SHOPPERS DRUG MART CORPORATION

2008 SECOND QUARTER REPORT TO SHAREHOLDERS

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SHOPPERS DRUG MART CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS

As at July 9, 2008

The following is a discussion of the consolidated financial condition and results of operations of Shoppers Drug Mart Corporation (the "Company") for the periods indicated and of certain factors that the Company believes may affect its prospective financial condition, cash flows and results of operations. This discussion and analysis should be read in conjunction with the unaudited consolidated financial statements of the Company and the notes thereto for the 12 and 24 week periods ended June 14, 2008. The Company's unaudited interim period financial statements and the notes thereto have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and are reported in Canadian dollars. 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 for the 52 week period ended December 29, 2007.

FORWARD-LOOKING INFORMATION AND STATEMENTS

This discussion of the consolidated financial condition and results of operations of the Company contains forward-looking information and statements which constitute "forward-looking information" (under Canadian securities law), and which may be material regarding, among other things, the Company's beliefs, plans, objectives, strategies, estimates, intentions and expectations, including as they relate to its operating and financial results, capital expenditures, dividend policy and the ability to execute on its operating, investing and financing strategies. The forward-looking information and statements contained herein are based on certain assumptions by management, certain of which are set out herein. Inherent in the forward-looking information and statements are known and unknown risks, uncertainties and other factors beyond the Company's ability to control or predict. Actual results or developments may differ materially from those contemplated by the forward-looking information and statements. The material risk factors that could cause actual results to differ materially from the forward-looking information and statements contained herein include, without limitation: the risk of adverse changes to laws and regulations relating to prescription drugs and their sale, including pharmacy reimbursement and the availability of manufacturer allowances, or changes to such laws and regulations that increase compliance costs; the risk of adverse changes to existing pharmacy reimbursement programs and the availability of manufacturer allowance funding; the risk of increased competition from other retailers; the risk of exposure to fluctuations in interest rates; the risk of material adverse changes in foreign currency exchange rates; the risk of an inability to attract and retain pharmacists; the risk of changes to the relationships of the Company with third-party service providers; the risk that the Company will not be able to lease or obtain suitable store locations on economically favourable terms; the risk that new, or changes to current, federal and provincial laws, rules and regulations, including environmental laws, rules and regulations, may adversely impact the Company's business and operations; the risk that changes in tax law, or changes in the way that tax law is expected to be interpreted, may adversely impact the Company's business and operations; the risk that new, or changes to existing, accounting pronouncements may adversely impact the Company; and the risk of damage to the reputation of brands promoted by the Company, or to the reputation of any supplier or manufacturer of these brands.

This is not an exhaustive list of the factors that may affect any of the Company's forward-looking information and statements. Investors and others should carefully consider these and other factors and not place undue reliance on the forward-looking information and statements. Further information regarding these and other risk factors is included in the Company's public filings with provincial securities regulatory authorities including, without limitation, the section entitled "Risks and Risk Management" in the Company's Management's Discussion and Analysis for the 52 week period ended December 29, 2007 and the section entitled "Risk Factors" in the Company's Annual Information Form for the same period. The forward-looking information and statements contained in this discussion of the consolidated financial condition and results of operations of the Company represent the Company's views only as of the date hereof. Forward-looking information and statements contained in this Management's Discussion and Analysis about prospective results of operations, financial position or cash flows that are based upon assumptions about future economic conditions and courses of action are presented for the purpose of assisting the Company's shareholders in understanding management's current views regarding those future outcomes and may not be appropriate for other purposes. While the Company anticipates that subsequent events and developments may cause the Company's views to change, the Company does not undertake to update any forward-looking information and statements, except to the extent required by applicable securities laws.

Additional information about the Company, including the Annual Information Form, can be found at www.sedar.com.

OVERVIEW

The Company is the licensor of full-service retail drug stores operating under the name Shoppers Drug Mart® (Pharmaprix® in Québec). As at June 14, 2008, there were 1,091 Shoppers Drug Mart/Pharmaprix retail drug stores owned and operated by the Company's licensees ("Associates"). An Associate is a pharmacist-owner of a corporation that is licensed to operate a retail drug store at a specific location using the Company's trademarks. The Company's licensed stores are located in prime locations in each province and two territories, making Shoppers Drug Mart/Pharmaprix stores among the most convenient retail outlets in Canada. The Company also licenses or owns 15 medical clinic pharmacies operating under the name Shoppers Simply Pharmacy™ (Pharmaprix Simplement Santé^MC in Québec).

