

# SHOPPERS DRUG MART CORPORATION

## Consolidated Statements of Earnings

(unaudited)

(in thousands of dollars except per share amounts)

	12 Weeks Ended January 2, 2010	13 Weeks Ended January 3, 2009	52 Weeks Ended January 2, 2010	53 Weeks Ended January 3, 2009
<b>Sales</b>	<b>\$ 2,488,544</b>	\$ 2,496,799	<b>\$ 9,985,600</b>	\$ 9,422,911
<b>Operating expenses</b>				
Cost of goods sold and other operating expenses (Notes 2 and 3)	<b>2,174,809</b>	2,190,321	<b>8,841,170</b>	8,350,367
Amortization	<b>58,343</b>	50,477	<b>248,794</b>	205,371
<b>Operating income</b>	<b>255,392</b>	256,001	<b>895,636</b>	867,173
Interest expense (Note 5)	<b>11,768</b>	15,940	<b>58,215</b>	63,952
<b>Earnings before income taxes</b>	<b>243,624</b>	240,061	<b>837,421</b>	803,221
<b>Income taxes</b> (Note 2)				
Current	<b>67,092</b>	64,809	<b>249,776</b>	254,159
Future	<b>5,472</b>	8,716	<b>2,737</b>	(5,083)
	<b>72,564</b>	73,525	<b>252,513</b>	249,076
<b>Net earnings</b> (Note 2)	<b>\$ 171,060</b>	\$ 166,536	<b>\$ 584,908</b>	\$ 554,145

### Net earnings per common share (Note 2):

Basic	\$ 0.79	\$ 0.77	\$ 2.69	\$ 2.55
Diluted	\$ 0.79	\$ 0.77	\$ 2.69	\$ 2.55
Weighted average common shares outstanding				
- Basic (millions)	217.4	217.1	217.4	217.0
- Diluted (millions)	217.5	217.4	217.5	217.5
Actual common shares outstanding (millions)	217.4	217.3	217.4	217.3

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

	<b>52 Weeks Ended January 2, 2010</b>	53 Weeks Ended January 3, 2009
<b>Retained earnings, beginning of period as reported</b>	\$ 1,938,023	\$ 1,559,551
Impact of the adoption of new accounting standard, Handbook Section 3064, Goodwill and Intangible Assets (Note 2)	(38,884)	(27,817)
Retained earnings, beginning of period as restated	<b>1,899,139</b>	1,531,734
Net earnings	<b>584,908</b>	554,145
Dividends	(186,956)	(186,679)
Premium on share capital purchased for cancellation	-	(61)
<b>Retained earnings, end of period</b>	<b>\$ 2,297,091</b>	\$ 1,899,139

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

	<b>12 Weeks Ended January 2, 2010</b>	13 Weeks Ended January 3, 2009	<b>52 Weeks Ended January 2, 2010</b>	53 Weeks Ended January 3, 2009
<b>Net earnings</b>	\$ 171,060	\$ 166,536	\$ 584,908	\$ 554,145
<b>Other comprehensive income (loss), net of tax</b>				
Change in unrealized loss/gain on interest rate derivatives (net of tax of \$204 and \$1,035 (2008 - \$634 and \$1,605))	437	(1,176)	1,967	(3,148)
Change in unrealized loss on equity forward derivatives (net of tax of \$44 and \$22 (2008 - \$93 and \$167))	119	(186)	56	(337)
Amount of previously unrealized loss/gain recognized in earnings during the period (net of tax of \$30 and \$117 (2008 - \$143 and \$145))	45	(200)	294	(204)
<b>Other comprehensive income (loss)</b>	<b>601</b>	<b>(1,562)</b>	<b>2,317</b>	<b>(3,689)</b>
<b>Comprehensive income</b>	<b>\$ 171,661</b>	\$ 164,974	<b>\$ 587,225</b>	\$ 550,456
<b>Accumulated other comprehensive (loss) income, beginning of period</b>			\$ (3,442)	\$ 247
Other comprehensive income (loss)			<b>2,317</b>	(3,689)
<b>Accumulated other comprehensive loss, end of period</b>			<b>\$ (1,125)</b>	\$ (3,442)

