

Financial Section

- 6 Management's Discussion and Analysis
- 37 Management's Report
- 37 Auditors' Report
- 38 Consolidated Financial Statements
- 42 Notes to the Consolidated Financial Statements

Other Information

- 60 Corporate Responsibility
- 64 Corporate Directory
- IBC Shareholder Information

management's discussion and analysis

As at March 6, 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 consolidated audited financial statements of the Company and the notes thereto for the 52 week period ended December 29, 2007 (the "consolidated financial statements"). The fiscal year of the Company consists of a 52 or 53 week period ending on the Saturday closest to December 31.

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. 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 December 29, 2007, there were 1,057 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 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 ("OTC medications"), health and beauty aids ("HBA"), 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 and disease management, 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. In addition, the Company provides a standby letter of credit to an independent trust (the "Trust") which provides additional financing to Associates to facilitate their purchase of inventory and to fund their working capital requirements. (See discussions on "Associate Loans" and "Associate Financing Trust" under "Off-balance Sheet Arrangements" in this Management's Discussion and Analysis and note 14 to the 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[®] trade name. 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[®] stores and their Associates benefit from the same infrastructure and support provided to all other Shoppers Drug Mart[®] 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 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 consolidated financial statements of the Company.)

The Company also owns and operates 64 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 MediSystem Technologies Inc., a provider of pharmaceutical products and services to long-term care facilities in Ontario and Alberta.

Strategies and Outlook

The Company's business strategies are designed to drive sales growth, maximize gross margin dollars and operating cash flow, leverage cost reduction opportunities and build customer loyalty. The Company believes that proper execution of its strategies will strengthen its position as the licensor of Canada's leading drug store group, thereby generating increased revenue and profitability, and should continue to provide superior returns to its shareholders.

In the opinion of the Company, the demographic trends of the aging Canadian population are expected to fuel continued strong growth in the pharmacy and beauty categories. The Company believes that it is well-positioned to continue to capitalize on the projected growth in the retail drug store industry given its strong brand recognition, focus on pharmacy, health care and beauty products and services, convenient locations and the dedication of its Associate-owners. The Company intends to build upon its leadership position in pharmacy by investing in new services and technology and, more importantly, in the recruitment, retention and training of pharmacists. The Company believes that its primary focus on pharmacy products and services will continue to drive customer traffic and provide profitable growth in its beauty and other front store categories. The Company believes that improved merchandising, a continued focus on operational excellence and the introduction of new products and services, including the tactical use of private label and exclusive national brand products, will increase customer satisfaction, thereby improving the attractiveness of Shoppers Drug Mart® and Pharmaprix® stores as a destination for the purchase of OTC medications, HBA, cosmetics, seasonal merchandise and convenient household products.

Sales growth is also being driven by the Company's store network investment program as it seeks to construct new stores, expand and remodel existing stores and relocate other stores to superior locations. Also, due to the fragmented nature of the Canadian retail drug store industry, the Company believes that it is well-positioned to capitalize on consolidation opportunities given its strong balance sheet and financial position. In fiscal 2007, the Company opened or acquired 121 drug stores, 44 of which were relocations, and closed seven stores. In addition to this activity, the Company also completed nine major drug store expansions during the year. The Company also added six home health care stores to its network during fiscal 2007. As a result of this activity, the selling square footage of the store network increased by 11.5% during fiscal 2007. The Company intends to continue making significant investments in its store base, with the goal of increasing the number and average size of its stores. These large-format stores offer customers greater convenience and a broader selection of front store products, while maintaining the high level of service for which Shoppers Drug Mart® and Pharmaprix® stores are known. The Company's capital expenditures are typically financed from internally generated cash flow.

In fiscal 2008, the Company plans to allocate approximately \$500 million to capital expenditures, with approximately 80% of this amount being invested in the store network, including acquisitions of drug stores, prescription files and land. Once again, this should result in an increase in selling square footage of more than 10%. This will be accomplished through the addition of between 120 and 130 new drug stores, approximately 40 to 45 of which will be relocations, and through the completion of up to 10 major expansions. The Company also plans to add up to five home health care stores to its network in fiscal 2008.

The Company is confident in its ability to execute upon its operating, investing and financing strategies in fiscal 2008 and beyond. The Company believes that the appropriate balance and successful implementation of these strategies and initiatives will result in long-term market share gains, while delivering consistent and meaningful growth in earnings per share. This in turn should provide superior returns to shareholders, through a combination of share price appreciation and dividends that are sustainable over time.

Overall Financial Performance

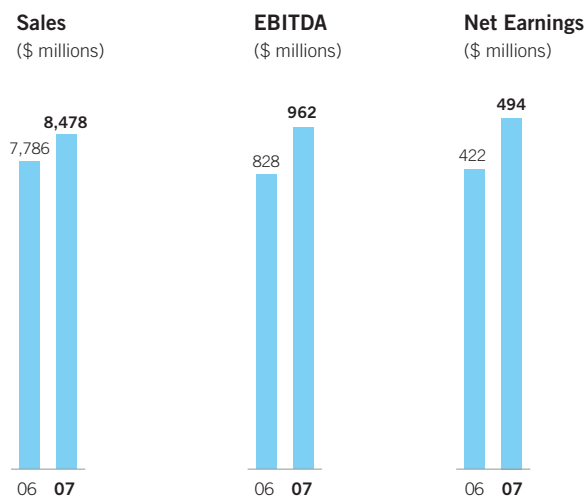
Key Operating, Investing and Financial Metrics

The following provides an overview of the Company's operating performance for the 52 week period ended December 29, 2007 compared to the 52 week period ended December 30, 2006, as well as certain other metrics with respect to investing activities for the 52 week period ended December 29, 2007 and financial position as at that same date.

- Sales of \$8.5 billion, an increase of 8.9%.
- Comparable store total sales growth of 5.2%.
 - > Comparable store prescription sales growth of 5.8%.
 - > Comparable store front store sales growth of 4.7%.
- EBITDA⁽¹⁾ of \$962 million, an increase of 16.2%.
 - > EBITDA margin⁽²⁾ of 11.35%, an increase of 72 basis points.
- Net earnings of \$494 million or \$2.27 per share (diluted), an increase of 16.8%.
- Capital expenditure program of \$535 million, which includes the acquisition of the assets of Centre d'Escomptes Racine (\$77 million). This compares to \$424 million in the prior year, which included the acquisitions of MediSystem Technologies Inc. (\$90 million) and Therapy Supplies & Rental Limited (\$19 million).
 - > 121 new drug stores opened or acquired, 44 of which were relocations.
 - > 28 drug stores expanded and/or renovated.
 - > Nine new home health care stores opened or acquired, two of which were relocations.
 - > 11.5% increase in selling square footage to in excess of 9.7 million square feet.
- Maintained strong balance sheet and financial position.
 - > Net debt to equity ratio of 0.34:1 compared to 0.32:1 at the end of the prior year.
 - > Net debt to total capitalization ratio of 0.25:1 compared to 0.24:1 at the end of the prior year.
- Increased quarterly dividend payments by 33.3%.
 - > Declared four quarterly dividends of 16 cents per share.

⁽¹⁾ Earnings before interest, taxes, depreciation and amortization. (See reconciliation to the most directly comparable GAAP measure under "Results of Operations – Fiscal 2007" in this Management's Discussion and Analysis.)

⁽²⁾ EBITDA divided by sales.



Results of Operations – Fiscal 2007

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

(\$000s, except per share data)	2007	2006	\$ Change	% Change
Sales	\$ 8,478,382	\$ 7,786,436	\$ 691,946	8.9%
Cost of goods sold and other operating expenses	7,516,291	6,958,361	(557,930)	(8.0%)
EBITDA ⁽¹⁾	962,091	828,075	134,016	16.2%
Amortization	172,075	144,549	(27,526)	(19.0%)
Operating income	790,016	683,526	106,490	15.6%
Interest expense	52,873	49,872	(3,001)	(6.0%)
Earnings before income taxes	737,143	633,654	103,489	16.3%
Income taxes	243,515	211,163	(32,352)	(15.3%)
Net earnings	\$ 493,628	\$ 422,491	\$ 71,137	16.8%
Per common share				
– Basic net earnings	\$ 2.28	\$ 1.97	\$ 0.31	
– Diluted net earnings	\$ 2.27	\$ 1.95	\$ 0.32	

⁽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 2007 were \$8.478 billion compared to \$7.786 billion in 2006, an increase of \$692 million or 8.9%. During 2007, the Company continued to experience strong sales growth in all regions of the country, led again by gains in Western Canada and Québec. On a same-store basis, sales increased 5.2% in 2007. The Company's capital investment program, which resulted in an 11.5% increase in selling space compared to a year ago, continues to have a positive impact on sales growth. Sales growth was also aided by the Company's efforts to acquire drug stores and prescription files, including the third quarter acquisition of the assets of Centre d'Escomptes Racine, a seven store pharmacy chain in the Québec City region.

