

Management's Responsibility for Financial Statements

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

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

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



Jürgen Schreiber

PRESIDENT AND CHIEF EXECUTIVE OFFICER



George Halatsis

EXECUTIVE VICE-PRESIDENT AND CHIEF FINANCIAL OFFICER

Auditors' Report

To the Shareholders of Shoppers Drug Mart Corporation

We have audited the consolidated balance sheets of Shoppers Drug Mart Corporation as at December 30, 2006 and December 31, 2005 and the consolidated statements of earnings, retained earnings and cash flows for the 52 week periods then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of Shoppers Drug Mart Corporation as at December 30, 2006 and December 31, 2005 and the results of its operations and its cash flows for the 52 week periods then ended in accordance with Canadian generally accepted accounting principles.



Chartered Accountants

TORONTO, ONTARIO

FEBRUARY 7, 2007

Consolidated Statements of Earnings

52 weeks ended December 30, 2006 and December 31, 2005
(in thousands of dollars, except per share amounts)

	2006	2005
Sales	\$ 7,786,436	\$ 7,151,115
Operating expenses		
Cost of goods sold and other operating expenses	6,958,361	6,430,933
Amortization	144,549	120,937
Operating income	683,526	599,245
Interest expense (Note 3)	49,872	48,649
Earnings before income taxes	633,654	550,596
Income taxes (Note 4)		
Current	220,398	177,197
Future	(9,235)	8,905
	211,163	186,102
Net earnings	\$ 422,491	\$ 364,494
Net earnings per common share (Note 10):		
Basic	\$ 1.97	\$ 1.72
Diluted	\$ 1.95	\$ 1.69

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

Consolidated Statements of Retained Earnings

52 weeks ended December 30, 2006 and December 31, 2005
(in thousands of dollars)

	2006	2005
Retained earnings, beginning of period	\$ 941,672	\$ 662,437
Net earnings	422,491	364,494
Premium on share capital purchased for cancellation (Note 10)	(35,595)	(13)
Dividends	(102,952)	(85,246)
Retained earnings, end of period	\$ 1,225,616	\$ 941,672

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

Consolidated Balance Sheets

As at December 30, 2006 and December 31, 2005
(in thousands of dollars)

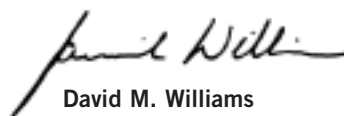
	2006	2005
Assets		
Current		
Cash	\$ 62,865	\$ 24,524
Accounts receivable	307,779	256,504
Inventory	1,372,124	1,216,549
Future income taxes (Note 4)	46,407	38,316
Prepaid expenses	32,248	29,018
	1,821,423	1,564,911
Property and equipment (Note 5)	907,728	748,840
Deferred costs (Note 6)	25,936	21,562
Goodwill	2,122,162	2,019,499
Other intangible assets (Note 7)	45,249	17,625
Other assets	6,516	2,946
Total assets	\$ 4,929,014	\$ 4,375,383
Liabilities		
Current		
Bank indebtedness	\$ 134,487	\$ 163,503
Commercial paper (Note 3)	503,550	469,850
Accounts payable and accrued liabilities	843,278	697,945
Income taxes payable	70,672	39,860
Dividends payable	25,797	21,343
	1,577,784	1,392,501
Long-term debt (Note 8)	300,000	325,000
Other long-term liabilities (Note 9)	188,938	140,758
Future income taxes (Note 4)	21,689	14,115
	2,088,411	1,872,374
Associate interest	116,649	116,501
Shareholders' equity		
Share capital (Note 10)	1,491,264	1,441,254
Contributed surplus (Note 11)	7,074	3,582
Retained earnings	1,225,616	941,672
	2,723,954	2,386,508
Total liabilities and shareholders' equity	\$ 4,929,014	\$ 4,375,383

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

On behalf of the Board of Directors:



