounting Guideline 15, “Consolidation of Variable Interest Entities” (“AcG-15”), requiring the consolidation of variable interest entities (“VIEs”) where a company is the primary beneficiary. In September 2003, the Accounting Standards Board of the CICA delayed the effective date of the implementation of AcG-15 until annual and interim periods beginning on or after November 1, 2004. The standard provided for implementation on a retroactive basis with or without restatement. A VIE is any type of legal structure in which control is determined through contractual or other financial arrangements, as opposed to traditional voting rights, if certain conditions exist. A primary beneficiary is an entity that will absorb a majority of a VIE’s expected losses, receive a majority of the expected residual returns, or both, and is therefore required to consolidate the VIE.

Associate-owned Stores

The Company has determined that the individual Associate-owned stores that comprise the Company’s store network are deemed to be VIEs and the Company is the primary beneficiary. As such, the Associate-owned stores are subject to consolidation by the Company. The Company has adopted AcG-15 with restatement of its results for the prior year in order to improve the comparability of those results. In conjunction with the adoption of AcG-15, there are certain adjustments that have been reflected in the Company’s fiscal 2004 financial position, cash flows and results of operations, as restated for comparative purposes. As the Associate-owned stores remain separate legal entities, consolidation of the Associate-owned stores has no impact on the underlying risks facing the Company.

Under AcG-15, the Company’s consolidated balance sheets include in assets the cash, third-party receivables, inventory and other assets, and the liabilities reflect the inclusion of trade payables, deferred lease obligations and third-party debt of the Associate-owned corporations. Amounts that were previously reported as receivable from Associate-owned stores have been eliminated upon consolidation. Associates’ equity in their corporations is shown on the consolidated balance sheets of the Company as Associate interest.

Under AcG-15, the Company includes the results of operations of its Associate-owned store network in its consolidated statements of earnings. Sales include the combined sales to external customers of the retail drug stores owned by the Associates and of the home health care stores owned by the Company. The Associates’ share of store profit is included in cost of goods sold and other operating expenses.

Notes to the Consolidated Financial Statements (continued)

December 31, 2005 and January 1, 2005 (in thousand of dollars, except per share data)

2. Change in Accounting Policy (continued)

The impact of the Company no longer recognizing its share of Associate-owned store profits throughout the year by way of a service fee, calculated as a percentage of sales based on annual store profitability, is a lower share of Associate store profits in the first three quarters of 2004 and a larger share in the fourth quarter. On a full year basis, the adoption of AcG-15 has no impact on the Company's share of Associate-owned store profits.

The Company adopted EIC-144, "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor", retroactively in the first quarter of 2004. The Company recognized cash consideration received from vendors in income as a reduction to cost of goods sold when the related inventory was shipped from its distribution centres to the Associate-owned stores. Upon consolidation of the Associate-owned stores under AcG-15, the recognition of cash consideration received from vendors occurs when the Associate-owned inventory is sold to customers. In addition, certain other adjustments have been recorded related primarily to changes made to store accounting policies in the areas of lease accounting and store opening costs upon the adoption of AcG-15.

The non-cash, timing-related adjustments resulting from the adoption of AcG-15 have impacted the fiscal 2004 comparative amounts as follows:

	52 Weeks Ended January 1, 2005
Fiscal 2004 impact	
Share of Associate-owned store profits	\$ –
EIC-144	(11,073)
Lease accounting, store opening costs and other adjustments	(2,524)
Total adjustments – pre-tax	(13,597)
Income tax	5,049
Net earnings impact	\$ (8,548)
Net earnings – reported	\$ 315,870
Earnings per share (diluted)	\$ 1.47
Net earnings restated for comparative purposes	\$ 307,322
Earnings per share (diluted)	\$ 1.43

The non-cash, timing-related adjustments resulting from the adoption of AcG-15 have impacted the opening retained earnings amounts as follows:

	2005	2004
Opening retained earnings adjustment		
EIC-144	\$ (77,212)	\$ (66,139)
Lease accounting, store opening costs and other adjustments	(33,892)	(31,368)
Total adjustments	(111,104)	(97,507)
Income tax	39,859	34,810
Retained earnings adjustment	\$ (71,245)	\$ (62,697)

Financing Trust

During the fourth quarter of 2004, the Company arranged for its Associates to obtain additional financing from an independent trust (the "Trust"). This arrangement was created to provide loans to facilitate the Associates' purchase of inventory and fund their working capital requirements. The Trust's activities are financed through the issuance of short-term, asset-backed notes to third-party investors. The Company has determined that the Trust is a VIE and that the Company is the primary beneficiary. As such, the Trust is subject to consolidation by the Company. See Note 13 for further discussion of the Trust.