The Company has successfully leveraged its leadership position in pharmacy and its convenient store locations to capture a significant share of the market in front store merchandise. Front store merchandise categories include over-the-counter medications, health and beauty aids, cosmetics and fragrances (including prestige brands), everyday household needs and seasonal products. The Company also offers a broad range of high-quality private label products marketed under the trademarks Life Brand®, Quo®, Everyday Market®, Bio-Life™, Nativa™ and Easypix®, among others, and value-added services such as the HealthWatch® program, which offers patient counselling and advice on medications, disease management and health and wellness, and the Shoppers Optimum™ program, one of the largest retail loyalty card programs in Canada. In fiscal 2007, the Company recorded consolidated sales of approximately $8.5 billion.

Under the licensing arrangement with Associates, the Company provides the capital and financial support to enable Associates to operate Shoppers Drug Mart® and Pharmaprix® stores without any initial investment. The Company also provides a package of services to facilitate the growth and profitability of each Associate's business. These services include the use of trademarks, operational support, marketing and advertising, purchasing and distribution, information technology and accounting. In return for being provided these and other services, Associates pay fees to the Company. Fixtures, leasehold improvements and equipment are purchased by the Company and leased to Associates over periods ranging from two to 15 years, with title retained by the Company. The Company also provides its Associates with assistance in meeting their working capital and long-term financing requirements through the provision of loans and loan guarantees. (See notes 7 and 8 to the accompanying unaudited consolidated financial statements of the Company.)

Under the licensing arrangement, the Company receives a substantial share of Associate store profits. The Company's share of Associate store profits is reflective of its investment in, and commitment to, the operations of the Associates' stores.

The Company operates in Québec under the Pharmaprix® and Pharmaprix Simplement SantéMC trade names. Under Québec law, profits generated from the prescription area or dispensary may only be earned by a pharmacist or a corporation controlled by a pharmacist. As a result of these restrictions, the licence agreement used for Québec Associates differs from the Associate agreement used in other provinces. Pharmaprix® and Pharmaprix Simplement SantéMC stores and their Associates benefit from the same infrastructure and support provided to all other Shoppers Drug Mart® and Shoppers Simply Pharmacy™ stores and Associates.

The Company has determined that the individual Associate-owned stores that comprise its store network are deemed to be variable interest entities and that the Company is the primary beneficiary in accordance with the Canadian Institute of Chartered Accountants Accounting Guideline 15, “Consolidation of Variable Interest Entities” (“AcG-15”). As such, the Associate-owned stores are subject to consolidation by the Company. However, as the Associate-owned stores remain separate legal entities from the Company, consolidation of these stores has no impact on the underlying risks facing the Company. (See note 1 to the accompanying unaudited consolidated financial statements of the Company.)

The Company also owns and operates 65 Shoppers Home Health Care® stores. These retail stores are engaged in the sale and service of assisted-living devices, medical equipment, home-care products and durable mobility equipment to institutional and retail customers.

In addition to its retail store network, the Company owns Shoppers Drug Mart Specialty Health Network Inc., a provider of specialty drug distribution, pharmacy and comprehensive patient support services, and MediSystem Technologies Inc., a provider of pharmaceutical products and services to long-term care facilities in Ontario and Alberta.

OVERALL FINANCIAL PERFORMANCE

Key Operating, Investing and Financial Metrics

The following provides an overview of the Company's operating performance for the 12 and 24 week periods ended June 14, 2008 compared to the 12 and 24 week periods ended June 16, 2007, as well as certain other metrics with respect to investing activities for the 12 and 24 week periods ended June 14, 2008 and financial position as at June 14, 2008.

- Second quarter sales of $2.109 billion, an increase of 9.4%.
  - First half sales of $4.133 billion, an increase of 9.7%.
- Second quarter comparable store sales growth, excluding tobacco, of 4.6%, comprised of comparable prescription sales growth of 6.4% and comparable front store sales growth of 3.0%.
  - First half comparable store sales growth, excluding tobacco[(1)], of 5.4%, comprised of comparable prescription sales growth of 5.7% and comparable front store sales growth of 5.1%.
- Second quarter EBITDA[(2)] of $247 million, an increase of 13.1%.
  - First half EBITDA of $453 million, an increase of 14.6%.
- Second quarter EBITDA margin[(3)] of 11.72%, an increase of 39 basis points.
  - First half EBITDA margin of 10.96%, an increase of 46 basis points.
- Second quarter net earnings of $128 million or $0.59 per share (diluted), an increase of 14.4%.
  - First half net earnings of $230 million or $1.06 per share (diluted), an increase of 16.3%.
- Second quarter capital expenditure program of $97 million compared to $78 million in the prior year. Opened or acquired 22 new drug stores, nine of which were relocations.
  - First half capital expenditure program of $243 million compared to $122 million in the prior year. Opened or acquired 73 new drug stores, 17 of which were relocations, and added one home health care store.
  - Year-over-year increase in drug store selling space of 13.9%.
- Maintained desired capital structure and financial position.
  - Net debt to total capitalization ratio of 0.27:1 at June 14, 2008 compared to 0.24:1 a year ago.