Jürgen Schreiber
DIRECTOR



David M. Williams
DIRECTOR

Consolidated Statements of Cash Flows

52 weeks ended December 30, 2006 and December 31, 2005
(in thousands of dollars)

	2006	2005
Operating activities		
Net earnings	\$ 422,491	\$ 364,494
Items not affecting cash		
Amortization	150,088	128,530
Future income taxes	(9,235)	8,905
Loss on disposal of property and equipment	7,185	4,283
Stock-based compensation (Note 11)	3,492	1,941
	574,021	508,153
Net change in non-cash working capital balances (Notes 2 and 12)	(26,551)	(89,352)
Increase in other long-term liabilities	48,180	44,032
Store opening costs	(16,644)	(12,258)
Cash flows from operating activities	579,006	450,575
Investing activities		
Purchase of property and equipment	(293,137)	(249,973)
Business acquisition – MediSystem (excluding shares exchanged of \$43,019 – Note 2)	(46,850)	–
Other business acquisitions (Note 2)	(47,016)	(24,540)
Other assets	(3,570)	331
Cash flows used in investing activities	(390,573)	(274,182)
Financing activities		
Bank indebtedness, net	(29,359)	(39,229)
Commercial paper, net	33,700	166,675
Repayment of long-term debt (Note 8)	(25,000)	(250,000)
Repayment of long-term debt assumed on acquisition of MediSystem	(2,025)	–
Revolving term debt, net	–	(4,943)
Deferred financing costs	(454)	–
Associate interest	148	6,134
Shares issued for stock options exercised	10,898	17,797
Repayment of share purchase loans	2,287	1,480
Repurchase of share capital	(41,789)	(16)
Dividends paid	(98,498)	(63,903)
Cash flows used in financing activities	(150,092)	(166,005)
Increase in cash	38,341	10,388
Cash, beginning of period	24,524	14,136
Cash, end of period	\$ 62,865	\$ 24,524
Supplemental cash flow information		
Interest paid	\$ 48,075	\$ 47,666
Income taxes paid	\$ 188,270	\$ 191,232

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

Notes to the Consolidated Financial Statements

December 30, 2006 and December 31, 2005 (in thousand of dollars, except per share data)

1. Significant Accounting Policies

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

Description of Business

Shoppers Drug Mart Corporation (“the Company”) is a licensor of approximately 987 Shoppers Drug Mart/Pharmaprix full-service retail drug stores across Canada. The Shoppers Drug Mart/Pharmaprix stores are licensed to Associate-owners (“Associates”). In addition, the Company owns and operates 58 Shoppers Home Health Care stores. Under Accounting Guideline 15, “Consolidation of Variable Interest Entities”, the Company consolidates the Associate-owned stores and the Financing Trust.

Fiscal Year

The fiscal year of the Company consists of a 52 or 53 week period ending on the Saturday closest to December 31. The Company’s 2006 and 2005 fiscal years each consisted of a 52 week period.

Basis of Consolidation

The consolidated financial statements include the accounts of Shoppers Drug Mart Corporation, its subsidiaries, the Associate-owned stores that comprise the Company’s store network and a financing trust from which the Company arranges for Associates to obtain additional financing. All intercompany balances and transactions are eliminated on consolidation.

Revenue Recognition

The Company recognizes revenue at the time goods are sold, net of returns.

Bank Indebtedness

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

Inventory

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

Property and Equipment

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

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

1. Significant Accounting Policies (continued)

Property and Equipment (continued)

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

Deferred Costs

Financing Costs

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

Store Opening Costs

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

Goodwill and Other Intangible Assets

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

Intangible assets 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	25 years
Other	Indefinite

Leases

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

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

Shoppers Optimum™ Loyalty Program

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

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

Employee Future Benefits

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

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

Stock-based Compensation

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

Income Taxes

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

1. Significant Accounting Policies (continued)

Derivative Financial Instruments

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

The Company uses a cash-settled equity forward contract to limit its exposure to future price changes in the Company's share price for share unit awards under the Company's long-term incentive plan ("LTIP"). The income and expense arising from the use of this instrument is included in cost of goods sold and other operating expense for the year. See Note 11 for a further discussion of the LTIP.