Prescription sales were \$3.989 billion in 2007 compared to \$3.655 billion in 2006, an increase of \$334 million or 9.1%. In addition to new real estate and acquisitions, the national roll-out of enhanced pharmacy services under the HealthWATCH[®] brand contributed to pharmacy sales growth. On a same-store basis, prescription sales increased 5.8% during the year. Consistent with the prior year, pharmacy sales growth was driven by strong growth in the number of prescriptions filled, with greater generic utilization having a deflationary impact on sales growth in the category. In 2007, prescription sales accounted for 47.0% of the Company's sales mix compared to 46.9% in the prior year.

Front store sales were \$4.489 billion in 2007 compared to \$4.131 billion in 2006, an increase of \$358 million or 8.7%, with the Company once again realizing sales gains in all categories. On a same-store basis, front store sales increased 4.7% in 2007. The Company's store network growth and revitalization program continued to deliver incremental selling square footage, most of which is devoted to front store categories, and this, combined with effective merchandising, an evolving and differentiated product and service offering and solid execution at store-level, continues to drive front store sales growth.

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 \$7.516 billion in 2007 compared to \$6.958 billion in 2006, an increase of \$558 million or 8.0%. Expressed as a percentage of sales, cost of goods sold declined by 117 basis points in 2007 compared to the prior year, reflecting an enhanced sales mix and the benefits from improved purchasing synergies. The inclusion of a full year of results of MediSystem Technologies Inc., which was acquired late in the third quarter of 2006, also contributed to year-over-year margin improvement in 2007. This improvement was partially offset by growth in other operating expenses, which increased by 45 basis points over the prior year when expressed as a percentage of sales. Higher operating expenses at store-level, primarily in the form of increased occupancy, wages and benefits associated with the expansion of the store network, along with increased marketing expenses tied to stepped-up promotional activities, accounted for much of this increase. Other operating expenses were also higher due to the inclusion of a full year of these expenses incurred at MediSystem Technologies Inc., as well as growth in distribution expenses stemming from higher transportation costs.

Amortization

Amortization of capital assets was \$172 million in 2007 compared to \$145 million in 2006, an increase of \$27 million or 19.0%. Expressed as a percentage of sales, amortization increased 17 basis points in 2007 compared to the prior year, reflecting the continued growth of the Company's capital investment and store development program.

Operating Income

Operating income was \$790 million in 2007 compared to \$684 million in 2006, an increase of \$106 million or 15.6%. As described above, sales growth, an enhanced mix and improved purchasing synergies, partially offset by higher operating costs and increased amortization tied to the Company's strategic growth and store network expansion initiatives, resulted in a higher operating margin (operating income divided by sales). In 2007, operating margin improved by 54 basis points to 9.32% compared to 8.78% in 2006. The Company's EBITDA margin was 11.35% in 2007, a 72 basis point improvement over the EBITDA margin of 10.63% posted in 2006.

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 \$53 million in 2007 compared to \$50 million in 2006, an increase of \$3 million or 6.0%. This increase over the prior year can be attributed to an increase in the amount of consolidated net debt outstanding combined with a market-driven increase in short-term interest rates.

Interest expense for 2007 includes \$1 million for the amortization of deferred financing costs compared to \$2 million in 2006. (See note 4 to the consolidated financial statements of the Company.)

Income Taxes

The Company's effective income tax rate in 2007 was 33.0%, essentially unchanged from the rate of 33.3% in the prior year. (See discussion on "Income and Other Taxes" under "Critical Accounting Estimates" in this Management's Discussion and Analysis and notes 1 and 5 to the consolidated financial statements of the Company.)

Net Earnings

Net earnings were \$494 million in 2007 compared to \$422 million in 2006, an increase of \$72 million or 16.8%. On a diluted basis, earnings per share were \$2.27 in 2007 compared to \$1.95 in 2006.

Financial Position

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

(\$000s)	2007	2006
Cash	\$ (27,588)	\$ (62,865)
Bank indebtedness	225,152	134,487
Commercial paper	543,847	503,550
Current portion of long-term debt	298,990	–
Long-term debt	–	300,000
Net debt	1,040,401	875,172
Shareholders' equity	3,097,047	2,723,954
Total capitalization	\$ 4,137,448	\$ 3,599,126
Net debt:Shareholders' equity	0.34:1	0.32:1
Net debt:Total capitalization	0.25:1	0.24:1
Net debt:EBITDA	1.08:1	1.06:1
EBITDA:Cash interest expense ⁽¹⁾	18.45:1	17.16:1

⁽¹⁾ Cash interest expense excludes the amortization of deferred financing costs. (See note 4 to the consolidated financial statements of the Company.)

Financial Ratios and Credit Ratings

As measured by the ratios set out above, the Company maintained its strong balance sheet and financial position in 2007. The Company is comfortable with its existing capital structure and financial position and expects to maintain similar ratios in 2008.

The following table provides a summary of the Company's credit ratings at the end of 2007.

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

There were no changes to any of the Company's credit ratings during fiscal 2007.

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 216,848,942 common shares outstanding at March 6, 2008. As at this same date, the Company had issued options to acquire 1,486,155 of its common shares pursuant to its stock-based compensation plans, of which 1,034,898 were exercisable. (See notes 11 and 12 to the consolidated financial statements of the Company.)

Dividend Policy

On February 8, 2007, the Company announced that its Board of Directors had declared a dividend of 16 cents per common share, payable April 13, 2007 to shareholders of record as of the close of business on March 30, 2007. This represented an increase in the amount of the Company's quarterly dividend payments of 33.3%, resulting in an annualized dividend payment of 64 cents per common share.

The following table provides a summary of dividends declared by the Company in 2007:

Declaration Date	Record Date	Payment Date	Dividend per Share
February 8, 2007	March 30, 2007	April 13, 2007	\$ 0.16
April 30, 2007	June 29, 2007	July 13, 2007	\$ 0.16
July 18, 2007	September 28, 2007	October 15, 2007	\$ 0.16
November 6, 2007	December 31, 2007	January 15, 2008	\$ 0.16

Subsequent to year-end, the Company announced, on February 5, 2008, that its Board of Directors had declared a dividend of 21.5 cents per common share, payable April 15, 2008 to shareholders of record as of the close of business on March 31, 2008. This represents an increase in the amount of the Company's quarterly dividend payments of 34.4%, resulting in an annualized dividend payment of 86 cents per common share.

Subject to financial results, capital requirements, available cash flow and any other factors that the Board of Directors may consider relevant, it is the intention of the Board of Directors to declare a comparable quarterly dividend on an ongoing basis. It is expected that future dividend payments will be made to shareholders of record as of the close of business on the last business day of each calendar quarter and that the related payment date will be the fifteenth day of the month following the record date, or if such day is not a business day, the immediately preceding business day.

All dividends paid by the Company in 2007 and, unless otherwise indicated, all dividends to be paid by the Company subsequent to 2007 are designated as *eligible dividends* in accordance with subsection 89(14) of the *Income Tax Act* (Canada) and any applicable corresponding provincial provisions.

Normal Course Issuer Bid

On September 5, 2007, the Company announced that its Board of Directors authorized the purchase of up to 5,400,000 of its common shares, representing approximately 2.5% of its common shares then outstanding, by way of normal course purchases on the Toronto Stock Exchange (the "TSX"). The Company was able to commence purchases under this program on September 10, 2007. The program will terminate on September 9, 2008, or on such earlier date as the Company may complete its purchases pursuant to a Notice of Intention filed with the TSX. Purchases will be made by the Company in accordance with the requirements of the TSX and the price that the Company pays for any such common shares will be the market price of such common shares at the time of acquisition. Common shares purchased under the program will be cancelled. As at December 29, 2007, no purchases had been made under this program.

The Company's previous share purchase program, announced on September 6, 2006, allowed the Company to purchase up to 5,350,000 of its common shares, representing approximately 2.5% of its common shares then outstanding, by way of normal course purchases on the TSX between September 8, 2006 and September 7, 2007. During fiscal 2007, no purchases were made under this program. From September 8, 2006 to December 30, 2006, the Company purchased and cancelled 913,600 common shares under this program at a cost of \$41.8 million. The premium paid over the average book value of the purchased common shares was charged to retained earnings. (See note 11 to the consolidated financial statements of the Company.)