(1) The sale of tobacco products is being phased out of the Company's remaining stores in Western Canada that list these products.

(2) Earnings before interest, taxes, depreciation and amortization. (See reconciliation to the most directly comparable GAAP measure under "Results of Operations" in this Management's Discussion and Analysis.)

(3) EBITDA divided by sales.

Results of Operations

The following table presents a summary of certain selected consolidated financial information for the Company for the periods indicated.

($000s, except per share data)	12 Weeks Ended June 14, 2008	12 Weeks Ended June 16, 2007	24 Weeks Ended June 14, 2008	24 Weeks Ended June 16, 2007
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Sales	$ 2,109,308	$ 1,928,094	$ 4,133,107	$ 3,766,889
Cost of goods sold and other operating expenses	1,862,190	1,709,587	3,680,065	3,371,469
EBITDA[1]	247,118	218,507	453,042	395,420
Amortization	46,324	38,575	91,095	75,810
Operating income	200,794	179,932	361,947	319,610
Interest expense	14,152	11,394	27,912	22,768
Earnings before income taxes	186,642	168,538	334,035	296,842
Income taxes	58,325	56,384	104,385	99,404
Net earnings	$ 128,317	$ 112,154	$ 229,650	$ 197,438
Per common share				
- Basic net earnings	$ 0.59	$ 0.52	$ 1.06	$ 0.92
- Diluted net earnings	$ 0.59	$ 0.52	$ 1.06	$ 0.91

[1] Earnings before interest, taxes, depreciation and amortization.

Sales

Sales represent the combination of sales of the retail drug stores owned by the Associates and sales of the Company-owned home health care business and MediSystem Technologies Inc.

Sales in the second quarter were $2.109 billion compared to $1.928 billion in the same period last year, an increase of $181 million or 9.4%, with the Company continuing to experience strong sales growth in all regions of the country. On a same-store basis, excluding tobacco products, sales increased 4.6% during the second quarter of 2008. Year-to-date, sales increased 9.7% to $4.133 billion. The Company's capital investment program, which resulted in a 13.9% increase in selling square footage versus a year ago, continues to have a positive impact on sales growth. On a same-store basis, excluding tobacco products, sales increased 5.4% during the first half of 2008.

Prescription sales were $1.010 billion in the second quarter compared to $905 million in the same period last year, an increase of $105 million or 11.6%. On a same-store basis, prescription sales increased 6.4% during the second quarter of 2008, with increased generic prescription utilization continuing to have a deflationary impact on sales growth in the category. Prescription sales represented 47.9% of the Company's sales mix during the second quarter of 2008 compared to 46.9% in the same period last year. Year-to-date, prescription sales increased 10.2% to $1.983 billion and accounted for 48.0% of the Company's sales mix. On a same-store basis, prescription sales increased 5.7% during the first half of 2008.

Front store sales were $1.099 billion in the second quarter compared to $1.023 billion in the second quarter of 2007, an increase of $76 million or 7.4%, with the Company continuing to experience sales gains in all categories except tobacco, which is being phased out of its remaining stores in Western Canada that list these products. On a same-store basis and excluding tobacco, front store sales increased 3.0%, a particularly strong result given the Easter calendar shift this year which benefited comparable front store sales in the first quarter of 2008 by approximately 200 basis points. Year-to-date, front store sales increased 9.3% to $2.151 billion. On a same-store basis, front store sales, excluding tobacco, increased 5.1% during the first half of 2008.

Cost of Goods Sold and Other Operating Expenses

Cost of goods sold is comprised of the cost of goods sold at the retail drug stores owned by the Associates and the cost of goods sold at the Company-owned home health care business and MediSystem Technologies Inc. Other operating expenses include corporate selling, general and administrative expenses, operating expenses at the retail drug stores owned by the Associates, including Associates' earnings, and operating expenses at the Company-owned home health care business and MediSystem Technologies Inc.

Total cost of goods sold and other operating expenses were $1.862 billion in the second quarter compared to $1.710 billion in the same period last year, an increase of $152 million or 8.9%. Expressed as a percentage of sales, cost of goods sold declined by 82 basis points in the second quarter of 2008 versus the comparative prior year period, reflecting improvements in cost of goods and a better sales mix and margin rate. Partially offsetting this improvement were higher operating expenses which, when expressed as a percentage of sales, increased by 43 basis points over the prior year period. Higher operating expenses at store-level, primarily occupancy, wages and benefits associated with the expansion of the store network, accounted for the bulk of this increase.

Year-to-date, total cost of goods sold and other operating expenses increased 9.2% to $3.680 billion. Expressed as a percentage of sales, cost of goods sold declined by 90 basis points in the first half of 2008 versus the comparative prior year period, while other operating expenses increased by 44 basis points.