The Company formally identifies, designates and documents all relationships between hedging instruments and hedged items, as well as its risk assessment objective and strategy for undertaking various hedge transactions. The Company assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

Associate Interest

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

Estimates

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

2. Acquisitions

MediSystem Technologies Inc.

During the year, the Company acquired 100% of the outstanding common shares of MediSystem Technologies Inc. ("MediSystem") through a series of transactions. MediSystem provides pharmaceutical products and services to long-term care facilities in Ontario and Alberta. MediSystem's results of operations have been included in the Company's results of operations subsequent to September 20, 2006.

The total cost of the acquisition, including costs incurred in connection with the acquisition, was \$91,274 and was allocated to the net assets on the basis of their fair value as follows:

Net working capital	\$	2,986
Property and equipment		4,551
Goodwill		67,936
Other intangible assets		25,865
Long-term debt		(2,025)
Future income taxes		(8,039)
Purchase price		91,274
Less: Cash included in working capital		(1,405)
Purchase price, net of cash acquired	\$	89,869
Cash and acquisition costs, net of cash acquired	\$	46,850
926,735 Common shares of Shoppers Drug Mart Corporation		43,019
Purchase price, net of cash acquired	\$	89,869

The acquired intangible assets subject to amortization consist of the following:

Developed technology	\$	1,065
Customer relationships		24,600
Other		200
	\$	25,865

Since this acquisition was completed late in 2006, the Company's determination of the fair values of the individual assets and liabilities acquired is preliminary and may change.

Other Business Acquisitions

Other business acquisitions include the acquisition of Therapy Supplies & Rental Ltd. for \$19,017. Since this acquisition was completed late in 2006, the Company's determination of the fair values of the individual assets and liabilities is preliminary and may change.

3. Interest Expense

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

	2006	2005
Interest on bank indebtedness	\$ 7,629	\$ 6,700
Interest on commercial paper	24,902	18,326
Interest on long-term debt	15,719	21,066
Amortization of deferred financing costs	1,622	2,557
	\$ 49,872	\$ 48,649

Commercial paper is issued with maturities from overnight to 90 days at floating interest rates based on Bankers' Acceptance rates. In December 2005, the Company entered into interest rate derivative agreements converting an aggregate notional principal amount of \$250,000 of floating rate commercial paper debt issued by the Trust into fixed rate debt. The fixed rates payable by the Company under these agreements ranged from 4.03% to 4.18%. See Note 14 for further discussion of the derivative agreements.

Notes to the Consolidated Financial Statements (continued)

December 30, 2006 and December 31, 2005 (in thousand of dollars, except per share data)

4. Income Taxes

The effective income tax rate is comprised of the following:

	2006	2005
Combined Canadian federal and provincial statutory tax rate	33.1%	35.0%
Adjusted for:		
Income not subject to tax	–	(1.2%)
Future income tax benefit resulting from the recognition of net capital loss carryforwards	(1.1%)	–
Non-deductible charges and other	1.3%	–
Effective income tax rate	33.3%	33.8%

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

	2006	2005
Current		
Deferred income	\$ 36,449	\$ 30,504
Accrued liabilities	11,132	9,096
Share issuance costs	–	26
Other	(1,174)	(1,310)
	\$ 46,407	\$ 38,316
Long-term		
Depreciable assets	\$ (51,719)	\$ (34,391)
Other long-term liabilities	31,894	27,700
Deferred costs	(6,323)	(4,959)
Net capital loss carryforwards	6,974	–
Other	(2,515)	(2,465)
	\$ (21,689)	\$ (14,115)