# SHOPPERS DRUG MART CORPORATION

## Consolidated Balance Sheets

(unaudited)

(in thousands of dollars)

	January 2, 2010	January 3, 2009
<b>Assets</b>		
Current		
Cash	\$ 44,391	\$ 36,567
Accounts receivable	471,029	448,476
Inventory (Note 3)	1,852,441	1,743,253
Income taxes recoverable	-	8,835
Future income taxes (Note 2)	86,161	84,770
Prepaid expenses and deposits (Note 2)	75,573	59,327
	<b>2,529,595</b>	<b>2,381,228</b>
Property and equipment (Note 2)	1,566,024	1,331,363
Goodwill (Note 2)	2,481,353	2,427,239
Intangible assets (Note 2)	258,766	212,279
Other assets (Note 2)	16,716	12,114
<b>Total assets</b>	<b>\$ 6,852,454</b>	<b>\$ 6,364,223</b>
<b>Liabilities</b>		
Current		
Bank indebtedness (Note 6)	\$ 270,332	\$ 240,844
Commercial paper	260,386	339,943
Short-term debt (Note 8)	-	197,845
Accounts payable and accrued liabilities	964,736	1,018,505
Income taxes payable	17,046	-
Dividends payable	46,748	46,709
	<b>1,559,248</b>	<b>1,843,846</b>
Long-term debt (Note 8)	946,098	647,250
Other long-term liabilities	347,951	303,117
Future income taxes	42,858	30,803
	<b>2,896,155</b>	<b>2,825,016</b>
Associate interest	130,189	118,678
<b>Shareholders' equity</b>		
Share capital	1,519,870	1,514,207
Contributed surplus	10,274	10,625
Accumulated other comprehensive loss	(1,125)	(3,442)
Retained earnings (Note 2)	2,297,091	1,899,139
	<b>2,295,966</b>	<b>1,895,697</b>
	<b>3,826,110</b>	<b>3,420,529</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 6,852,454</b>	<b>\$ 6,364,223</b>

# SHOPPERS DRUG MART CORPORATION

## Consolidated Statements of Cash Flows

(unaudited)

(in thousands of dollars)

	12 Weeks Ended January 2, 2010	13 Weeks Ended January 3, 2009	52 Weeks Ended January 2, 2010	53 Weeks Ended January 3, 2009
<b>Operating activities</b>				
Net earnings (Note 2)	\$ 171,060	\$ 166,536	\$ 584,908	\$ 554,145
Items not affecting cash				
Amortization (Note 2)	61,951	51,903	250,202	204,533
Future income taxes (Note 2)	5,472	8,716	2,737	(5,083)
(Gain) loss on disposal of property and equipment	(7,365)	253	(3,456)	3,436
Stock-based compensation	112	186	694	1,498
	<b>231,230</b>	<b>227,594</b>	<b>835,085</b>	<b>758,529</b>
Net change in non-cash working capital balances (Note 2)	(59,495)	(80,118)	(177,724)	(328,806)
Increase in other long-term liabilities	143	9,658	35,757	45,609
Cash flows from operating activities	<b>171,878</b>	<b>157,134</b>	<b>693,118</b>	<b>475,332</b>
<b>Investing activities</b>				
Purchase of property and equipment (Note 2)	(154,598)	(182,444)	(461,438)	(476,315)
Proceeds from disposition of property and equipment	5,107	6,096	30,106	24,690
Business acquisitions (Note 4)	(5,265)	(46,196)	(97,100)	(243,901)
Deposits	(1,187)	28,804	3,527	88,522
Purchase and development of intangible assets (Note 2)	(14,832)	(23,670)	(33,989)	(48,650)
Other assets (Note 2)	322	318	(4,310)	(5,255)
Cash flows used in investing activities	<b>(170,453)</b>	<b>(217,092)</b>	<b>(563,204)</b>	<b>(660,909)</b>
<b>Financing activities</b>				
Bank indebtedness, net (Note 6)	7,430	(18,550)	29,488	15,692
Commercial paper, net	7,000	(4,000)	(80,000)	(203,350)
Issuance of short-term debt	-	200,000	-	200,000
Repayment of short-term debt (Note 8)	-	-	(200,000)	-
Issuance of Series 2 notes	-	-	-	450,000
Issuance of Series 3 notes (Note 8)	-	-	250,000	-
Issuance of Series 4 notes (Note 8)	-	-	250,000	-
Revolving term debt, net	1,298	200,000	(198,702)	200,000
Repayment of Series 1 notes	-	(300,000)	-	(300,000)
Financing costs incurred	-	(2,550)	(2,088)	(6,050)
Associate interest	14,995	16,064	11,511	5,559
Proceeds from shares issued for stock options exercised	497	2,388	4,481	7,144
Repayment of share purchase loans	-	69	137	288
Repurchase of share capital	-	(36)	-	(71)
Dividends paid	(46,742)	(46,677)	(186,917)	(174,656)
Cash flows (used in) from financing activities	<b>(15,522)</b>	<b>46,708</b>	<b>(122,090)</b>	<b>194,556</b>
<b>(Decrease) increase in cash</b>	<b>(14,097)</b>	<b>(13,250)</b>	<b>7,824</b>	<b>8,979</b>
<b>Cash, beginning of period</b>	<b>58,488</b>	<b>49,817</b>	<b>36,567</b>	<b>27,588</b>
<b>Cash, end of period</b>	<b>\$ 44,391</b>	<b>\$ 36,567</b>	<b>\$ 44,391</b>	<b>\$ 36,567</b>
<b>Supplemental cash flow information</b>				
Interest paid	\$ 11,457	\$ 26,224	\$ 44,818	\$ 63,893
Income taxes paid	\$ 28,580	\$ 55,720	\$ 223,296	\$ 327,184