Amortization

Amortization of capital assets and other intangible assets was $46 million in the second quarter compared to $39 million in the same period last year, an increase of $7 million or 20.1%. Expressed as a percentage of sales, amortization increased 20 basis points in the second quarter of 2008 versus the comparative prior year period, reflecting the continued growth of the Company's capital investment and store development program.

Year-to-date, amortization of capital assets and other intangible assets increased 20.2% to $91 million. Expressed as a percentage of sales, amortization increased 19 basis points in the first half of 2008 versus the comparative prior year period.

Operating Income

Operating income was $201 million in the second quarter of 2008 compared to $180 million in the same period last year, an increase of $21 million or 11.6%. Solid top line growth and a strong sales mix, combined with improved purchasing synergies and an ongoing commitment to cost reduction and efficiency, partially offset by higher operating costs and increased amortization in new and relocated stores, resulted in a higher operating margin (operating income divided by sales). In 2008, second quarter operating margin improved by 19 basis points to 9.52% compared to 9.33% in the second quarter of last year. The Company's EBITDA margin (EBITDA divided by sales) was 11.72% in the second quarter of 2008, a 39 basis point improvement over the EBITDA margin of 11.33% posted in the second quarter of last year.

Year-to-date, operating income increased 13.2% to $362 million and operating margin improved by 28 basis points to 8.76%. During the first half of 2008, EBITDA margin was 10.96%, a 46 basis point improvement over the EBITDA margin of 10.50% posted during the first half of 2007.

Interest Expense

Interest expense is comprised of interest expense arising from borrowings at the Associate-owned stores and from debt obligations of the Company.

Interest expense was $14 million in the second quarter of 2008 compared to $11 million in the same period last year, an increase of $3 million or 24.2%. This increase versus the comparative prior year period can be attributed to an increase in the amount of consolidated net debt outstanding, coupled with a market-driven increase in short-term interest rates. Year-to-date, interest expense increased 22.6% to $28 million. (See note 4 to the accompanying unaudited consolidated financial statements of the Company.)

Income Taxes

The Company's effective income tax rate in the second quarter and first half of 2008 was 31.2% compared to 33.5% in the same periods last year. This decrease in the effective income tax rate can be attributed to a reduction in statutory rates.

Net Earnings

Second quarter net earnings were $128 million compared to $112 million in the same period last year, an increase of $16 million or 14.4%. On a diluted basis, earnings per share were $0.59 in the second quarter of 2008 compared to $0.52 in the same period last year.

Year-to-date, net earnings increased 16.3% to $230 million. On a diluted basis, earnings per share were $1.06 in the first half of 2008 compared to $0.91 in the same period last year.

Capital Structure and Financial Position

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

($000s)	June 14, 2008	December 29, 2007
Cash	$ (80,452)	$ (27,588)
Bank indebtedness	260,441	225,152
Commercial paper	248,713	543,847
Current portion of long-term debt	299,899	298,990
Long-term debt	446,845	-
Net debt	1,175,446	1,040,401
Shareholders' equity	3,216,460	3,075,710
Total capitalization	$ 4,391,906	$ 4,116,111
Net debt:Shareholders' equity	0.37:1	0.34:1
Net debt:Total capitalization	0.27:1	0.25:1
Net debt:EBITDA[1]	1.16:1	1.09:1
EBITDA:Cash interest expense[1][2]	17.77:1	18.37:1

(1) For purposes of calculating the ratios, EBITDA is comprised of EBITDA for each of the 52 week periods then ended.

(2) Cash interest expense is comprised of interest expense for each of the 52 week periods then ended and excludes the amortization of deferred financing costs.

Outstanding Share Capital

The Company's outstanding share capital is comprised of common shares. An unlimited number of common shares is authorized and the Company had 217,061,283 common shares outstanding at July 9, 2008. As at this same date, the Company had issued options to acquire 1,273,814 of its common shares pursuant to its stock-based compensation plans, of which 834,198 were exercisable.

Financing Activities

On April 22, 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 million to $800 million. The bank credit facility is available for general corporate purposes, including refinancing existing indebtedness, and to backstop the Company's commercial paper program. The Company's initial credit spread on BA borrowings under the amended credit facility is 50 basis points. (See note 7 to the accompanying unaudited consolidated financial statements of the Company).

In conjunction with this amendment, the Company increased its commercial paper program from $300 million to $500 million. The Company's commercial paper program retained its rating of R-1 (low) by DBRS Limited.

On April 23, the Company issued $200 million of commercial paper and used the proceeds to purchase loans provided to Associates by an independent trust (the "Trust") whose activities were financed through the issuance of short-term, asset-backed notes. The purchase of these loans reduced the outstanding Trust loans to Associates from $499 million to $299 million. 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 million to $30 million. On a consolidated basis, no incremental debt was incurred by the Company as a result of the above refinancing activities.