5. Property and Equipment

	2006			2005		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Land	\$ 46,250	\$ –	\$ 46,250	\$ 40,565	\$ –	\$ 40,565
Buildings	97,100	23,708	73,392	75,638	21,110	54,528
Equipment, fixtures and computer software	728,078	355,931	372,147	608,837	285,953	322,884
Leasehold improvements	563,966	148,027	415,939	451,118	120,255	330,863
	\$ 1,435,394	\$ 527,666	\$ 907,728	\$ 1,176,158	\$ 427,318	\$ 748,840

The Company amortized \$133,845 (2005 – \$114,090) of property and equipment into amortization during the year.

6. Deferred Costs

	2006			2005		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Financing costs	\$ 15,041	\$ 12,816	\$ 2,225	\$ 14,587	\$ 11,194	\$ 3,393
Store opening costs	58,653	34,942	23,711	42,009	23,840	18,169
	\$ 73,694	\$ 47,758	\$ 25,936	\$ 56,596	\$ 35,034	\$ 21,562

The Company amortized \$1,622 (2005 – \$2,557) of deferred financing costs into interest expense and \$11,102 (2005 – \$9,319) of store opening costs into cost of goods sold and other operating expenses during the year.

7. Other Intangible Assets

	2006			2005		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Prescription files	\$ 26,703	\$ 7,192	\$ 19,511	\$ 22,396	\$ 4,771	\$ 17,625
Developed technology	1,305	95	1,210	–	–	–
Customer relationships	24,600	272	24,328	–	–	–
Other	200	–	200	–	–	–
	\$ 52,808	\$ 7,559	\$ 45,249	\$ 22,396	\$ 4,771	\$ 17,625

The Company amortized \$3,152 (2005 – \$2,564) of prescription files, \$95 (2005 – \$nil) of developed technology and \$272 (2005 – \$nil) of customer relationships into amortization during the year.

8. Long-term Debt

	Maturity	2006	2005
Medium-term notes Series 1 – 4.97%	October 2008	\$ 300,000	\$ 300,000
Non-revolving term facilities		–	25,000
\$550,000 Revolving term facility	June 2011	–	–
\$250,000 Revolving term facility		–	–
		\$ 300,000	\$ 325,000

On June 6, 2006, the Company amended its \$250,000 revolving term facility and its \$300,000 364-day extendible credit facility that was in addition to the bank credit facilities described in the table into one \$550,000 revolving term facility and extended the maturity until June 2011. The Company closed its non-revolving term facilities when the last payment was made bringing the balance to nil.

As at December 30, 2006, \$50,931 of the \$550,000 revolving term facility was utilized, all in respect of letters of credit and trade finance guarantees, of which \$45,500 relates to a letter of credit for the benefit of the financing trust (Note 13). As at December 31, 2005, \$48,116 of the \$250,000 revolving term facility was utilized, all in respect of letters of credit and trade finance guarantees, of which \$43,000 relates to a letter of credit for the benefit of the financing trust (Note 13).

Notes to the Consolidated Financial Statements (continued)

December 30, 2006 and December 31, 2005 (in thousand of dollars, except per share data)

8. Long-term Debt (continued)

Minimum Repayments

Future minimum required repayments of long-term debt are as follows:

Medium-term notes	
2008	\$ 300,000

9. Other Long-term Liabilities

Other long-term liabilities are comprised as follows:

	2006	2005
Deferred rent obligation	\$ 163,532	\$ 121,958
Employee future benefits	13,648	10,988
Other	11,758	7,812
	\$ 188,938	\$ 140,758

Deferred Rent Obligation

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

Employee Future Benefits

The Company maintains registered defined benefit pension plans under which benefits are available to certain employee groups. The Company also makes supplementary retirement benefits available to certain employees under a non-registered pension plan. The pension plans are funded through contributions based on actuarial cost methods as permitted by pension regulatory bodies as applicable. Earnings are charged with the cost of benefits earned by employees as services are rendered. Benefits under these plans are based on the employees' years of service and final average earnings.