The impact of consolidating the Trust is the reclassification of Associate loans payable to the Trust to commercial paper issued to third parties.

3. Significant Accounting Policies

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles.

Basis of Consolidation

The consolidated financial statements include the accounts of Shoppers Drug Mart Corporation, its subsidiaries, the Associate-owned stores that comprise the Company's store network and the above-mentioned Trust.

Revenue Recognition

Sales include the combined sales to external customers of the retail drug stores owned by the Associates and of the home health care stores owned by the Company and are recognized at the time goods are sold, net of returns.

Bank Indebtedness

Bank indebtedness is comprised of corporate bank overdraft balances and bank lines of credit used by the Associate-owned stores to meet their operating needs and outstanding cheques.

Inventory

Inventory is valued at the lower of cost and estimated net realizable value, with cost being determined on the first-in, first-out basis.

Property and Equipment

Property and equipment are recorded at cost. Amortization is recorded on a straight-line basis over the estimated useful lives of the assets at the rates indicated below:

Buildings	20 years
Equipment and fixtures	3 to 10 years
Computer software and equipment	2 to 10 years
Leasehold improvements	Lesser of term of the lease and useful life

Long-lived assets are tested for impairment when events or circumstances indicate their carrying value exceeds the sum of the undiscounted cash flows expected from their use and eventual disposal. An impairment loss is measured as the amount by which the long-lived assets' carrying value exceeds the fair value. The Company reviews long-lived assets for impairment annually.

Notes to the Consolidated Financial Statements

December 31, 2005 and January 1, 2005 (in thousand of dollars, except per share data)

3. Significant Accounting Policies (continued)

Deferred Costs

Financing Costs

Deferred financing costs are amortized on a straight-line basis over the term of the debt to which they relate. Any unamortized amounts are charged against earnings when the related debt has been settled.

Store Opening Costs

Certain costs associated with the opening of new and relocated stores are deferred and amortized into cost of goods sold and other operating expenses over a period of three years.

Goodwill and Other Intangible Assets

The Company records as goodwill the excess amount of the purchase price of an acquired business over the fair value of the underlying net assets, including intangible assets, at the date of acquisition. Goodwill is not amortized but is tested for impairment on an annual basis. In the event of an impairment, the excess of the carrying amount over the fair value of these assets would be charged to earnings. Intangible assets, consisting of acquired prescription files, are amortized over their expected useful lives of seven years.

Leases

The Company leases most of its store locations and office space. Terms vary in length and typically permit renewal for additional periods. Minimum rent, including scheduled escalations, is expensed on a straight-line basis over the term of the lease, including any rent free periods. The Company capitalizes rent expense during a store's fixturing period to leasehold improvements. Landlord inducements are deferred and amortized as reductions to rent expense on a straight-line basis over the same period.

Leases may include additional payments for real estate taxes, maintenance and insurance. These amounts are expensed in the period to which they relate.

Shoppers Optimum™ Loyalty Program

The Shoppers Optimum™ loyalty card program (the "Program") allows members to earn points on their purchases in Shoppers Drug Mart, Pharmaprix and Shoppers Home Health Care stores at a rate of 10 points for each dollar spent on eligible products and services, plus any applicable bonus points. Members can then redeem points, in accordance with the Program rewards schedule or other offers, for discounts on front store merchandise at the time of a future purchase transaction. When points are earned by Program members, the Company records an expense and establishes a liability for future redemptions by multiplying the number of points issued by the estimated cost per point. The Program liability is included in accounts payable and accrued liabilities on the Company's consolidated balance sheets. The actual cost of Program redemptions is charged against the liability account.

The estimated cost per point is determined based on many factors, including the historical behaviour of Program members, expected future redemption patterns and associated costs. The Company monitors, on an ongoing basis, trends in redemption rates (points redeemed as a percentage of points issued) and net redemption values and adjusts the estimated cost per point based upon expected future activity. To the extent that estimates differ from actual experience, the Program costs could be higher or lower.