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 \$550 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 \$300 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 Dominion Bond Rating Service. In the event that the Company's commercial paper program is unable to maintain this rating, the program is supported by the Company's \$550 million revolving bank credit facility. The Company does not currently foresee any reasonable circumstances under which this credit rating would not be maintained. (See note 9 to the consolidated financial statements of the Company.)

The Company has also arranged for its Associates to obtain financing to facilitate their purchase of inventory and fund their working capital requirements from the following sources: (i) an independent trust (the "Trust") whose activities are financed through the issuance of short-term, asset-backed notes that are rated R-1 (middle) by Dominion Bond Rating Service to third-party investors; and (ii) by providing guarantees to various Canadian chartered banks that support Associate loans. Due to current liquidity constraints in the Canadian asset-backed commercial paper market, the aggregate amount of Trust funding available to the Company's Associates is currently limited to \$500 million. (See discussions on "Associate Loans" and "Associate Financing Trust" under "Off-balance Sheet Arrangements" in this Management's Discussion and Analysis and notes 9, 14 and 15 to the consolidated financial statements of the Company.)

The Company has obtained additional long-term financing from 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 "Notes"). The Notes 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 Notes were assigned a rating of A (low) from Dominion Bond Rating Service and BBB from Standard & Poor's. (See note 9 to the consolidated financial statements of the Company.)

At December 29, 2007, \$61 million of the Company's \$550 million revolving credit facility was utilized, all in respect of letters of credit and trade finance guarantees. At the end of the prior year, \$51 million of this facility was utilized, all in respect of letters of credit and trade finance guarantees. At December 29, 2007, the Company had \$45 million of commercial paper issued and outstanding under its commercial paper program compared to \$50 million at the end of the prior year. At year end, Associates had obtained an aggregate amount of \$499 million of Trust financing and had drawn an aggregate amount of \$228 million in the form of Associate loans from various Canadian chartered banks compared to \$454 million and \$141 million, respectively, at the end of the prior year. (See notes 9 and 14 to the consolidated financial statements of the Company.)

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 2007, 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 \$565 million in 2007, compared to \$570 million in the prior year. In 2007, growth in net earnings, adjusted for non-cash items, was offset by a greater investment in non-cash working capital balances versus the prior year. Growth in inventory and accounts receivable, tied largely to expansion of the store network and increased sales activity, combined with a shift in the timing of income taxes paid, comprised the bulk of this investment. (See note 13 to the consolidated financial statements of the Company.)

Cash Flows Used in Investing Activities

Cash flows used in investing activities were \$613 million in 2007 compared to \$381 million in 2006, an increase of \$232 million or 60.7%. Of these totals, purchases of property and equipment, net of proceeds from any dispositions, amounted to \$378 million in 2007 compared to \$284 million in 2006, reflecting the Company's stepped-up capital investment and store revitalization program. In 2007, approximately 77% of the amount invested in property and equipment was allocated to the store network, relatively unchanged from the allocation in the prior year. In order to support the continued growth and expansion of the store network, the Company also allocated additional capital to certain infrastructure projects in information technology and distribution. In 2007, the Company completed the expansion of its western distribution centre located in Calgary, Alberta, having completed the expansion of its central distribution centre located in Mississauga, Ontario, during the prior year. In 2005, the Company completed the expansion of its eastern distribution centre located in Moncton, New Brunswick. In 2008, the Company will open a new 175,000 square-foot distribution centre in Richmond, British Columbia to handle imported merchandise and manage bulk and fast-moving products for its store network in this market.

In 2007, the Company invested an additional \$140 million in business acquisitions and \$94 million in deposits compared to an investment of \$94 million in business acquisitions in the prior year. Consistent with its stated growth objectives, these investments relate primarily to acquisitions of drug stores and prescription files, including funds deposited and held in escrow in respect of outstanding offers. Of the \$140 million invested in business acquisitions in 2007, \$77 million was used to acquire the assets of Centre d'Escomptes Racine, a seven store pharmacy chain in the Québec City region. (See note 3 to the consolidated financial statements of the Company.) The balance of the amount invested in business acquisitions in 2007 consisted primarily of purchases of single drug store prescription files; however, in some instances, the Company will acquire a drug store and continue to operate it at its existing location as a Shoppers Drug Mart® or Pharmaprix® store. In 2008, the Company will continue to pursue attractive acquisition opportunities in Canada's fragmented retail drug store marketplace.

During 2007, 121 new drug stores were opened or acquired, 44 of which were relocations, seven drug stores were closed and 28 drug stores were expanded and/or renovated. The Company also opened nine new home health care stores in 2007, two of which were relocations, and closed one store. At the end of 2007, there were 1,121 stores in the system, comprised of 1,057 drug stores and 64 Shoppers Home Health Care® stores. During 2007, the selling square footage of the store network increased by 11.5% to in excess of 9.7 million square feet. Consistent with the prior year, proportionately more square footage was added in Western Canada and Québec in 2007, two markets in which the Company has been historically underrepresented. At year-end, the average selling space per drug store was approximately 9,000 square feet compared to 8,700 square feet at the end of the prior year.

The following table provides a summary of the Company's store network, and changes thereto, for the periods indicated.

	2007		2006	
	Drug Stores	Home Health Care Stores	Drug Stores	Home Health Care Stores
Store count – beginning of year	987	58	950	51
Stores opened/acquired	77	7	47	7
Stores closed	7	1	10	–
Store count – end of year	1,057	64	987	58
Stores relocated	44	2	48	3
Stores renovated/expanded	28	–	29	1

The Company intends to continue making significant investments in its store base, with the goal of increasing the number and average size of its stores. In fiscal 2008, the Company plans to allocate approximately \$500 million to capital expenditures, with approximately 80% of this amount being invested in the store network, including acquisitions of drug stores, prescription files and land. Once again, this should result in an increase in selling square footage of more than 10%. This will be accomplished through the addition of between 120 and 130 new drug stores, approximately 40 to 45 of which will be relocations, and through the completion of up to 10 major expansions. The Company also plans to add up to five home health care stores to its network in fiscal 2008.

Cash Flows From (Used in) Financing Activities

Cash flows from financing activities were \$12 million in 2007, as cash inflows of \$145 million were mostly offset by cash outflows of \$133 million. Cash inflows were comprised of a \$91 million increase in bank indebtedness, a \$41 million increase in the amount of commercial paper issued and outstanding under the Company's commercial paper programs (\$46 million of additional Trust financing obtained by Associates, partially offset by a \$5 million reduction in the amount of commercial paper issued and outstanding by the Company) and \$14 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 \$4 million reduction in the amount of Associate investment and \$129 million for the payment of dividends.

In 2007, the net result of the Company's operating, investing and financing activities was a decrease in cash balances of \$35 million.

Future Liquidity

The Company believes that its current credit facilities, 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.

Contractual Obligations

The following table presents a summary of the maturity periods of the Company's contractual obligations as at the end of 2007.

(\$000s)	Payments Due during 2008	Payments Due in 2009 and 2010	Payments Due in 2011 and 2012	Payments Due after 2012	Obligations with No Fixed Maturity	Total
Medium-term notes	\$ 300,000	\$ –	\$ –	\$ –	\$ –	300,000
Employee future benefits ⁽¹⁾	–	–	–	–	15,247	15,247
Other	5,714	6,421	260	17	1,440	13,852
Operating leases ⁽²⁾	273,762	571,047	507,300	1,823,171	–	3,175,280
Total	\$ 579,476	\$ 577,468	\$ 507,560	\$ 1,823,188	\$ 16,687	\$ 3,504,379

⁽¹⁾ See discussion on "Employee Future Benefits" under "Critical Accounting Estimates" in this Management's Discussion and Analysis and note 10 to the consolidated financial statements of the Company.

⁽²⁾ Represents the minimum lease payments under long-term leases for store locations and office space as at December 29, 2007. (See note 14 to the consolidated financial statements of the Company.)

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.

The Company has entered into an agreement with a third party to provide distribution services to the Company's store network. Under the terms of the distribution services agreement, which expires on December 31, 2009, the third party will charge the Company specified costs incurred to provide the distribution services, plus an annual management fee. In addition, the Company has entered into an agreement to outsource certain information services activities from a third party. The Company has committed to average annual payments of approximately \$7 million over the term of the information services agreement, which expires in 2009.

Off-balance Sheet Arrangements

Associate Loans

The Company has provided guarantees to various Canadian chartered banks that support Associate loans. At the end of 2007, the Company's maximum obligation in respect of such guarantees was \$415 million compared to \$370 million at the end of the prior year. At December 29, 2007, an aggregate amount of \$356 million in available lines of credit had been allocated to the Associates by the various banks compared to \$323 million at the end of the prior year. As at December 29, 2007, Associates had drawn an aggregate amount of \$228 million against these available lines of credit compared to \$141 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, excluding inventory. 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.