The most recent actuarial valuations of the registered plans for funding purposes were performed as at December 31, 2003 and January 1, 2005 and the next valuations will be completed in 2007 with an effective valuation date as at December 31, 2006. The most recent actuarial valuation of the non-registered plan for funding purposes was as at December 31, 2006 and the next valuation will be required as at December 31, 2007.

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

Included in other long-term liabilities are employee future benefits in the amount of \$13,648 as at December 30, 2006 and \$10,988 as at December 31, 2005 in respect of pension and other post-retirement benefit plans.

Information about the Company's pension and other post-retirement benefit plans, measured at November 30, 2006 and 2005, respectively, is as follows:

	2006		2005	
	Pension Plans	Other Benefit Plans	Pension Plans	Other Benefit Plans
Fair value of plan assets				
Fair value of plan assets, beginning of period	\$ 67,718	\$ –	\$ 61,245	\$ –
Actual return on plan assets	7,043	–	4,594	–
Company contribution	4,237	344	4,098	298
Participant contributions	958	–	931	–
Benefits paid	(4,131)	(344)	(3,150)	(298)
Fair value of plan assets, end of period	\$ 75,825	\$ –	\$ 67,718	\$ –
Accrued benefit obligation				
Benefit obligation, beginning of period	\$ 94,393	\$ 4,302	\$ 78,546	\$ 3,998
Service cost	5,967	392	4,683	353
Interest cost	3,722	245	3,557	249
Participant contributions	958	–	931	–
Plan amendments	–	–	(684)	–
Actuarial loss	115	–	10,510	–
Benefits paid	(4,131)	(344)	(3,150)	(298)
Accrued benefit obligation, end of period	\$ 101,024	\$ 4,595	\$ 94,393	\$ 4,302
Funded status – plan deficit				
Unrecognized plan amendments	\$ (1,708)	\$ –	\$ (1,909)	\$ –
Unrecognized losses	17,854	–	21,898	–
Accrued benefit liability	\$ (9,053)	\$ (4,595)	\$ (6,686)	\$ (4,302)

The significant actuarial assumptions adopted are as follows:

	2006			2005		
	Registered Pension Plans	Non-registered Pension Plan	Other Benefit Plans	Registered Pension Plans	Non-registered Pension Plan	Other Benefit Plans
Accrued benefit obligation, end of period						
Discount rate	5.00%	2.50%	5.00%	5.00%	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%	5.75%	2.88%	5.75%
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 health care cost trend rates used were 5.5% for 2006 and 2005, with 5.5% being the ultimate trend rate for later years. A 1% change in the assumed health care cost trend rate would not have a significant effect on the amounts reported for other benefit plans.

Notes to the Consolidated Financial Statements (continued)

December 30, 2006 and December 31, 2005 (in thousand of dollars, except per share data)

9. Other Long-term Liabilities (continued)

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

	2006		2005	
	Pension Plans	Other Benefit Plans	Pension Plans	Other Benefit Plans
Service costs	\$ 5,967	\$ 392	\$ 4,683	\$ 353
Interest cost	3,722	245	3,557	249
Actual return on plan assets	(7,043)	–	(4,594)	–
Actuarial loss	115	–	10,510	–
Plan amendments	–	–	(684)	–
Costs arising from events of the period	2,761	637	13,472	602
Difference between:				
Actual and expected return on plan assets	3,295	–	1,301	–
Actuarial gain or loss recognized for the year and actual actuarial gain or loss on accrued benefit obligation	749	–	(10,084)	–
Amortization of plan amendment and actual plan amendments	(201)	–	540	–
Net expense	\$ 6,604	\$ 637	\$ 5,229	\$ 602

Total cash payments for employee future benefits consist of the Company's contributions to the pension plans and cash payments made directly to beneficiaries of the other benefit plans and totalled \$4,581 (2005 – \$4,396).