Employee Future Benefits

The Company accrues its obligations for employee benefit plans under the following policies:

- The cost of pensions and other retirement benefits earned by employees is actuarially determined using the projected benefit method pro-rated on service and management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and expected health care costs.
- For the purpose of calculating the expected return on plan assets, those assets are valued at fair value.
- The excess of the net actuarial gain (loss) over 10% of the greater of the benefit obligation and the fair value of plan assets is amortized over the average remaining service period of active employees. The average remaining service period of the active employees covered by the pension plans and other retirement benefit plans is 14 and 10 years, respectively.

Stock-based Compensation

The Company has stock option compensation plans which are described in Note 11. Compensation expense is recognized for these plans for stock options granted to employees and directors after December 28, 2002 using the fair value method. Any consideration paid by employees and directors on exercise of stock options is credited to share capital.

Income Taxes

The Company accounts for income taxes using the liability method of accounting. Under the liability method, future income tax assets and liabilities are determined based on differences between the carrying amounts of balance sheet items and their corresponding tax values. The liability method requires the computation of future income taxes using the substantively enacted corporate income tax rates for the years in which the differences are expected to reverse.

Derivative Financial Instruments

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

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, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

Associate Interest

Associate interest reflects the investment the Associates have in the net assets of their corporations.

Estimates

The preparation of the consolidated financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates are used when accounting for items such as inventory provisions, Shoppers Optimum™ loyalty card program costs, assumptions underlying the actuarial determination of employee future benefits, income taxes and testing goodwill and long-lived assets for impairment. Changes in those estimates could materially affect the consolidated financial statements.

Notes to the Consolidated Financial Statements (continued)

December 31, 2005 and January 1, 2005 (in thousand of dollars, except per share data)

3. Significant Accounting Policies (continued)

Comparative Amounts

Certain comparative amounts have been reclassified to conform with the current year's financial statement presentation.

4. Interest Expense

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

	2005	2004
Interest on bank indebtedness	\$ 6,700	\$ 12,081
Interest on commercial paper	18,326	10,220
Interest on long-term debt	21,066	36,076
Amortization of deferred financing costs	2,557	2,495
	\$ 48,649	\$ 60,872

Commercial paper is issued with maturities from overnight to 90 days at floating interest rates based on Bankers' Acceptance rates. 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 fixed rates payable by the Company under these agreements ranged from 4.03% to 4.18%. See Note 14 for further discussion of the derivative agreements.

5. Income Taxes

The effective income tax rate is comprised of the following:

	2005	2004
Combined Canadian federal and provincial statutory tax rate	35.0%	35.1%
Adjusted for:		
Income not subject to tax	(1.2%)	-
Non-deductible charges and other	-	0.3%
Effective income tax rate	33.8%	35.4%

The significant components of the Company's future income tax assets and liabilities are as follows:

	2005	2004
Current		
Deferred income	\$ 30,504	\$ 27,039
Accrued liabilities	9,096	7,654
Share issuance costs	26	2,193
Other	(1,310)	(1,158)
	\$ 38,316	\$ 35,728
Long-term		
Depreciable assets	\$ (34,391)	\$ (18,984)
Other long-term liabilities	27,700	23,036
Deferred costs	(4,959)	(3,476)
Share issuance costs	-	26
Other	(2,465)	(1,665)
	\$ (14,115)	\$ (1,063)

The Company has \$41,206 of capital losses available to be applied against future capital gains. No income tax benefit related to the losses has been recognized.

6. Property and Equipment

	2005			2004		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Land	\$ 40,565	\$ –	\$ 40,565	\$ 33,487	\$ –	\$ 33,487
Buildings	75,638	21,110	54,528	73,083	17,793	55,290
Equipment, fixtures and computer software	608,837	285,953	322,884	501,079	227,895	273,184
Leasehold improvements	451,118	120,255	330,863	353,441	98,065	255,376
	\$ 1,176,158	\$ 427,318	\$ 748,840	\$ 961,090	\$ 343,753	\$ 617,337

7. Deferred Costs

	2005			2004		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Financing costs	\$ 14,587	\$ 11,194	\$ 3,393	\$ 14,587	\$ 8,637	\$ 5,950
Store opening costs	42,009	23,840	18,169	29,751	14,521	15,230
	\$ 56,596	\$ 35,034	\$ 21,562	\$ 44,338	\$ 23,158	\$ 21,180

The Company amortized \$2,557 (2004 – \$2,495) of deferred financing costs into interest expense and \$9,319 (2004 – \$8,148) of store opening costs into cost of goods sold and other operating expenses during the year.