Associate Financing Trust

The Company has arranged for its Associates to obtain financing from the Trust to facilitate their purchase of inventory and fund their working capital requirements. At the end of 2007, the total amount of loans outstanding from the Trust to the Company's Associates was \$499 million compared to \$454 million at the end of the prior year. The Company has determined that the Trust is deemed to be a variable interest entity and that the Company is the primary beneficiary. As such, the Trust is subject to consolidation by the Company and these loans are included in commercial paper on the Company's consolidated balance sheets. 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 \$50 million, as a form of credit enhancement which, in turn, enables the Trust to provide favourable financing terms to the Company's Associates. (See notes 1 and 14 to the consolidated financial statements of the Company.)

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 Trust will assign to the Company the Associate's loan agreement and related security documentation. 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.

Selected Annual Information

The following table provides a summary of certain selected consolidated annual financial information for the Company. The Company's fiscal year consists of a 52 or 53 week period ending on the Saturday closest to December 31. This information has been prepared in accordance with Canadian generally accepted accounting principles.

(\$000s, except per share data)	2007	2006	2005
	(52 weeks)	(52 weeks)	(52 weeks)
Sales	8,478,382	7,786,436	7,151,115
Net earnings	493,628	422,491	364,494
Per common share			
– Basic net earnings	\$ 2.28	\$ 1.97	\$ 1.72
– Diluted net earnings	\$ 2.27	\$ 1.95	\$ 1.69
Dividends declared per common share	\$ 0.64	\$ 0.48	\$ 0.40
Total assets	5,644,039	4,929,014	4,375,383
Total long-term liabilities	274,828	510,627	479,873

Sales

2007 Compared to 2006

Sales in 2007 were \$8.478 billion compared to \$7.786 billion in 2006, an increase of \$692 million or 8.9%. During 2007, the Company continued to experience strong sales growth in all regions of the country, led again by gains in Western Canada and Québec. On a same-store basis, sales increased 5.2% in 2007. The Company's capital investment program, which resulted in an 11.5% increase in selling space compared to a year ago, continues to have a positive impact on sales growth. Sales growth was also aided by the Company's efforts to acquire drug stores and prescription files, including the third quarter acquisition of the assets of Centre d'Escomptes Racine, a seven store pharmacy chain in the Québec City region.

Prescription sales were \$3.989 billion in 2007 compared to \$3.655 billion in 2006, an increase of \$334 million or 9.1%. In addition to new real estate and acquisitions, the national roll-out of enhanced pharmacy services under the HealthWATCH® brand contributed to pharmacy sales growth. On a same-store basis, prescription sales increased 5.8% during the year. Consistent with the prior year, pharmacy sales growth was driven by strong growth in the number of prescriptions filled, with greater generic utilization having a deflationary impact on sales growth in the category. In 2007, prescription sales accounted for 47.0% of the Company's sales mix compared to 46.9% in the prior year.

Front store sales were \$4.489 billion in 2007 compared to \$4.131 billion in 2006, an increase of \$358 million or 8.7%, with the Company once again realizing sales gains in all categories. On a same-store basis, front store sales increased 4.7% in 2007. The Company's store network growth and revitalization program continued to deliver incremental selling square footage, most of which is devoted to front store categories, and this, combined with effective merchandising, an evolving and differentiated product and service offering and solid execution at store-level, continues to drive front store sales growth.

2006 Compared to 2005

Sales in 2006 were \$7.786 billion compared to \$7.151 billion in 2005, an increase of \$635 million or 8.9%. During 2006, the Company also experienced strong sales growth in all regions of the country, led by gains in Western Canada and Québec. On a same-store basis, sales increased 6.5% in 2006. The Company's capital investment program, which resulted in a 10.6% increase in selling space versus the prior year, had a positive impact on sales growth.

Prescription sales were \$3.655 billion in 2006 compared to \$3.337 billion in 2005, an increase of \$318 million or 9.5%. In addition to new real estate, the launch of enhanced pharmacy services under the HealthWATCH® brand in Ontario and the third quarter acquisition of MediSystem Technologies Inc. contributed to pharmacy sales growth. On a same-store basis, prescription sales increased 7.9% in 2006. Prescription sales accounted for 46.9% of the Company's sales mix in 2006 compared to 46.7% in 2005.

Front store sales were \$4.131 billion in 2006 compared to \$3.814 billion in 2005, an increase of \$317 million or 8.3%. In 2006, the Company experienced sales gains in all categories, led by strong growth in HBA, OTC medications and beauty. On a same-store basis, front store sales increased 5.3% in 2006. The continued roll-out of new, larger-format stores, where the bulk of the incremental selling square footage is devoted to front store categories, combined with innovative marketing tactics and a differentiated product and service offering, drove sales growth in the front of the store.

Net Earnings

2007 Compared to 2006

Net earnings were \$494 million in 2007 compared to \$422 million in 2006, an increase of \$72 million or 16.8%. On a diluted basis, earnings per share were \$2.27 in 2007 compared to \$1.95 in 2006. Sales growth, an enhanced mix and improved purchasing synergies, partially offset by higher operating costs and increased amortization tied to the Company's strategic growth and store network expansion initiatives, resulted in higher operating income and net earnings.

2006 Compared to 2005

Net earnings were \$422 million in 2006 compared to \$364 million in 2005, an increase of \$58 million or 15.9%. On a diluted basis, earnings per share were \$1.95 in 2006 compared to \$1.69 in 2005. Sales growth, an enhanced mix and an ongoing commitment to cost reduction, productivity and efficiency, partially offset by higher operating costs and increased amortization in new and relocated stores, resulted in higher operating income and net earnings.

Net earnings growth also benefited from a modest decline in the Company's effective income tax rate in 2006 to 33.3% from 33.8% in 2005.

Dividends Declared per Common Share

On February 8, 2007, the Company announced that its Board of Directors had declared a dividend of 16 cents per common share, payable April 13, 2007 to shareholders of record as of the close of business on March 30, 2007. This represented an increase in the amount of the Company's quarterly dividend payments of 33.3%. Subject to financial results, capital requirements, available cash flow and any other factors that the Board of Directors may consider relevant, it is the intention of the Board of Directors to declare a comparable quarterly dividend on an ongoing basis.

The following table provides a summary of dividends declared by the Company in 2007 and 2006:

Declaration Date	Record Date	Payment Date	Dividend per Share
February 8, 2007	March 30, 2007	April 13, 2007	\$ 0.16
April 30, 2007	June 29, 2007	July 13, 2007	\$ 0.16
July 18, 2007	September 28, 2007	October 15, 2007	\$ 0.16
November 6, 2007	December 31, 2007	January 15, 2008	\$ 0.16
February 8, 2006	March 31, 2006	April 13, 2006	\$ 0.12
May 1, 2006	June 30, 2006	July 14, 2006	\$ 0.12
July 19, 2006	September 29, 2006	October 13, 2006	\$ 0.12
November 8, 2006	December 29, 2006	January 15, 2007	\$ 0.12

Total Assets

2007 Compared to 2006

Total assets were \$5.644 billion at the end of 2007 compared to \$4.929 billion at the end of 2006, an increase of \$715 million or 14.5%. Of this increase, \$351 million can be attributed to higher current asset balances, primarily accounts receivable, inventory and prepaid expenses and deposits. The increase in accounts receivable and inventory is tied largely to growth in the store network and increased sales activity, while the increase in prepaid expenses and deposits can be largely attributed to funds deposited and held in escrow in respect of outstanding offers to purchase drug stores and prescription files. (See note 3 to the consolidated financial statements of the Company.) Net property and equipment balances increased by \$219 million or 24.1% over the prior year, reflecting a further step-up in the Company's capital investment and store revitalization program. Combined, the net balances of goodwill and other intangible assets accounted for a further \$136 million of the increase in total assets, driven largely by the acquisitions of drug stores and prescription files, including the acquisition of the assets of Centre d'Escomptes Racine in the third quarter of 2007. (See notes 3 and 8 to the consolidated financial statements of the Company.)

2006 Compared to 2005

Total assets were \$4.929 billion at the end of 2006 compared to \$4.375 billion at the end of 2005, an increase of \$554 million or 12.7%. Higher current asset balances, primarily accounts receivable and inventory, tied largely to growth in the store network and increased sales activity, accounted for \$257 million of this increase. In 2006, net property and equipment balances increased by \$159 million or 21.2% over the prior year, reflecting the Company's stepped-up capital investment and store revitalization program. Combined, the net balance of goodwill and other intangible assets accounted for a further \$130 million of the increase in total assets in 2006, driven in large part by the acquisitions of MediSystem Technologies Inc. and Therapy Supplies & Rental Limited in the third quarter of that year.