The assets of the registered pension plans consist of cash, contributions receivable and a proportionate share of a Master Trust. The assets held by the Master Trust are invested in a limited number of pooled funds, based on market values as at November 30, 2006 and 2005, respectively, as follows:

	2006	2005
Equity	59%	59%
Fixed income	40%	40%
Cash and cash equivalents	1%	1%

The assets of the non-registered plan consist of cash and investments. The investments are in pooled funds with an allocation of 60% equities and 40% bonds based on market values as at November 30, 2006 and 2005, respectively.

10. Share Capital

Authorized

Unlimited number of common shares

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

Outstanding

	2006		2005	
	Number of Common Shares	Stated Value	Number of Common Shares	Stated Value
Beginning balance	213,430,744	\$ 1,441,254	209,990,845	\$ 1,421,980
Shares issued	2,459,012	53,915	3,440,419	17,797
Shares repurchased	(913,811)	(6,192)	(520)	(3)
Repayment of share purchase loans	–	2,287	–	1,480
Ending balance	214,975,945	\$ 1,491,264	213,430,744	\$ 1,441,254

Weighted Average Shares Outstanding

December 30, 2006

Basic	213,931,722
Diluted	216,668,141

December 31, 2005

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

The common shares that may be issued under the Company's stock option plans, including contingently returnable shares issued as part of those plans, have a dilutive impact on the weighted average number of shares of 2,736,420 (2005 – 4,273,541).

Individual shareholder agreements address matters related to the transfer of certain shares issued to the Company's management and Associates, including shares issued under options granted to management. In particular, each provides, subject to certain exceptions, for a general prohibition on any transfer of a member of management's or Associate's shares for a period of five years from the date that the individual entered into the shareholder agreement.

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

10. Share Capital (continued)

Normal Course Issuer Bid

On September 8, 2006 the Company implemented a normal course issuer bid to repurchase for cancellation up to 5,350,000 common shares, representing approximately 2.5% of the Company's outstanding common shares, over a 12-month period ending no later than September 7, 2007. Repurchases are made at market prices through the Toronto Stock Exchange.

From September 8, 2006 to December 30, 2006, the Company purchased for cancellation 913,600 common shares under the normal course issuer bid at a cost of \$41,780. The premium paid over the average book value of the shares repurchased has been charged to retained earnings.

11. Stock-based Compensation

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

In 2003, the Company adopted the guidance of accounting standard 3870, "Stock-based Compensation and Other Stock-based Payments" on a prospective basis. The guidance requires the use of the fair value method to account for stock options issued under employee and director stock option programs. The Company expensed \$3,492 in 2006 (2005 – \$1,973) associated with stock options issued under the employee and director plans.

If compensation expense under the fair value method of accounting had been recognized on stock options issued in 2002, the Company's net earnings for the periods ended December 30, 2006 and December 31, 2005 would have been reduced by \$582 and \$1,176, respectively. Basic earnings per share would have been unchanged for both periods and diluted earnings per share would have been unchanged for the period ended December 30, 2006 and \$1.68 for the period ended December 31, 2005.

The fair value of each option was estimated on the date of the grant using the Black-Scholes option-pricing model. The following weighted average assumptions were used to calculate the option value for options issued under the employee and director option plan:

	Employee Plan	Director Plan
Fair value per option	\$ 46.32	\$ 44.02
Valuation assumptions		
Expected life	7.5 years	6.5 years
Expected dividends	1.00%	1.00%
Expected volatility	26.3%	26.0%
Risk-free interest rate	4.08%	4.05%