8. Other Intangible Assets

	2005			2004		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Prescription files	\$ 22,396	\$ 4,771	\$ 17,625	\$ 15,057	\$ 2,207	\$ 12,850

The Company amortized \$2,564 (2004 – \$1,442) of prescription files into cost of goods sold and other operating expenses during the year.

Notes to the Consolidated Financial Statements (continued)

December 31, 2005 and January 1, 2005 (in thousand of dollars, except per share data)

9. Long-term Debt

	Maturity	2005	2004
Medium-term notes Series 1 – 4.97%	October 2008	\$ 300,000	\$ 300,000
Non-revolving term facilities	January 2007	25,000	275,000
		\$ 325,000	\$ 575,000
\$250,000 revolving term facility	February 2007	–	4,943
		\$ 325,000	\$ 579,943
Less current portion of long-term debt		–	25,000
		\$ 325,000	\$ 554,943

The non-revolving and revolving term facilities bear interest based on Prime and Bankers' Acceptance rates.

In addition to the bank credit facilities described in the table, the Company has a 364-day extendible revolving credit facility of \$300,000 to support the Company's commercial paper program.

As at December 31, 2005, \$48,116 of the \$250,000 revolving term facility was utilized, all in respect of letters of credit and trade finance guarantees, of which \$43,000 relates to a letter of credit for the benefit of the independent trust (Note 13). As at January 1, 2005, \$30,790 of the \$250,000 revolving term facility was utilized, including drawings of \$25,847 in respect of letters of credit and trade finance guarantees, of which \$20,500 relates to a letter of credit for the benefit of the independent trust (Note 13).

Minimum Repayments

Future minimum required repayments of long-term debt for the next three calendar years are as follows:

Term facility		
2007		\$ 25,000
Medium-term notes		
2008		300,000
		\$ 325,000

10. Other Long-term Liabilities

Other long-term liabilities are comprised as follows:

	2005	2004
Deferred rent obligation	\$ 121,958	\$ 82,512
Employee future benefits	10,988	9,558
Other	7,812	4,656
	\$ 140,758	\$ 96,726

Deferred Rent Obligation

The deferred rent obligation represents the difference between rent expense and cash rent payments and the deferral of landlord inducements. Landlord inducements are amortized as reductions to rent expense on a straight-line basis over the term of the lease.

Employee Future Benefits

The Company maintains registered defined benefit pension plans under which benefits are available to certain employee groups. The Company also makes supplementary retirement benefits available to certain employees under a non-registered pension plan.

The pension plans are funded through contributions based on actuarial cost methods as permitted by pension regulatory bodies as applicable. Earnings are charged with the cost of benefits earned by employees as services are rendered. Benefits under these plans are based on the employee's years of service and final average earnings.

The most recent actuarial valuations of the registered plans for funding purposes were performed as at December 31, 2003 and January 1, 2005 and the next valuations will be required as at December 31, 2006. The most recent actuarial valuation of the non-registered plan for funding purposes was as at December 31, 2005 and the next valuation will be required as at December 31, 2006.

The Company also maintains post-retirement benefit plans, other than pensions, covering benefits such as health and life insurance benefits for retirees. The cost of these plans is charged to earnings as benefits are earned by employees on the basis of service rendered.

Included in other long-term liabilities are employee future benefits in the amount of \$10,988 as at December 31, 2005 and \$9,558 as at January 1, 2005 in respect of pension and other post-retirement benefit plans.

Information about the Company's pension and other post-retirement benefit plans, measured at November 30, 2005 and 2004, respectively, is as follows:

	2005		2004	
	Pension Plans	Other Benefit Plans	Pension Plans	Other Benefit Plans
Fair value of plan assets				
Fair value of plan assets, beginning of period	\$ 61,245	\$ -	\$ 55,122	\$ -
Actual return on plan assets	4,594	-	4,228	-
Company contribution	4,098	298	3,907	357
Participant contributions	931	-	958	-
Benefits paid	(3,150)	(298)	(2,970)	(357)
Fair value of plan assets, end of period	\$ 67,718	\$ -	\$ 61,245	\$ -
Accrued benefit obligation				
Benefit obligation, beginning of period	\$ 78,546	\$ 3,998	\$ 75,951	\$ 3,411
Service cost	4,683	353	5,081	722
Interest cost	3,557	249	3,639	222
Participant contributions	931	-	958	-
Plan amendments	(684)	-	(289)	-
Actuarial loss (gain)	10,510	-	(3,824)	-
Benefits paid	(3,150)	(298)	(2,970)	(357)
Accrued benefit obligation, end of period	\$ 94,393	\$ 4,302	\$ 78,546	\$ 3,998
Funded status – plan deficit	\$ (26,675)	\$ (4,302)	\$ (17,301)	\$ (3,998)
Unrecognized plan amendments	(1,909)	-	(1,369)	-
Unrecognized losses	21,898	-	13,110	-
Accrued benefit liability	\$ (6,686)	\$ (4,302)	\$ (5,560)	\$ (3,998)