Total Long-term Liabilities

2007 Compared to 2006

Total long-term liabilities were \$275 million at the end of 2007 compared to \$511 million at the end of 2006, a decrease of \$236 million or 46.2%. This decrease is largely attributable to the reclassification of \$300 million of medium-term notes due in October of 2008 from long-term debt to current portion of long-term debt, partially offset by a \$56 million increase in other long-term liabilities. The \$56 million increase in other long-term liabilities was driven largely by a \$43 million increase in deferred rent obligations at store-level, stemming from the further step-up in the Company's capital investment and store revitalization program. (See notes 1 and 10 to the consolidated financial statements of the Company.)

2006 Compared to 2005

Total long-term liabilities were \$511 million at the end of 2006 compared to \$480 million at the end of 2005, an increase of \$31 million or 6.4%. This increase was largely attributable to a \$48 million increase in other long-term liabilities, partially offset by a \$25 million reduction in long-term debt outstanding. The \$48 million increase in other long-term liabilities was tied principally to a \$42 million increase in deferred rent obligations at store-level, reflecting the stepped-up store network development program.

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)	2007	Fourth Quarter 2006	2007	Third Quarter 2006	2007	Second Quarter 2006	2007	First Quarter 2006
	(12 weeks)	(12 weeks)	(16 weeks)	(16 weeks)	(12 weeks)	(12 weeks)	(12 weeks)	(12 weeks)
Sales	\$ 2,168,822	\$ 2,018,067	\$ 2,542,671	\$ 2,329,051	\$ 1,928,094	\$ 1,768,199	\$ 1,838,795	\$ 1,671,119
Net earnings	\$ 153,659	\$ 132,500	\$ 142,574	\$ 123,880	\$ 112,264	\$ 94,407	\$ 85,131	\$ 71,704
Per common share								
– Basic net earnings	\$ 0.71	\$ 0.62	\$ 0.66	\$ 0.58	\$ 0.52	\$ 0.44	\$ 0.40	\$ 0.34
– Diluted net earnings	\$ 0.71	\$ 0.61	\$ 0.66	\$ 0.57	\$ 0.52	\$ 0.44	\$ 0.39	\$ 0.33

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 comparative quarterly results, particularly when a 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.

Results of Operations – Fourth Quarter of Fiscal 2007

The Company released its unaudited financial statements and the notes thereto for the fourth quarter and fiscal year ended December 29, 2007 on February 5, 2008. This information can be found on the Canadian Securities Administrators' website at www.sedar.com.

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

(\$000s, except per share data)	12 Weeks Ended	
	December 29, 2007 (unaudited)	December 30, 2006 (unaudited)
Sales	\$ 2,168,822	\$ 2,018,067
Cost of goods sold and other operating expenses	1,885,434	1,771,151
EBITDA ⁽¹⁾	283,388	246,916
Amortization	41,323	38,083
Operating income	242,065	208,833
Interest expense	14,185	10,895
Earnings before income taxes	227,880	197,938
Income taxes	74,221	65,438
Net earnings	\$ 153,659	\$ 132,500
Per common share		
– Basic net earnings	\$ 0.71	\$ 0.62
– Diluted net earnings	\$ 0.71	\$ 0.61

⁽¹⁾ Earnings before interest, taxes, depreciation and amortization.

Sales

Sales in the fourth quarter were \$2.169 billion compared to \$2.018 billion in the same period last year, an increase of \$151 million or 7.5%, with the Company once again experiencing strong sales growth in all regions of the country. On a same-store basis, sales increased 3.9% during the fourth quarter of 2007. A robust capital program, combined with effective marketing campaigns, strong seasonal programs and solid in-store execution drove this top-line growth.

Prescription sales were \$975 million in the fourth quarter compared to \$897 million in the fourth quarter of 2006, an increase of \$78 million or 8.8%. On a same-store basis, prescription sales increased 5.6% during the fourth quarter of 2007, driven by strong growth in the number of prescriptions filled, while increased generic utilization continued to have a deflationary impact on prescription sales growth. Prescription sales accounted for 45.0% of the Company's sales mix during the fourth quarter of 2007 compared to 44.4% in the same period last year.

Front store sales were \$1.194 billion in the fourth quarter compared to \$1.121 billion in the fourth quarter of 2006, an increase of \$73 million or 6.4%, with the Company continuing to experience sales and market share gains in all core categories. On a same-store basis, front store sales increased 2.6% during the fourth quarter of 2007, a strong result considering the adverse weather experienced in Central and Eastern Canada that coincided with a major promotional event. Private label and exclusive brand penetration in the fourth quarter was 16.1% of front store sales, the highest ever for the Company, led by strong seasonal category penetration. While deflationary to sales, increased private label penetration remains one of the Company's key strategic objectives

as it is beneficial to margins and profitability. Certain other seasonal merchandise, notably cards, wrap, books and magazines, also experienced deflationary pressure during the quarter, as prices were reduced in response to the appreciation of the Canadian dollar. However, as a result of increased support from the Company's vendor partners, these price reductions did not have a negative impact on overall profitability.

Cost of Goods Sold and Other Operating Expenses

Cost of goods sold and other operating expenses were \$1.885 billion in the fourth quarter of 2007 compared to \$1.771 billion in the same period last year, an increase of \$114 million or 6.5%. Expressed as a percentage of sales, cost of goods sold declined by 130 basis points versus the comparative prior year period, reflecting an enhanced sales mix and the benefits from improved buying synergies. Partially offsetting this improvement were higher fourth quarter operating expenses which, when expressed as a percentage of sales, increased by 47 basis points over the prior year period. Operating expenses were higher due in large part to increased store-level expenses associated with the continued investment in, and expansion of, the store network, primarily occupancy and labour, as well as increased marketing expenses tied to stepped-up promotional activities.

Amortization

Amortization of capital assets was \$41 million in the fourth quarter of 2007 compared to \$38 million in the same period last year, an increase of \$3 million or 8.5%. This increase in amortization reflects the continued growth of the Company's capital investment program, although the rate of increase was muted somewhat in the fourth quarter of 2007 as a result of reduced losses on dispositions of capital property compared to the prior year. Expressed as a percentage of sales, amortization increased by 2 basis points versus the comparative prior year period.

Operating Income

Operating income was \$242 million in the fourth quarter of 2007 compared to \$209 million in the same period last year, an increase of \$33 million or 15.9%. As described above, sales growth, combined with a reduction in cost of goods and an enhanced mix, partially offset by investments in growth initiatives and increased amortization, resulted in a higher operating margin (operating income divided by sales). In 2007, fourth quarter operating margin improved by 81 basis points to 11.16% from 10.35% in the same period last year. The Company's EBITDA margin (EBITDA divided by sales) was 13.07% in the fourth quarter of 2007, an 83 basis point improvement over the EBITDA margin of 12.24% posted in the fourth quarter of last year.

Interest Expense

Interest expense was \$14 million in the fourth quarter of 2007 compared to \$11 million in the same period last year, an increase of \$3 million or 30.2%. 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.

Income Taxes

The Company's effective income tax rate in the fourth quarter of 2007 was 32.6% compared to 33.1% in the same period last year. This decrease versus the comparative prior year period is primarily attributable to a reduction in statutory rates in certain jurisdictions.

Net Earnings

Fourth quarter net earnings were \$154 million compared to \$133 million in the same period last year, an increase of \$21 million or 16.0%. On a diluted basis, earnings per share were \$0.71 in the fourth quarter of 2007 compared to \$0.61 in the same period last year.

Cash Flows

Cash flows from operating activities were \$220 million in the fourth quarter of 2007 compared to \$239 million in the same period last year, a decrease of \$19 million or 7.9%. Operating income was higher in the fourth quarter of this year compared to the fourth quarter of 2006; however, the increase was more than offset by a reduction in the amount of cash generated from the change in working capital balances versus the amount generated in the comparative prior year period. Compared to the same period last year, growth in inventory and accounts receivable balances was more than offset by an increase in accounts payable; however, a shift in the timing of income taxes paid resulted in less cash being generated in the fourth quarter of this year.

Cash flows used in investing activities were \$174 million in the fourth quarter of 2007 compared to \$119 million in the same period last year, an increase of \$55 million or 46.0%. Of these totals, purchases of property and equipment, net of proceeds of any dispositions, amounted to \$135 million in the fourth quarter of 2007 compared to \$112 million in the fourth quarter of 2006, reflecting another step-up in the Company's real estate program. The Company also invested \$19 million in business acquisitions and \$19 million in trust deposits in the fourth quarter of 2007 compared to an investment of \$11 million in business acquisitions in the same period last year. During the fourth quarter of 2007, 30 new drug stores were opened or acquired, seven of which were relocations, and one drug store was closed. The Company also added two home health care stores to its network during the fourth quarter of 2007.