Employee Stock Option Plan

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

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

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

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

	2006		2005	
	Options on Common Shares	Weighted Average Exercise Price Per Share	Options on Common Shares	Weighted Average Exercise Price Per Share
Outstanding, beginning of period	4,015,825	\$ 9.65	7,305,409	\$ 7.70
Granted	350,000	46.32	—	—
Exercised	(1,412,277)	6.71	(3,260,419)	5.16
Forfeited/Cancelled including repurchased	(37,098)	22.83	(29,165)	24.73
Outstanding, end of period	2,916,450	\$ 15.30	4,015,825	\$ 9.65
Options exercisable, end of period	2,206,468	\$ 9.37	2,904,482	\$ 7.93

	2006 Outstanding Options			2006 Exercisable Options		
Range of Exercise Price	Number of Options Outstanding	Weighted Average Contractual Life (Years)	Weighted Average Exercise Price Per Share	Number of Exercisable Options	Weighted Average Exercise Price Per Share	
\$ 5.00 – \$ 5.60	1,756,212	4.0	\$ 5.30	1,684,010	\$ 5.30	
\$17.13 – \$24.84	569,626	5.3	20.69	421,096	20.72	
\$25.86 – \$26.57	59,334	6.7	26.04	32,634	26.04	
\$29.30 – \$36.41	181,278	7.4	31.85	68,728	31.65	
\$46.32	350,000	9.7	46.32	—	—	
	2,916,450	5.2	\$ 15.30	2,206,468	\$ 9.37	

Director Stock Option Plan

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

Notes to the Consolidated Financial Statements (continued)

December 30, 2006 and December 31, 2005 (in thousand of dollars, except per share data)

11. Stock-based Compensation (continued)

A summary of the status of the director stock option plan and changes during the period are presented below.

	2006		2005	
	Options on Common Shares	Weighted Average Exercise Price Per Share	Options on Common Shares	Weighted Average Exercise Price Per Share
Outstanding, beginning of period	420,000	\$ 29.93	480,000	\$ 22.49
Granted	180,000	44.02	120,000	41.80
Exercised	(120,000)	20.74	(180,000)	18.00
Cancelled	(20,000)	34.14	–	–
Outstanding, end of period	460,000	37.66	420,000	29.93
Options exercisable, end of period	200,000	\$ 30.28	240,000	\$ 23.54

Range of Exercise Price	2006 Outstanding Options			2006 Exercisable Options		
	Number of Options Outstanding	Weighted Average Contractual Life (Years)	Weighted Average Exercise Price Per Share	Number of Exercisable Options	Weighted Average Exercise Price Per Share	
\$23.35 – \$26.95	120,000	6.2	\$ 25.15	120,000	\$ 25.15	
\$34.14 – \$41.80	160,000	8.4	39.89	80,000	37.97	
\$44.02	180,000	9.1	44.02	–	–	
	460,000	8.1	\$ 37.66	200,000	\$ 30.28	

Deferred Share Unit Plan for Non-employee Directors

The Company maintains a deferred share unit (DSU) plan to provide directors with the option to elect to receive DSUs in lieu of cash payment for all or a portion of their director fees. When such an election is made, the Company credits to the account of each director a number of DSUs (each equivalent in value to a common share) equal to the amount of fees divided by the fair market value of the common shares. The directors' accounts shall be credited with dividend equivalents in the form of additional DSUs if and when the Company pays dividends on the common shares. Upon the director ceasing to be a member of the Board of Directors, the director shall receive a cash amount equal to the number of DSUs in his or her account multiplied by the fair market value of the common shares on the date the director ceases to be a member of the Board of Directors or on a later date selected by the director, which shall in any event be a date prior to the end of the following calendar year. During the period, the Company issued an aggregate of 9,689 DSUs (2005 – 7,177) and recorded \$464 (2005 – \$546) in director fee compensation.

Long-term Incentive Plan

During the first quarter of 2006, the Company issued awards under a long-term incentive plan ("LTIP") to certain employees. Under the LTIP, the employees are eligible to receive an award of share units equivalent in value to common shares of the Company. On February 17, 2006, the Company awarded 147,403 share units which vest equally over a three year period, of which 138,564 are outstanding as at December 30, 2006. During the period, the Company has recorded compensation expense of \$3,308 associated with the share units.