# **SHOPPERS DRUG MART CORPORATION**

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

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

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### **1. BASIS OF PRESENTATION**

The unaudited interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”) and follow the same accounting policies and methods of application with those used in the preparation of the audited annual consolidated financial statements for the 53 week period ended January 3, 2009, except as described in Note 2, Changes in Accounting Policies. These financial statements do not contain all disclosures required by Canadian GAAP for annual financial statements and, accordingly, should be read in conjunction with the most recently prepared annual consolidated financial statements and the accompanying notes included in the Company’s 2008 Annual Report.

The consolidated financial statements of the Company include the accounts of Shoppers Drug Mart Corporation, its subsidiaries and entities considered to be variable interest entities, as defined by the Canadian Institute of Chartered Accountants (“CICA”) Accounting Guideline 15, “Consolidation of Variable Interest Entities” (“AcG-15”). Under AcG-15, the Company has consolidated the Associate-owned stores.

The individual Associate-owned stores that comprise the Company’s store network are variable interest entities and the Company is the primary beneficiary. As such, the Associate-owned stores are subject to consolidation by the Company. The Associate-owned stores remain separate legal entities and consolidation of the Associate-owned stores has no impact on the underlying risks facing the Company.

### **2. CHANGES IN ACCOUNTING POLICIES**

#### **Adoption of New Accounting Standards**

##### **Financial Statement Concepts**

In February 2008, the CICA issued amendments to Section 1000, “Financial Statement Concepts” (“Section 1000”), to clarify the criteria for recognition of an asset and the timing of expense recognition, specifically, deleting the guidance permitting the deferral of costs. The new requirements were effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2008. The Company adopted the amendments to Section 1000 at the beginning of its current fiscal year in conjunction with Section 3064, “Goodwill and Intangible Assets”.

# SHOPPERS DRUG MART CORPORATION

## Notes to the Consolidated Financial Statements

(unaudited)

(in thousands of dollars except per share amounts)

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

#### Goodwill and Intangible Assets

In February 2008, the CICA issued a new accounting standard concerning Goodwill and Intangible Assets (“Section 3064”), which was based on the International Accounting Standards Board’s (“IASB”) International Accounting Standard 38, “Intangible Assets”. The new section replaced the existing guidance on goodwill and other intangible assets and research and development costs. The objective of Section 3064 was to eliminate the practice of deferring costs that do not meet the definition and recognition criteria of assets. Section 3064 was effective for interim and annual financial statements for fiscal years beginning on or after October 1, 2008. The Company adopted Section 3064 retrospectively at the beginning of its current fiscal year, with restatement of prior periods. Intangible assets recognized prior to the Company’s current fiscal year that no longer met the new recognition or measurement criteria and the definition of an asset were removed from the consolidated balance sheets in accordance with CICA Handbook Section 1506, “Accounting Changes”. The balance of any such deferred costs as at the end of the Company’s 2007 and 2008 fiscal years was reflected as a charge to opening retained earnings.