On May 22, 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 the date of the final receipt. No incremental debt was incurred by the Company as a result of this filing.

On June 2, the Company issued $450 million of five-year medium-term notes maturing June 3, 2013, which bear interest at a fixed rate of 4.99% per annum (the "Series 2 Notes"). The Series 2 Notes were issued pursuant to the Prospectus, as supplemented by a pricing supplement dated May 28, 2008, and filed by the Company with Canadian securities regulators in all of the provinces of Canada. At the time of issuance, the Series 2 Notes were assigned a rating of A (low) from DBRS Limited and BBB+ from Standard & Poor's.

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 million standby letter of credit provided by the Company to the Trust as a form of credit enhancement was returned to the Company by the Trust and cancelled. The Trust itself was terminated on June 10, 2008. As a result of applying the net proceeds from the issuance of the Series 2 Notes to refinance existing indebtedness, the consolidated debt position of the Company remained substantially unchanged.

Liquidity and Capital Resources

Sources of Liquidity

The Company has the following sources of liquidity: (i) cash provided by operating activities; (ii) cash available from a committed $800 million revolving bank credit facility maturing June 6, 2011, less what is currently drawn and/or being utilized to support commercial paper issued and outstanding; and (iii) up to $500 million in availability under its commercial paper program, less what is currently issued. The Company's commercial paper program is rated R-1 (low) by DBRS Limited. In the event that the Company's commercial paper program is unable to maintain this rating, the program is supported by the Company's $800 million revolving bank credit facility. The Company does not currently foresee any reasonable circumstances under which this credit rating would not be maintained.

The Company has also arranged for its Associates to obtain financing to facilitate their purchase of inventory and fund their working capital requirements by providing guarantees to various Canadian chartered banks that support Associate loans.

The Company has obtained additional long-term financing from: i) the issuance of $300 million of five-year medium-term notes maturing October 24, 2008, which bear interest at a fixed rate of 4.97% per annum (the "Series 1 Notes") and were issued pursuant to a short form base shelf prospectus dated October 10, 2003, as supplemented by a pricing supplement dated October 20, 2003, and filed by the Company with Canadian securities regulators in all of the provinces of Canada. At the time of issuance, the Series 1 Notes were assigned a rating of A (low) from DBRS Limited and BBB from Standard & Poor's; and ii) the issuance of $450 million of Series 2 Notes as described above under "Financing Activities".

At the end of the second quarter, $14 million of the Company's $800 million revolving bank credit facility was utilized, all in respect of outstanding letters of credit and trade finance guarantees. At December 29, 2007, $61 million of this facility was utilized, all in respect of letters of credit and trade finance guarantees. As at June 14, 2008, the Company had $250 million of commercial paper issued and outstanding under its commercial paper program compared to $45 million at the end of the prior year. At the end of the second quarter, Associates had drawn an aggregate amount of $262 million in loans from various Canadian chartered banks compared to $228 million at the end of the prior year.

In addition to the above, MediSystem Technologies Inc., a subsidiary of the Company, has arranged for up to $1 million of revolving demand bank credit facilities. At the end of the second quarter, no amounts were outstanding on these facilities, unchanged from the end of the prior year.

Cash Flows from Operating Activities

Cash flows from operating activities were $164 million in the second quarter of 2008 compared to $184 million in the same period last year. This decrease versus the comparative period is largely the result of growth in net earnings, adjusted for non-cash items, being more than offset by an increased investment in non-cash working capital balances in the second quarter of this year as opposed to last year, when the Company experienced a reduction in the amount invested in non-cash working capital balances. The increased investment in non-cash working capital balances in the second quarter of this year can be largely attributed to growth in inventory, which is tied to store network growth and increased sales, and the timing of tax payments and trade payables.

Year-to-date, the Company has generated $158 million of cash from operating activities compared to $181 million in the first half of 2007.

Cash Flows Used in Investing Activities

Cash flows used in investing activities were $103 million in the second quarter of 2008 compared to $87 million in the same period last year, an increase of $16 million or 18.5%. Of these totals, investments in property and equipment, net of proceeds from any dispositions, amounted to $84 million in the second quarter of this year compared to $71 million in the same period last year, reflecting the continued expansion of the Company's store network growth and revitalization program. The Company also invested $10 million in business acquisitions and $4 million in other assets during the second quarter of 2008 compared to $7 million and $9 million, respectively, in the same period last year. Consistent with the Company's stated growth objectives, these investments relate primarily to acquisitions of drug stores and prescription files, as the Company continues to pursue attractive opportunities in the marketplace. During the second quarter of 2008, the balance of funds deposited and held in escrow in respect of outstanding offers to purchase drug stores and land increased by $5 million.