In order to limit the Company's exposure to future share price changes, the Company has entered into an agreement with a counterparty to use a cash-settled equity forward contract to hedge this exposure. The Company has designated this derivative instrument as a hedge for accounting purposes.

12. Net Change in Non-cash Working Capital Balances

	2006	2005
Accounts receivable	\$ (38,227)	\$ (18,914)
Inventory	(146,515)	(80,824)
Prepaid expenses	(2,904)	9,923
Accounts payable and accrued liabilities	130,795	6,675
Income taxes payable	30,300	(6,212)
	\$ (26,551)	\$ (89,352)

The net change in non-cash working capital balances reported on the consolidated statement of cash flows does not include the working capital balances acquired in connection with the Company's acquisitions of MediSystem or Therapy Supplies & Rental Ltd., which are included in investing activities.

13. Commitments and Contingent Liabilities

Obligations under Operating Leases

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

	2007	2008	2009	2010	2011	Thereafter
Total lease obligations	\$ 247,801	\$ 257,789	\$ 238,994	\$ 223,641	\$ 202,033	\$ 1,401,611

Distribution Services

The Company has entered into an agreement with a third party to provide distribution services to the Company's locations to December 31, 2009. Under the terms of this agreement, the third party will charge the Company specified costs incurred to provide the distribution services, plus an annual management fee.

Information Services

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

Financing Trust

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

The Company has arranged for a standby letter of credit for the benefit of the Trust from a syndicate of banks that is equal to approximately 10% of the aggregate principal amount of the loans, or \$45,500, as a form of credit enhancement which, in turn, enables the Trust to provide favourable financing terms to the Company's Associates.

13. Commitments and Contingent Liabilities (continued)

Financing Trust (continued)

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

The Company has determined that the Trust is a VIE and the Company is the primary beneficiary. As such, the Trust is subject to consolidation by the Company. The impact of consolidating the Trust is the reclassification of Associate loans payable to the Trust, to commercial paper issued by the Trust to third parties. As at December 30, 2006, \$453,550 (2005 – \$419,850) of the consolidated commercial paper balance was commercial paper issued by the Trust.

Litigation

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

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

Other

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

14. Financial Instruments

Interest Rate Derivatives

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

Based on market values at December 30, 2006, the Company would have realized gains of \$338 to terminate these interest rate derivative agreements. Market values were determined based on information received from the Company's counterparties to these agreements.

Equity Forward Derivative

The Company uses a cash-settled equity forward contract to limit its exposure to future price changes in the Company's share price for share unit awards under the Company's long-term incentive plan ("LTIP"). The income and expense arising from the use of this instrument are included in cost of goods sold and other operating expense for the year.

Based on market values at December 30, 2006, the Company would have realized a gain of \$610 to terminate the cash-settled equity forward contract. Market values were determined based on information received from the Company's counterparties to these agreements.

Counterparty Risk

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

Credit Risk

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

Fair Value of Financial Instruments

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

The fair values of cash, accounts receivable, bank indebtedness, commercial paper, accounts payable and dividends payable approximate their carrying values given their short-term maturities. The fair values of long-term receivables, long-term liabilities and long-term debt approximate their carrying values given the current market rates associated with these instruments.

The fair values of the interest rate and equity forward derivatives, as noted above, are determined based on current market rates and on information received from the Company's counterparties to these agreements.

Earnings Coverage Exhibit to the Consolidated Financial Statements (unaudited)

52 Weeks Ended December 30, 2006

Earnings coverage on long-term debt obligations	43.48 times
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The earnings coverage ratio on long-term debt (including any current portion) is equal to net earnings (before interest and income taxes) divided by interest expense on long-term debt (including any current portion). Interest expense excludes any amounts in respect of amortization that were included in interest expense as shown in the consolidated statement of earnings of the Company for the period.