Cash flows used in financing activities were \$36 million in the fourth quarter of 2007, as cash outflows of \$56 million were partially offset by cash inflows of \$20 million. Cash outflows were comprised of \$22 million to reduce bank indebtedness and \$35 million for the payment of dividends. Cash inflows were comprised of a \$7 million increase in the amount of commercial paper issued and outstanding under the Company's commercial paper programs (a \$5 million increase in the amount of commercial paper issued and outstanding by the Company plus \$2 million of additional Trust financing obtained by Associates), \$10 million of additional Associate investment and \$3 million of proceeds received from the issuance of common shares and loan repayments under the Company's stock-based incentive plans.

In the fourth quarter of 2007, the net result of the Company's operating, investing and financing activities was an increase in cash balances of \$10 million.

Critical Accounting Estimates

The Company's consolidated financial statements are prepared in accordance with Canadian GAAP, which require management to make certain estimates, judgements and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. The Company bases its estimates, judgements and assumptions on historical experience, current trends and other factors that management believes to be important at the time the consolidated financial statements are prepared. The Company reviews its accounting policies and how they are applied on a regular basis. While the Company believes that the historical experience, current trends and other factors considered support the preparation of its consolidated financial statements in accordance with Canadian GAAP, actual results could differ from its estimates and such differences could be material.

The Company's significant accounting policies are discussed in note 1 to the consolidated financial statements of the Company. The following accounting policies incorporate a higher degree of judgement and/or complexity and, accordingly, are considered to be critical accounting policies.

Inventory

Inventory is valued at the lower of cost and estimated net realizable value, with cost being determined on a first-in, first-out basis. Significant estimation or judgement is required in the determination of estimated inventory losses, or shrinkage, occurring between the date of the last physical inventory count and the balance sheet date.

Shrinkage is estimated as a percentage of sales for the period from the date of the last physical inventory count to the balance sheet date. Such estimates are based on experience and recent physical inventory count results. To the extent that actual inventory losses experienced vary from estimates, both inventories and operating income could be impacted.

Shoppers Optimum™

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 the net cost per point redeemed and adjusts the estimated redemption rate and 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.

At the beginning of 2006, the Company changed the Program rewards schedule and, accordingly, adjusted certain of the assumptions used to determine the estimated cost per point issued thereafter.

Employee Future Benefits

The cost and accrued benefit plan obligations of the Company's registered and non-registered defined benefit pension plans and other post-employment benefit plans are accrued based on actuarial valuations which are dependent upon assumptions determined by management. These assumptions include the discount rate, the expected long-term rate of return on plan assets, the rate of compensation increases, retirement ages, mortality rates and the expected inflation rate of health care costs. These assumptions are reviewed annually by the Company's management and its actuaries.

The most significant of these actuarial assumptions are set out in the following table.

	2007			2006		
	Registered Defined Benefit Pension Plans	Non-registered Defined Benefit Pension Plan	Other Post- employment Benefit Plans	Registered Defined Benefit Pension Plans	Non-registered Defined Benefit Pension Plan	Other Post- employment Benefit Plans
Accrued benefit obligation, end of period						
Discount rate	5.25%	2.63%	5.25%	5.00%	2.50%	5.00%
Compensation increase	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
Benefit expense for the period						
Discount rate	5.00%	2.50%	5.00%	5.00%	2.50%	5.00%
Expected return on assets	7.50%	3.75%	N/A	7.50%	3.75%	N/A
Compensation increase	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%

The discount rate is based on current market interest rates at the end of the Company's fiscal year, assuming a portfolio of corporate AA rated bonds with terms to maturity that, on average, match the terms of the accrued benefit plan obligations. A 1% increase in the assumed discount rate would decrease the amount of the Company's accrued benefit obligation and benefit expense in respect of its registered and non-registered defined benefit plans by \$15 million and \$2 million, respectively. Conversely, a 1% decrease in the assumed discount rate would increase the amount of the Company's accrued benefit obligation and benefit expense in respect of its registered and non-registered defined benefit plans by \$17 million and \$3 million, respectively.

The expected long-term rate of return on plan assets is based on the asset mix of invested assets and historical returns. A 1% increase in the assumed long-term rate of return on plan assets would decrease the amount of the Company's benefit expense in respect of its registered and non-registered defined benefit plans by \$1 million. Conversely, a 1% decrease in the assumed long-term rate of return on plan assets would increase the amount of the Company's benefit expense in respect of its registered and non-registered defined benefit plans by \$1 million. In calculating the benefit expense for its registered and non-registered defined benefit plans for 2007, the Company has assumed a long-term rate of return on plan assets of 7.5%.

A 1% increase in the assumed rate of compensation increases would increase the amount of the Company's accrued benefit obligation and benefit expense in respect of its registered and non-registered defined benefit plans by \$6 million and \$2 million, respectively. Conversely, a 1% decrease in the assumed rate of compensation increases would decrease the amount of the Company's accrued benefit obligation and benefit expense in respect of its registered and non-registered defined benefit plans by \$5 million and \$2 million, respectively.

The expected inflation rate of health care costs is based on historical trends and external data. The growth rate assumption used by the Company in determining its accrued benefit obligation and benefit expense in respect of its other post-employment benefit plans was 5.5% in 2007, unchanged from the prior year. This is also the assumed growth rate for future years. A 1% change in the assumed growth rate of health care costs would not have a significant impact on the Company's accrued benefit obligation and benefit expense in respect of its other post-employment benefit plans.

These assumptions may change in the future and any changes could have a material impact on the accrued benefit plan obligations of the Company and the cost of these plans which is reflected in the Company's consolidated statements of earnings. However, the magnitude of any immediate impact on net earnings of the Company is mitigated by the fact that, in accordance with Canadian

GAAP, the excess of any net accumulated actuarial gain or loss over 10% of the greater of the accrued benefit obligation and the fair value of plan assets is amortized, on a straight-line basis, over the expected average remaining service period of the active employees covered by the plans. At December 29, 2007, the expected average remaining service period of active employees covered by the Company's registered and non-registered defined benefit pension plans and other post-employment benefit plans was 14 and 10 years, respectively.

At December 29, 2007, the funded status of the Company's obligations under its registered and non-registered defined benefit pension plans and other post-employment benefit plans was a deficit of \$25 million, compared to a deficit of \$30 million at the end of the prior year. Included in other long-term liabilities on the Company's consolidated balance sheets at December 29, 2007, was an amount of \$15 million in respect of the Company's obligations under its registered and non-registered defined benefit pension plans and other post-employment benefit plans, compared to \$14 million at the end of the prior year. As of this same date, the unamortized net actuarial loss in respect of the Company's obligations under its registered and non-registered defined benefit pension plans and other post-employment benefit plans was \$10 million, compared to \$16 million at the end of the prior year. (See note 10 to the consolidated financial statements of the Company.)

The actual rate of return on plan assets and changes in interest rates could also result in changes in the Company's funding requirements for its defined benefit pension plans.

Income and Other 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 determination of the income tax provision requires management to interpret regulatory requirements and to make certain judgements. While income, capital and commodity tax filings are subject to audits and reassessments, management believes that adequate provisions have been made for all income and other tax obligations. However, changes in the interpretations or judgements may result in an increase or decrease in the Company's income, capital or commodity tax provisions in the future. The amount of any such increase or decrease cannot be reasonably estimated.

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 accounts for a significant amount of the Company's total assets. Goodwill is evaluated for impairment annually. The process of evaluating goodwill involves the determination of fair value. Inherent in such fair value determinations are certain judgements and estimates including, but not limited to, projected future sales, earnings and capital investment, discount rates and terminal growth rates. These judgements and estimates may change in the future due to uncertain competitive, market and general economic conditions, or as a result of changes in the business strategies and outlook of the Company.

A goodwill impairment loss would be recognized to the extent that the carrying value of goodwill exceeds the implied fair value. Any goodwill impairment would result in a reduction in the carrying value of goodwill on the consolidated balance sheets of the Company and the recognition of a non-cash impairment charge in operating income. Based on the analysis performed, the Company has not identified any goodwill impairment.

Other intangible assets are amortized on a straight-line basis over the estimated useful lives of the assets at the rates indicated below.