Notes to the Consolidated Financial Statements (continued)

December 31, 2005 and January 1, 2005 (in thousand of dollars, except per share data)

10. Other Long-term Liabilities (continued)

The significant actuarial assumptions adopted are as follows:

	2005			2004		
	Registered Pension Plans	Non-registered Pension Plan	Other Benefit Plans	Registered Pension Plans	Non-registered Pension Plan	Other Benefit Plans
Accrued benefit obligation, end of period						
Discount rate	5.00%	2.50%	5.00%	5.75%	2.88%	5.75%
Compensation increase	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
Benefit expense, for the period						
Discount rate	5.75%	2.88%	5.75%	6.00%	3.00%	6.00%
Expected return on assets	7.50%	3.75%	N/A	7.50%	3.75%	N/A
Compensation increase	4.00%	4.00%	4.00%	4.50%	4.50%	4.50%

The health care cost trend rates used were 5.5% for 2005 and 2004, with 5.5% being the ultimate trend rate for later years. A 1% change in the assumed health care cost trend rate would not have a significant effect on the amounts reported for other benefit plans.

The components of the Company's pension and other post-retirement benefit plans expense are as follows:

	2005		2004	
	Pension Plans	Other Benefit Plans	Pension Plans	Other Benefit Plans
Service costs	\$ 4,683	\$ 353	\$ 5,081	\$ 722
Interest cost	3,557	249	3,639	222
Actual return on plan assets	(4,594)	–	(4,228)	–
Actuarial loss (gain)	10,510	–	(3,824)	–
Plan amendments	(684)	–	(289)	–
Costs arising from events of the period	13,472	602	379	944
Difference between:				
Actual and expected return on plan assets	1,301	–	1,298	–
Actuarial gain or loss recognized for the year and actual actuarial gain or loss on accrued benefit obligation	(10,084)	–	4,649	–
Amortization of plan amendment and actual plan amendments	540	–	169	–
Net expense	\$ 5,229	\$ 602	\$ 6,495	\$ 944

Total cash payments for employee future benefits consist of the Company's contributions to the pension plans and cash payments made directly to beneficiaries of the other benefit plans and totalled \$4,396 (2004 – \$4,264).

The assets of the registered pension plans consist of cash, contributions receivable and a proportionate share of a master trust. The assets held by the master trust are invested in a limited number of pooled funds, based on market values as at November 30, 2005 and 2004, respectively, as follows:

	2005	2004
Equity	59%	60%
Fixed income	40%	40%
Cash and cash equivalents	1%	-

The assets of the non-registered plan consist of cash and investments. The investments are in pooled funds with an allocation of 60% equities and 40% bonds based on market values as at November 30, 2005 and 2004, respectively.

11. Share Capital

Authorized

Unlimited number of common shares

Unlimited number of preferred shares, issuable in series without nominal or par value

Outstanding

	2005		2004	
	Number of Common Shares	Stated Value	Number of Common Shares	Stated Value
Beginning balance	209,990,845	\$ 1,421,980	209,724,407	\$ 1,411,878
Shares issued	3,440,419	17,797	275,632	5,008
Shares repurchased	(520)	(3)	(9,194)	(62)
Share purchase loans, net	-	1,480	-	5,156
Ending balance	213,430,744	\$ 1,441,254	209,990,845	\$ 1,421,980

Weighted Average Shares Outstanding

December 31, 2005

Basic	211,814,577
Diluted	216,088,118

January 1, 2005

Basic	208,149,810
Diluted	214,942,244

The common shares that may be issued under the Company's stock option plans, including contingently returnable shares issued as part of those plans, have a dilutive impact on the weighted average number of shares of 4,273,541 (2004 – 6,792,434).