Year-to-date, cash flows used in investing activities were $206 million compared to $131 million in the first half of 2007. Of these totals, investments is property and equipment, net of proceeds from any dispositions, amounted to $148 million in the first half of 2008 compared to $111 million in the same period last year. Investments in business acquisitions and other assets were $87 million and $10 million, respectively, in the first half of 2008 compared to $11 million and $9 million, respectively, in the same period last year. During the first half of 2008, the balance of funds deposited and held in escrow in respect of outstanding offers to purchase drug stores and land decreased by $39 million.

During the second quarter of 2008, 22 new drug stores were opened or acquired, nine of which were relocations, and two smaller drug stores were closed. Year-to-date, 73 new drug stores have been opened or acquired, 17 of which were relocations, and seven drug stores have been closed. As a result of this activity, drug store selling space has increased by 13.9% compared to a year ago. The Company also added one home health care store to its network during the first half of 2008. At the end of the second quarter there were 1,171 stores in the Company's retail network, comprised of 1,106 drug stores and 65 Shoppers Home Health Care® stores.

Cash Flows from Financing Activities

Cash flows used in financing activities were $17 million in the second quarter of 2008, as cash inflows of $523 million were more than offset by cash outflows of $540 million. Cash inflows were comprised of an $69 million increase in the amount of bank indebtedness, $450 million from the issuance of medium-term notes and $3 million of proceeds received from the issuance of common shares and loan repayments under the Company's stock-based incentive plans. Cash outflows were comprised of a $487 million decrease in the amount commercial paper issued and outstanding under the Company's commercial paper programs (a $499 million decrease in the amount of commercial paper issued by the Trust, partially offset by a $12 million increase in the amount of commercial paper issued and outstanding by the Company), $4 million to fund costs associated with various financing activities, a $2 million reduction in the amount of Associate investment and $47 million for the payment of dividends. (See discussion above under "Financing Activities".)

In the second quarter of 2008, the net result of the Company's operating, investing and financing activities was an increase in cash of $45 million.

Year-to-date, cash flows from in financing activities were $100 million and the net result of the Company's operating, investing and financing activities was an increase in cash of $53 million.

Future Liquidity

The Company believes that its current credit facility, commercial paper program and financing programs available to its Associates, together with cash generated from operating activities, will be sufficient to fund its operations, including the operations of its Associate-owned store network, investing activities and commitments for the foreseeable future. The Company does not foresee any difficulty in obtaining long-term financing given its current credit ratings and past experiences in the capital markets.

NEW ACCOUNTING PRONOUNCEMENTS

Accounting Standards Implemented in 2008

Capital Disclosures

In 2006, the Canadian Institute of Chartered Accountants (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. Section 1535 also requires an entity to disclose if it has complied with any capital requirements and, if it has not complied, the consequences of such non-compliance. The standard is effective for interim and annual financial statements for fiscal years beginning on or after October 1, 2007. The Company applied the new accounting standard at the beginning of its current fiscal year and its implementation did not have an impact on the Company's results of operations or financial position. The resulting disclosures from implementation are presented in the Company's interim financial statements.

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 risks associated with financial instruments and how those risks are managed. The new presentation standard carried forward the former presentation requirements under the replaced CICA Handbook Section 3861. The new accounting 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 their implementation did not have an impact on the Company's results of operations or financial position. The resulting disclosures from implementation are presented in the Company's interim financial statements and this MD&A.

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 International Accounting Standard 2 and replaced CICA Handbook 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 new 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 weeks ended June 16, 2007 reflect an increase in cost of goods sold and other operating expenses and a decrease in operating income of $26 thousand and a decrease in net earnings of $110 thousand, with basic and diluted net earnings per share remaining unchanged. The results for the 24 weeks ended June 16, 2007 reflect a decrease in cost of goods sold and other operating expenses and an increase in operating income of $377 thousand and an increase in net earnings of $43 thousand, with basic and diluted net earnings per share remaining unchanged. The impact for year ended December 29, 2007 is an increase in cost of goods sold and other operating expenses and a decrease in operating income of $3.7 million and a decrease in net earnings of $3.2 million, resulting in a decrease of $0.01 in basic and diluted net earnings per share.

The implementation of the new standard has resulted in a reduction to 2008 and 2007 opening retained earnings of $21.3 million and $18.2 million, respectively. The impact on balances as at December 29, 2007 and June 16, 2007 was a decrease in inventory of $31.9 million and $27.8 million, respectively, an increase in future income tax asset of $9.9 million and $9.3 million, respectively, and a decrease in income taxes payable of $725 thousand and $473 thousand, respectively.

Determining Whether a Contract is Routinely Denominated as a Single Currency

In January 2008, the Emerging Issues Committee of the CICA (the "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 and its implementation did not have a significant impact on the Company's results of operations, financial position or disclosures.