Prescription files	7 years
Developed technology	3 years
Customer relationships	5 to 25 years
Other	Indefinite

New Accounting Pronouncements

Accounting Standards Implemented in 2007

Financial Instruments

In 2006, the Canadian Institute of Chartered Accountants (the “CICA”) issued new accounting standards concerning financial instruments: Financial Instruments – Recognition and Measurement (“Section 3855”); Hedges (“Section 3865”); and Comprehensive Income (“Section 1530”). These standards required prospective application and were effective for the Company’s 2007 fiscal year. The Company applied the new accounting standards at the beginning of its current fiscal year and their implementation did not have a significant impact on the Company’s results of operations or financial position.

Financial Assets and Liabilities

Section 3855 establishes standards for recognizing and measuring financial instruments. Under the new standards, all financial instruments are classified into one of the following five categories: held for trading; held-to-maturity investments; loans and receivables; available-for-sale financial assets; or, other financial liabilities. This classification drives the basis of measurement and the accounting treatment in the financial statements. (See note 2 to the consolidated financial statements of the Company.)

Derivatives and Hedge Accounting

The Company has entered into various interest rate derivative agreements converting an aggregate notional principal amount of \$250 million of floating rate, short-term, asset-backed notes issued by the Trust 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. These interest rate derivative agreements are designated as hedges in accordance with the new standards. Accordingly, the fair value of these agreements has been included in “other assets” on the consolidated balance sheet of the Company. Any after-tax adjustments related to the fair values of these interest rate derivative agreements have been included in “accumulated other comprehensive income” on the consolidated balance sheet of the Company. (See notes 2 and 15 to the consolidated financial statements of the Company.)

In addition, the Company has entered into cash-settled equity forward agreements to limit its exposure to future changes in the market price of 172,988 of its common shares by virtue of its obligations under its stock-based long-term incentive plan (“LTIP”). These agreements mature in December 2008 and December 2009. A percentage of these equity forward derivative agreements, related to the unearned units under the LTIP, has been designated as a hedge in accordance with the new standards. Accordingly, upon adoption of the new standards, the fair value of this hedge was reflected in the opening balance of “accumulated other comprehensive income”, net of tax.

During 2007, the change in the fair value of the percentage of these equity forward agreements that related to the unearned LTIP units was recorded in "other comprehensive income". (See notes 2 and 15 to the consolidated financial statements of the Company.)

Convertible and Other Debt Instruments with Embedded Derivatives

In March 2007, the Emerging Issues Committee of the CICA (the "EIC") issued EIC-164, "Convertible and Other Debt Instruments with Embedded Derivatives" ("EIC-164"). EIC-164 addresses accounting for debt instruments with certain conversion features. EIC-164 applies retrospectively to financial instruments accounted for in accordance with Section 3855 in interim or annual financial statements ending on or after June 30, 2007. The implementation of EIC-164 did not have an impact on the Company's results of operations or financial position.

Accounting by an Investor upon Loss of Significant Influence

In April 2007, the EIC issued EIC-165, "Accounting by an Investor upon Loss of Significant Influence" ("EIC-165"). EIC-165 addresses how an investor that loses significant influence in an investee should account for the amount the investor has in accumulated other comprehensive income for its proportionate share of the investee's equity adjustments for other comprehensive income. EIC-165 applies retrospectively to financial statements for interim and annual periods ending after June 30, 2007. The implementation of EIC-165 did not have an impact on the Company's results of operations or financial position.

Accounting Policy Choice for Transaction Costs

In June 2007, the EIC issued EIC-166, "Accounting Policy Choice for Transaction Costs" ("EIC-166"). EIC-166 addresses whether transaction costs related to financial assets and liabilities that are not classified as held for trading can be recognized in net income for certain of these financial assets and liabilities and added to the carrying amount for other financial assets and liabilities. EIC-166 applies retrospectively to financial statements issued for interim and annual reports ending on or after September 30, 2007. The implementation of EIC-166 did not have a significant impact on the Company's results of operations or financial position.

Equity

As a result of the issuance of guidance on financial instruments accounting, the CICA issued an amended accounting standard regarding Equity ("Section 3251"), which replaces Section 3250, Equity. Section 3251 requires companies to disclose the impact of the new financial instruments accounting standards on equity within the consolidated balance sheets and consolidated statements of retained earnings. Section 3251 requires prospective application and was effective for the Company's first quarter of fiscal 2007. The Company applied the new accounting standards at the beginning of its 2007 fiscal year.

Future Accounting Standards

Capital Disclosures

In 2006, the CICA issued a new accounting standard concerning Capital Disclosures ("Section 1535"), which requires the disclosure of both quantitative and qualitative information that enables users of financial statements to evaluate an 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 will apply the new accounting standard at the beginning of its 2008 fiscal year with the impact being limited to the Company's disclosures, with no impact on its results of operations or financial position.

Financial Instruments – Disclosure and Presentation

The Company will be required to adopt two new accounting standards concerning financial instruments: “Financial Instruments – Disclosures” (“Section 3862”) and “Financial Instruments – Presentation” (“Section 3863”). These standards were issued in December 2006 and will replace Section 3861, “Financial Instruments, Disclosure and Presentation”. The new disclosure standard increases the emphasis on the risk associated with financial instruments and how those risks are managed. The new presentation standard carries forward the former presentation requirements under the existing Section 3861. The standards are effective for interim and annual financial statements for fiscal years beginning on or after October 1, 2007. The Company will apply the new accounting standards at the beginning of its 2008 fiscal year with the impact being limited to the Company’s disclosures, with no impact on its results of operations or financial position.

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. The new section replaced the existing guidance on inventories. Section 3031 provides additional guidance on measuring the cost of inventory and the measurement and presentation of cost of goods sold, as well as requiring additional associated disclosures. The new standard also allows for the reversal of any write-downs previously recognized. The standard is effective for interim and annual financial statements for fiscal years beginning on or after January 1, 2008. The Company will apply the new accounting standard at the beginning of its 2008 fiscal year. The Company is currently assessing the impact of the new standard on its results of operations, financial position and disclosures; however, the Company expects the impact will be immaterial.

Going Concern

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

Risks and Risk Management

The Company is exposed to a number of risks in the normal course of its business that have the potential to affect its operating and financial performance.

Industry and Regulatory

The Company is reliant on prescription drug sales for a significant and growing portion of its sales and profits. Prescription drugs and their sales are subject to numerous federal, provincial, territorial and local laws and regulations. Changes to these laws and regulations, or non-compliance with these laws and regulations, could have a material adverse impact on the Company’s business, sales and profitability.

Federal and provincial laws and regulations that establish the public drug plans regulate prescription drug coverage, patient eligibility, pharmacy reimbursement and may also regulate manufacturer allowances that may be provided to pharmacy. With respect to pharmacy reimbursement, such laws and regulations typically regulate the allowable drug cost of a prescription drug product, the permitted mark-up on a prescription drug product and the professional fees that may be charged on prescription drug

sales to eligible patients. In addition, other federal, provincial, territorial and local laws and regulations govern the approval, packaging, labelling, sale, marketing, advertising, handling, storage, distribution, dispensing and disposal of prescription drugs.

Third-party payers, such as governments, insurers or corporate employers, continue to pursue measures to manage the costs of their drug plans. Sales of prescription drugs and pharmacy reimbursement may be affected by changes to the health care industry, including legislative or other changes, that impact patient eligibility, the allowable cost, mark-up or dispensing fees paid by third-party payers or changes that impact the provision or receipt of manufacturer allowances.

Some jurisdictions have implemented, and others are implementing, legislation directed towards managing pharmacy services and controlling increasing drug costs incurred by public drug plans. In Ontario, the *Transparent Drug System for Patients Act, 2006* which came into effect in October of 2006, included legislative changes to pharmacy reimbursement, including reducing the price of and allowable cost for most generic prescription drugs, and placed restrictions on manufacturer allowance funding. Legislation in the Province of Québec requires a commitment from the manufacturer guaranteeing that the selling price of prescription drug products for Québec's public drug programs will not be higher than the selling price under other provincial drug insurance programs and beginning in 2008, the Province of Québec will be decreasing the prices for many prescription drug products. In addition, Québec amended its legislation in 2007 to reduce the mark-up that manufacturers and wholesalers could charge on prescription drug products and to accommodate the provision of certain manufacturer allowance funding to pharmacy. As a result of legislative changes in the Province of Newfoundland and Labrador, beginning in 2008 the maximum allowable cost of a prescription drug product will be restricted to the Ontario public drug program price. In addition to legislative changes, other measures to control drug costs are being considered by certain government payers, including restricting the number of interchangeable prescription drug products which are eligible for reimbursement, which may impact pharmacy reimbursement levels and manufacturer allowances. Where legislative or other measures that appear to be effective in reducing prescription drug costs are implemented in one jurisdiction, governments in other jurisdictions are looking or may look to implement similar measures. In some jurisdictions, elements of the laws and regulations that impact pharmacy reimbursement and manufacturer allowances for sales to the public drug plans may be extended by legislation to sales in the private sector. Also, private third-party payers (such as corporate employers and their insurers) are looking or may look to benefit from any measures implemented by government payers to reduce drug costs for public plans by attempting to extend these measures to drug plans they own or manage. Accordingly, changes to pharmacy reimbursement and manufacturer allowances for a public drug plan could also impact pharmacy reimbursement and manufacturer allowances for private sector sales. In addition, private third-party payers could reduce pharmacy reimbursement for prescription drugs provided to their members.