Individual shareholder agreements address matters related to the transfer of certain shares issued to the Company's management and Associates, including shares issued under options granted to management. In particular, each provides, subject to certain exceptions, for a general prohibition on any transfer of a member of management's or Associate's shares for a period of five years from the date that the individual entered into the shareholder agreement. As at December 31, 2005, 251,355 and 27,242 shares issued to management and Associates, respectively, are subject to this restriction.

11. Share Capital (continued)

The Company has issued loans to certain key employees under a stock purchase plan to acquire common shares of the Company. The share purchase loans receivable are non-interest bearing, mature in 2007 to 2010, are subject to certain terms of repayment pursuant to a shareholder's agreement and are secured by the shares to which the loans relate. Share purchase loans are presented as a reduction in share capital and the related shares are deducted in the determination of the weighted average shares outstanding for purposes of the basic net earnings per common share calculation.

Stock-based Compensation

The Company has established stock option plans for certain employees and its Board of Directors as described below and has reserved 20,000,000 common shares for issuance under the plans. The Company has established a deferred share unit plan for non-employee directors, which plan is also described below.

In 2003, the Company adopted the guidance of accounting standard 3870, "Stock-based Compensation and Other Stock-based Payments", on a prospective basis. The guidance requires the use of the fair value method to account for stock options issued under employee and director stock option programs. The Company expensed \$1,973 associated with stock options issued in 2005 (2004 – \$1,426) under the employee and director plans.

If compensation expense under the fair value method of accounting had been recognized on stock options issued in 2002, the Company's net earnings for the periods ended December 31, 2005 and January 1, 2005 would have been reduced by \$1,176 and \$1,926, respectively. Basic earnings per share would have been unchanged and \$1.47, respectively, and diluted earnings per share would have been \$1.68 and \$1.42, respectively.

The fair value of each option was estimated on the date of the grant using the Black-Scholes option-pricing model. There were no options granted under the employee stock option plan in 2005. The following weighted average assumptions were used to calculate the option value for options issued under the director option plan:

	Director Plan
Fair value per option	\$ 13.28
Valuation assumptions	
Expected life	6.5 years
Expected dividends	1.00%
Expected volatility	27.6%
Risk-free interest rate	3.68%

Employee Stock Option Plan

Options issued to certain employees have an exercise price per share of no less than the fair market value on the date of the option grant and are granted in equal proportions between time-based vesting and performance-based vesting criteria. Time-based options are exercisable 20% per year on the anniversary of the grant date in each of the five subsequent years. Performance-based options are exercisable 20% per year on the anniversary of the grant date in each of the five subsequent years provided that the Company achieves specified earnings-based performance targets. Performance targets not achieved are considered to be met if the performance is achieved on a cumulative basis in subsequent years. The performance-based options become fully exercisable on the ninth anniversary of the date of grant, provided that they have not otherwise been terminated, whether or not the performance targets are achieved.

Upon the termination of an optionee's employment, all unexercisable options expire immediately and exercisable options expire within 180 days of the date of termination. The plan provides that the Company may pay, in cash, certain terminated option holders the appreciated value of the options to cancel exercisable options.

Subject to certain prior events of expiry, such as the termination of the employee's employment for cause, all exercisable options expire on the tenth anniversary of the date of grant.

A summary of the status of the employee stock option plan and changes during the period are presented below:

	2005		2004	
	Options on Common Shares	Weighted Average Exercise Price Per Share	Options on Common Shares	Weighted Average Exercise Price Per Share
Outstanding, beginning of period	7,305,409	\$ 7.70	7,185,592	\$ 7.11
Granted	–	–	207,108	31.64
Exercised	(3,260,419)	5.16	(61,114)	11.07
Forfeited/Cancelled including repurchased	(29,165)	24.73	(26,177)	26.78
Outstanding, end of period	4,015,825	\$ 9.65	7,305,409	\$ 7.70
Options exercisable, end of period	2,904,482	\$ 7.93	5,091,128	\$ 6.06

	2005 Outstanding Options			2005 Exercisable Options	
Range of Exercise Price	Number of Options Outstanding	Weighted Average Contractual Life (Years)	Weighted Average Exercise Price Per Share	Number of Exercisable Options	Weighted Average Exercise Price Per Share
\$ 5.00 – \$ 5.60	3,045,475	5.2	\$ 5.37	2,435,973	\$ 5.34
\$17.13 – \$24.84	718,752	6.3	20.47	413,621	20.33
\$25.86 – \$26.57	59,334	7.7	26.04	20,767	26.04
\$29.30 – \$36.41	192,264	8.4	31.82	34,121	31.43
	4,015,825	5.6	\$ 9.65	2,904,482	\$ 7.93

Director Stock Option Plan

Under the director stock option plan, each director is issued time-based options to purchase 60,000 common shares. The options have an exercise price per share at fair market value on the date of the option grant, which is normally the date the optionee becomes a director. One-third of the options become exercisable in each of the following three years on the anniversary of the date of grant. Unexercisable options expire upon the optionee ceasing to be a director. Exercisable options expire on the earlier of 180 days of the optionee ceasing to be a director or the expiry date of the options, which is on the tenth anniversary of the date of grant.