Transition to International Financial Reporting Standards

In January 2006, the Accounting Standards Board (the "AcSB") announced its decision to require all publicly accountable enterprises to report under International Financial Reporting Standards ("IFRS") for years beginning on or after January 1, 2011. As a result, financial reporting by Canadian publicly accountable enterprises will change significantly from current Canadian GAAP to IFRS. These changes are part of a world-wide shift to IFRS, intended to facilitate global capital flows and bring greater clarity and consistency to financial reporting in the global marketplace.

On February 13, 2008, the AcSB confirmed that publicly accountable enterprises will be required to use IFRS, as issued by the International Accounting Standards Board, unless modifications or additions to the requirements of IFRS are issued by the AcSB. IFRS must be adopted for interim and annual financial statements related to fiscal years beginning on or after January 1, 2011, with restatement of comparative periods.

The AcSB issued an Omnibus Exposure Draft of IFRS in April 2008 for public comment. The deadline for comments is July 31, 2008. The Omnibus Exposure Draft contains the text of the standards proposed to be adopted and the AcSB's guiding principles for the adoption of IFRS.

The Company is currently assessing the future impact of these new standards on its consolidated financial statements.

OFF-BALANCE SHEET ARRANGEMENTS

Associate Loans

The Company has provided guarantees to various Canadian chartered banks that support Associate loans. At the end of the second quarter of 2008, the Company's maximum obligation in respect of such guarantees was $425 million compared to $415 million at the end of the first quarter and prior year. At June 14, 2008, an aggregate amount of $376 million in available lines of credit had been allocated to the Associates by the various banks compared to $370 million at the end of the first quarter and $356 million at the end of the prior year. As at June 14, 2008, Associates had drawn an aggregate amount of $262 million against these available lines of credit compared to $218 million at the end of the first quarter and $228 million at the end of the prior year. Any amounts drawn by the Associates are included in bank indebtedness on the Company's consolidated balance sheets. As recourse in the event that any payments are made under the guarantees, the Company holds a first ranking security interest on all assets of Associate-owned stores, subject to certain prior ranking statutory claims. As the Company is involved in allocating the available lines of credit to its Associates, it estimates that the net proceeds from secured assets would exceed the amount of any payments required in respect of the guarantees.

SELECTED QUARTERLY INFORMATION

Reporting Cycle

The annual reporting cycle of the Company is divided into four quarters of 12 weeks each, except for the third quarter which is 16 weeks in duration. The fiscal year of the Company consists of a 52 or 53 week period ending on the Saturday closest to December 31. When a fiscal year consists of 53 weeks, the fourth quarter is 13 weeks in duration.

Summary of Quarterly Results

The following table provides a summary of certain selected consolidated financial information for the Company for each of the eight most recently completed fiscal quarters. This information has been prepared in accordance with Canadian generally accepted accounting principles.

($000s, except per share data – unaudited)	**Second Quarter**		**First Quarter**		**Fourth Quarter**		**Third Quarter**	
	2008 (12 Weeks)	**2007** (12 Weeks)	**2008** (12 Weeks)	**2007** (12 Weeks)	**2007** (12 Weeks)	**2006** (12 Weeks)	**2007** (16 Weeks)	**2006** (16 Weeks)
Sales	$ 2,109,308	$ 1,928,094	$ 2,023,799	$ 1,838,795	$ 2,168,822	$ 2,018,067	$ 2,524,671	$ 2,329,051
Net earnings	$ 128,317	$ 112,154	$ 101,333	$ 85,284	$ 151,331	$ 132,500	$ 141,672	$ 123,880
Per common share								
- Basic net earnings	$ 0.59	$ 0.52	$ 0.47	$ 0.40	$ 0.70	$ 0.62	$ 0.65	$ 0.58
- Diluted net earnings	$ 0.59	$ 0.52	$ 0.47	$ 0.39	$ 0.70	$ 0.61	$ 0.65	$ 0.57

The Company experienced growth in sales and net earnings in each of the four most recent quarters when compared to the same quarter of the prior year. The Company continues to invest capital in expanded and relocated stores and in new store development, which has allowed the Company to increase the selling square footage of its store network, resulting in increased sales and profitability.

The Company’s core prescription drug operations are not typically subject to seasonal fluctuations. The Company’s front store operations include seasonal promotions which may have an impact on quarterly results, particularly when the season, notably Easter, does not fall in the same quarter each year. Also, as the Company continues to expand its front store product and service offerings, including seasonal promotions, its results of operations may become subject to more seasonal fluctuations.

RISKS AND RISK MANAGEMENT

Financial Instruments

The following discussion on Risks and Risk Management provides certain of the required disclosures under CICA Handbook Section 3862, "Financial Instruments – Disclosures" related to the nature and extent of risks arising from financial instruments, as permitted by the standard. Therefore, this section forms an integral part of the unaudited interim consolidated financial statements for the 12 and 24 week periods ended June 14, 2008.