Changes impacting pharmacy reimbursement programs and manufacturer allowance funding, legislative or otherwise, may have a material adverse impact on the Company's business, sales and profitability. In addition, the Company could incur significant costs in the course of complying with any changes in the regulatory regime affecting prescription drugs. Non-compliance with any such laws or regulations, particularly those that provide for the licensing and conduct of wholesalers, the licensing and conduct of pharmacists, the regulation and ownership of pharmacies, the advertising of pharmacies and prescription services and the pricing of prescription drugs, could result in civil or regulatory proceedings, fines, injunctions, recalls or seizures, any of which may impact the Company's business, sales or profitability.

Competition

The Company faces competition from many retailers in the front store merchandise and non-prescription drug categories. The Company's competitors in the retail pharmacy business include independent operators, banner groups, retail chains, mass merchandisers and larger supermarket chains with combination food/drug retail operations. These competitors may reduce prices in front store merchandise or reduce dispensing fees to increase market share, which could have an adverse impact on the Company's market share and/or earnings.

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 in interest rates will have an adverse effect on the earnings 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.

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.

Foreign Currency Exchange Risk

The Company has no foreign operations and 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.

Property and Casualty Exposures

Certain property and casualty risks and exposures are inherent in the operation of the Company's business. The Company has a number of integrated risk management programs in place which are designed to reduce its exposures and mitigate any losses. These include self-insuring certain exposures to levels appropriate and customary for the Company given its relative size and financial condition, as well as purchasing excess coverage from financially stable third-party insurance companies to provide adequate coverage for normal insurable commercial risks.

Ability to Attract and Retain Pharmacists

The Company is dependent upon its ability to attract, motivate and retain pharmacists for the stores in its network. Demographic trends and increased competition have led to a shortage of pharmacists in certain markets in Canada. The inability to attract and retain pharmacists could adversely affect the Company's business, financial condition and results of operations.

The Company believes that its Associate Concept provides it with a competitive advantage when recruiting pharmacists. In particular, pharmacy school graduates are attracted to the Company because its Associate Concept enables pharmacists to own their own businesses while benefiting from the training, capital and operational support provided by the Company. The Company has also invested in a number of recruitment and retention programs in order to attract pharmacists employed elsewhere in the workforce, which include enhanced benefits, opportunities for mobility and advancement and financial support for continuing education. Moreover, the Associate-owned stores in the Company's network continue to employ more pharmacy students and interns to ensure a source of supply of new graduates in future years. In recent years, the Company has made a number of enhancements to its pharmacist compensation and benefit plans in order to further improve its retention rate of existing pharmacists.

Third-party Service Providers

The Company is reliant upon third-party service providers in respect of certain of its operations. It is possible that negative events affecting these third-party service providers could, in turn, negatively impact the Company. While the Company has no direct influence over how such third parties are managed, it has entered into contractual arrangements to formalize these relationships. In order to minimize operating risks, the Company actively monitors and manages its relationships with its third-party service providers.

Real Estate

Successful implementation of the Company's growth strategies is dependent upon the Company's ability to increase the selling square footage of its Associate-owned store network through new store openings and acquisitions, expansions of existing stores and by relocating other stores to superior sites. The availability of suitable store locations and redevelopment opportunities with respect to existing stores, and the lease terms that the Company is able to negotiate in connection with new leases and store upgrading, may impact the Company's ability to execute its strategic plan to the extent that desirable locations and/or redevelopment opportunities are not available on reasonable commercial terms.

Seasonality

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 comparative quarterly results, particularly when a 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.

Environmental Compliance

As an owner or lessee of property, the Company is subject to various federal and provincial laws and regulations relating to environmental matters. Non-compliance with environmental laws and regulations may result in regulatory action including orders, fines and other penalties. Such laws also provide that the owner or lessee could be liable for costs of assessment, monitoring, removal and remediation of certain hazardous substances on its properties, or disposed of at other locations. The failure to remove or remediate such substances, if any, could lead to regulatory action or claims against the Company. Future developments and increasingly stringent environmental regulation may require the Company to incur additional expenditures.

The Company endeavours to be socially and environmentally responsible. To that end, the Company has established policies and procedures aimed at ensuring compliance with applicable environmental laws and regulations. Environmental protection measurements do not have, and are not expected to have, a material effect on the Company's operations, business practices and/or financial performance.

Ethical Business Conduct

Any violation of law, breach of Company policies or unethical behaviour could significantly affect the Company's reputation and ability to operate, which could have an adverse impact on the Company's financial performance. The Company is committed to ethical business practices and maintenance of the Company's reputation for honesty and integrity is the cornerstone of this business philosophy. To that end, the Company has established policies and practices to ensure that employees and directors uphold the highest standards of ethical behaviour.

Workplace Health and Safety

The Company recognizes that ensuring a healthy and safe workplace minimizes injuries and other risks employees may face in carrying out their duties, improves productivity and helps to minimize the liability or penalties which could be incurred in connection with workplace injuries. The Company has health and workplace safety programs in place and has established policies and procedures aimed at ensuring compliance with applicable legislative requirements.

Employee Future Benefits

The Company has certain obligations under its registered and non-registered defined benefit pension plans and other post-employment benefit plans. There is no assurance that the Company's benefit plans will be able to earn the assumed rate of return. New regulations and market-driven changes may result in changes in the discount rates and other variables which would result in the Company being required to make contributions in the future that differ significantly from estimates. An extended period of depressed capital markets and low interest rates could require the Company to make contributions to these plans in excess of those currently contemplated which, in turn, could have an adverse impact on the financial performance of the Company.

Legal, Tax and Accounting

Changes to any of the various federal and provincial laws, rules, regulations or policies related to the Company's business could have a material impact on its operations and financial results. Compliance with any proposed changes could also result in a significant cost to the Company. Failure to fully comply with various laws, rules, regulations or policies may expose the Company to proceedings or actions which may materially affect its performance. Similarly, changes in tax regulations and/or accounting pronouncements introduced by authoritative bodies may positively or negatively impact the Company's financial performance.

Associate-owned Store Network

The success of the Company and the reputation of its brands are closely tied to the performance of its Associate-owned drug stores. Accordingly, the Company relies on its Associates to successfully operate, manage and execute the retail programs and strategies of the Company at their respective locations.

The Company supports the operations of its Associates in many ways, including the provision of training and continuing education programs, as well as assistance with various administrative tasks. In addition, each Associate agrees to comply with the policies, marketing plans and operating standards prescribed by the Company, as specified in the Associate agreements with individual Associates. As well, through head lease control, the Company maintains control of all locations in its Associate-owned store network.

Supplier and Brand Reputations

The Company promotes nationally branded, non-proprietary products, as well as private label, proprietary products. Damage to the reputation of any of these brands, or to the reputation of any supplier or manufacturer of these brands, could negatively impact consumer opinion of the Company or the related products, which could have an adverse impact on the financial performance of the Company.

Other

The Company's operating and financial performance may also be affected by other specific risks that may be highlighted from time to time in other public filings of the Company available on the Canadian Securities Administrators' website at www.sedar.com.

Disclosure Controls and Procedures

The Company maintains a system of disclosure controls and procedures that have been designed to provide reasonable assurance that information required to be disclosed by the Company in its filings is recorded, processed, summarized and reported within required time periods and includes controls and procedures designed to ensure that all relevant information is accumulated and communicated to senior management, including the Company's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), to allow timely decisions regarding required disclosure.

Management, with the participation of the CEO and CFO and members of the Company's Disclosure Committee, has evaluated the effectiveness of the Company's disclosure controls and procedures as of December 29, 2007 and has concluded that the disclosure controls and procedures are designed and operating effectively to provide reasonable assurance that information required to be disclosed relating to the Company, including its consolidated subsidiaries and Associate-owned store network, is recorded, processed, summarized and reported to the CEO and CFO by others within the Company, particularly during the period in which the annual filings were being prepared.

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.