Notes to the Consolidated Financial Statements (continued)

December 31, 2005 and January 1, 2005 (in thousand of dollars, except per share data)

11. Share Capital (continued)

A summary of the status of the director stock option plan and changes during the period is presented below:

	2005		2004	
	Options on Common Shares	Weighted Average Exercise Price Per Share	Options on Common Shares	Weighted Average Exercise Price Per Share
Outstanding, beginning of period	480,000	\$ 22.49	600,000	\$ 19.98
Granted	120,000	41.80	60,000	34.14
Exercised	(180,000)	18.00	(180,000)	18.00
Outstanding, end of period	420,000	29.93	480,000	22.49
Options exercisable, end of period	240,000	\$ 23.54	340,000	\$ 19.80

	2005 Outstanding Options			2005 Exercisable Options	
Range of Exercise Price	Number of Options Outstanding	Weighted Average Contractual Life (Years)	Weighted Average Exercise Price Per Share	Number of Exercisable Options	Weighted Average Exercise Price Per Share
\$18.00	60,000	5.9	\$ 18.00	60,000	\$ 18.00
\$23.35 – \$26.95	180,000	7.0	24.59	160,000	24.30
\$34.14 – \$41.80	180,000	9.3	39.25	20,000	34.14
	420,000	7.8	\$ 29.93	240,000	\$ 23.54

Deferred Share Unit Plan for Non-employee Directors

The Company maintains a deferred share unit (DSU) plan to provide directors with the option to elect to receive DSUs in lieu of cash payment for all or a portion of their director fees. When such an election is made, the Company credits to the account of each director a number of DSUs (each equivalent in value to a common share) equal to the amount of fees divided by the fair market value of the common shares. The directors' accounts shall be credited with dividend equivalents in the form of additional DSUs if and when the Company pays dividends on the common shares. Upon the director ceasing to be a member of the Board of Directors, the director shall receive a cash amount equal to the number of DSUs in his or her account multiplied by the fair market value of the common shares on the date the director ceases to be a member of the Board of Directors or on a later date selected by the director, which shall in any event be a date prior to the end of the following calendar year. During the period, the Company issued an aggregate of 7,177 DSUs (2004 – 8,207) and recorded \$546 (2004 – \$424) in director fee compensation.

12. Net Change in Non-cash Working Capital Balances

	2005	2004
Accounts receivable	\$ (18,914)	\$ (26,324)
Inventory	(80,824)	(115,729)
Prepaid expenses	9,923	(7,078)
Accounts payable and accrued liabilities	6,675	(17,701)
Income tax payable	(6,212)	18,821
	\$ (89,352)	\$ (148,011)

13. Commitments and Contingent Liabilities

Obligations Under Operating Leases

The minimum lease payments on a calendar year basis under long-term leases for store locations and office space are as follows:

	2006	2007	2008	2009	2010	Thereafter
Total lease obligations	\$ 216,965	\$ 220,131	\$ 207,372	\$ 186,254	\$ 170,790	\$ 1,069,112

Distribution Services

The Company has entered into an agreement with a third party to provide distribution services to the Company's locations to December 31, 2006. Under the terms of this agreement, the third party will charge the Company specified costs incurred to provide the distribution services, plus an annual management fee.

Information Services

During 2004 the Company entered into a five-year agreement to outsource certain information services activities to a third party. The Company has committed to average annual payments of approximately \$7,000 over the term of the agreement.

Financing Trust

During the fourth quarter of 2004, the Company arranged for its Associates to obtain additional financing from an independent trust (the "Trust"). This arrangement was created to provide loans to facilitate the Associates' purchase of inventory and fund their working capital requirements. The Trust's activities are financed through the issuance of short-term, asset-backed notes to third-party investors.