The Company is exposed to a number of risks associated with financial instruments that have the potential to affect its operating and financial performance. The Company's primary financial instrument risk exposures are interest rate risk and liquidity risk. The Company's exposures to foreign currency risk, credit risk and other price risk are not considered to be material. 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.

Exposure to Interest Rate Fluctuations

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

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 financial institutions. There is no net exposure as at June 14, 2008, as the interest rate derivative agreements are in a liability position. At June 16, 2007, the maximum exposure was equal to the carrying value of the interest rate derivative agreements of $3.9 million.

As at June 14, 2008 the Company had $262 million of unhedged floating rate debt. During the 12 weeks ended June 14, 2008, the Company's average outstanding unhedged floating rate debt was $402 million. Had interest rates been higher or lower by 50 basis points during the period, net earnings would have decreased or increased, respectively, by approximately $0.3 million as a result of the Company's exposure to interest rate fluctuations on its unhedged floating rate debt.

Foreign Currency Exchange Risk

The Company conducts the vast majority of its business in Canadian dollars. The Company's foreign currency exchange risk principally relates to purchases made in U.S. dollars and this risk is tied to fluctuations in the exchange rate of the Canadian dollar, vis-à-vis the U.S. dollar. The Company monitors its foreign currency purchases in order to monitor its foreign currency exchange risk. The Company does not consider its exposure to foreign currency exchange rate risk to be material.

Credit Risk

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

The Company's primary objectives when managing its capital and liquidity 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 acquisition of sites as part of a land bank program, 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.

For a complete description of the Company's sources of liquidity, see the discussions under "Sources of Liquidity" and "Future Liquidity" under "Liquidity and Capital Resources" in this Management's Discussion and Analysis.

Current liabilities and long-term liabilities

The contractual maturities of the Company's current and long-term liabilities as at June 14, 2008 are as follows:

$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	260,441	-	-	-	260,441
Commercial paper	248,713	-	-	-	248,713
Accounts payable	788,950	32,929	8,815	7,448	838,142
Current portion of long-term debt	-	299,899	-	-	299,899
Long-term debt	-	-	-	446,845	446,845
Other long-term liabilities	49,462	10	13,662	5,608	68,742
Total	1,347,566	332,838	22,477	459,901	2,162,782

There is no difference between the carrying value of bank indebtedness and the amount the Company is required to pay.

Industry and Regulatory Developments

As discussed in the Company's Management's Discussion and Analysis in its 2007 Annual Report for the 52 week period ended December 29, 2007, government payers continue to look to implement measures to control drug costs. One such measure involves restricting the number of interchangeable prescription drug products that are eligible for reimbursement. In furtherance of this objective, at a briefing to pharmacy stakeholders on July 7, 2008, the Ontario Ministry of Health and Long-Term Care (the "Ministry") indicated that it will be implementing a competitive bid process for a small number of high volume off-patent drug products that have been identified as less expensive in jurisdictions outside of Canada. For those interchangeable drug products that are made subject to the bid process, the number of interchangeable generic products eligible for reimbursement under the Ontario Drug Benefit program may be limited to two or three products in consideration of, among other things, volume discounts to be provided directly from the manufacturer to the Ministry. The Ministry indicated that the bid process will not affect the number of interchangeable generic drug products in the private payer system.

The volume discounts provided to the Ministry pursuant to the bid process may decrease the amount of professional allowance funding available in the system for public sector sales. The small number of interchangeable drug products which will ultimately be subject to the bid process is not presently known to industry. Accordingly, at this time, the Company is unable to determine the impact, if any, of the Ministry's bid process on the Company's future operating results.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

The CEO and CFO have designed, or caused to be designed under their supervision, internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting, its compliance with Canadian GAAP and the preparation of financial statements for external purposes. Internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be designed effectively can provide only reasonable assurance with respect to financial reporting and financial statement preparation.

There were no changes in internal control over financial reporting that occurred during the Company's most recent interim period that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

NON-GAAP FINANCIAL MEASURES

The Company reports its financial results in accordance with Canadian GAAP. However, the foregoing contains references to non-GAAP financial measures, such as operating margin, EBITDA (earnings before interest, taxes, depreciation and amortization), EBITDA margin and cash interest expense. 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.

These non-GAAP financial measures have been included in this Management's Discussion and Analysis as they are measures which management uses to assist in evaluating the Company's operating performance against its expectations and against other companies in the retail drug store industry. Management believes that non-GAAP financial measures assist in identifying underlying operating trends.

These non-GAAP financial measures, particularly EBITDA and EBITDA margin, are also common measures used by investors, financial analysts and rating agencies. These groups may use EBITDA and other non-GAAP financial measures to value the Company and assess the Company's ability to service its debt.