The Company has arranged for a standby letter of credit for the benefit of the Trust from a syndicate of banks that is equal to approximately 10% of the aggregate principal amount of the loans, or \$43,000, as a form of credit enhancement which, in turn, enables the Trust to provide favourable financing terms to the Company's Associates.

If at any time the Trust's cost of borrowing and applicable fees are greater than the interest rate charged to Associates on their loans, the Trust has the right to request payment from the Company for any shortfall. In the opinion of the Company's management, the Company is unlikely to have to make any such payment as it is involved in setting the rate that Associates are charged on their loans. In the event that an Associate defaults on a loan from the Trust, the Company has the right to purchase the Associate's loan from the Trust, at which time the Company is assigned the Associate's debt instrument and related security documentation provided to the Trust. The assignment of this documentation would provide the Company with first priority security over the Associate's inventory, subject to certain prior ranking statutory claims. The Company expects that the net proceeds from secured assets would cover any payments made to purchase a defaulted loan from the Trust, including any related expenses, as it is involved in setting the amount borrowed from the Trust by its Associates. In the event that the Company does not elect to purchase a defaulted loan from the Trust, the Trust may draw upon the standby letter of credit or realize on its security. If the Trust draws against the standby letter of credit, the Company has agreed to reimburse the issuing syndicate of banks for the amount so drawn.

The Company has determined that the Trust is a VIE and the Company is the primary beneficiary. As such, the Trust is subject to consolidation by the Company. The impact of consolidating the Trust is the reclassification of Associate loans payable to the Trust to commercial paper issued by the Trust to third parties. As at December 31, 2005, \$419,850 (2004 – \$198,000) of the consolidated commercial paper balance is commercial paper issued by the Trust.

13. Commitments and Contingent Liabilities (continued)

Litigation

The Company has indemnified Imperial Tobacco Canada Limited for all legal claims against the Company for the period prior to February 4, 2000. In addition, the Company is involved in certain legal claims arising in the normal course of business.

In the opinion of the Company's management, the eventual settlement of such claims will not have a significant effect on the Company's financial position or results of operations. Management has recorded a provision for these claims based on its best estimate of the final settlements.

Other

In the normal course of business, the Company enters into significant commitments for the purchase of goods and services, such as the purchase of inventory or capital assets, most of which are short-term in nature and are settled under normal trade terms.

14. Financial Instruments

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 fixed rates payable by the Company under these agreements ranged 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 to match the maturities of the underlying issued commercial paper.

Based on market values at December 31, 2005, the Company would have realized gains of \$113 to terminate these interest rate derivative agreements. Market values were determined based on information received from the Company's counterparties to these agreements.

At January 1, 2005, the Company had interest rate derivative agreements converting an aggregate notional principal amount of \$350,000 of floating rate debt into fixed rate debt. The fixed rates payable by the Company under these agreements range from 6.07% to 6.10%. These agreements matured on April 14, 2005. Based on market values at January 1, 2005, the Company would have incurred losses of \$3,252 to terminate these interest rate derivative agreements. Market values were determined based on information received from the Company's counterparties to these agreements.

Counterparty Risk

Changes in the underlying interest rates of the Company's interest rate derivative agreements will result in market gains and losses. Furthermore, the Company may be exposed to losses should any counterparty to its derivative agreements fail to fulfil its obligations. The Company has sought to minimize counterparty risk by transacting with counterparties that are large international financial institutions.

Credit Risk

The Company has credit risk associated with accounts receivable. The risk of collection is mitigated since these balances have been billed primarily to governments and third-party drug plans. There is no concentration of balances with debtors in the remaining accounts receivable.

Fair Value of Financial Instruments

The fair value of a financial instrument is the estimated amount that the Company would receive or pay to terminate the contracts at the reporting date.

The fair values of cash, accounts receivable, bank indebtedness, commercial paper, accounts payable and dividends payable approximate their carrying values given their short-term maturities. 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 fair value of the interest rate, as noted above, is determined based on current market rates and on information received from the Company's counterparties to these agreements.

15. Related Party Transactions

The Company incurred management fees and expenses of \$584 during the period ended January 1, 2005, to certain shareholders who collectively held 25.5% of the common shares of the Company until April 6, 2004, at which point the management fees and expenses ceased upon the termination of an agreement between the shareholders.

Earnings Coverage Exhibit to the Consolidated Financial Statements

52 Weeks Ended December 31, 2005

Earnings coverage on long-term debt obligations	28.45 times
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The earnings coverage ratio on long-term debt (including any current portion) is equal to net 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.