Goodwill is recorded as 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 at least on an annual basis. In the event of an impairment, the excess of the carrying amount over the fair value of goodwill would be charged to earnings.

#### *Net Earnings Impact*

The following table summarizes the impact of the implementation of Section 3064 on the Company’s consolidated statements of earnings for the 13 and 53 weeks ended January 3, 2009, respectively:

	13 weeks ended January 3, 2009	53 weeks ended January 3, 2009
Adjustment – pre-tax	\$ (8,932)	\$ (15,329)
Income taxes	2,417	4,262
Net earnings impact	\$ (6,515)	\$ (11,067)
Net earnings per common share (diluted) impact	\$ (0.03)	\$ (0.05)
Net earnings, as reported	\$ 173,051	\$ 565,212
Net earnings per common share (diluted), as reported	\$ 0.80	\$ 2.60
Net earnings, as restated	\$ 166,536	\$ 554,145
Net earnings per common share (diluted), as restated	\$ 0.77	\$ 2.55

The adjustment relates to previously deferred costs, primarily store opening costs, that no longer qualify for recognition as an asset.

# SHOPPERS DRUG MART CORPORATION

## Notes to the Consolidated Financial Statements

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

#### *Opening Retained Earnings Adjustment*

The implementation of Section 3064 has resulted in a reduction to the Company's 2009 and 2008 fiscal years' opening retained earnings of \$38,884 and \$27,817, respectively.

#### *Balance Sheet Adjustments*

The following paragraphs summarize the impact of the implementation of Section 3064 on the Company's consolidated balance sheets as at January 3, 2009.

The impact on balances as at January 3, 2009 was primarily an increase in net future income tax assets of \$17,676, a decrease in prepaid expenses and deposits of \$4,727, a decrease in property and equipment of \$110,772, a decrease in deferred costs of \$47,213, an increase in intangible assets of \$114,466, and a decrease in other assets of \$8,328. The increase in intangible assets and decrease in property and equipment primarily reflects the reclassification of certain computer software costs, previously included in property and equipment.

#### **Credit Risk and the Fair Value of Financial Assets and Financial Liabilities**

In January 2009, the Emerging Issues Committee ("EIC") issued a new abstract concerning the measurement of financial assets and financial liabilities, EIC-173 "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities" ("EIC-173"). There had been diversity in practice as to whether an entity's own credit risk and the credit risk of the counterparty are taken into account in determining the fair value of financial instruments. The EIC reached a consensus that these risks should be taken into account in the measurement of financial assets and financial liabilities. EIC-173 was effective for all financial assets and financial liabilities measured at fair value in interim and annual financial statements issued for periods ending on or after the date of issuance of EIC-173 with retrospective application without restatement of prior periods. The Company adopted EIC-173 at the beginning of its current fiscal year. The implementation did not have a significant impact on the Company's results of operations, financial position or disclosures.

#### **Financial Instruments – Recognition and Measurement**

In August 2009, the CICA made amendments to Section 3855, "Financial Instruments – Recognition and Measurement" ("Section 3855"), adding and amending paragraphs regarding financial asset measurement categories and impairment as well as providing specific transitional guidance. The Company adopted the amendments to Section 3855 in its 2009 third and fourth quarter interim financial statements. The implementation did not have a significant impact on the Company's results of operations, financial position or disclosures.

# SHOPPERS DRUG MART CORPORATION

## Notes to the Consolidated Financial Statements

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

#### Future Accounting Standards

##### Financial Instruments – Recognition and Measurement

In April 2009, the CICA amended Section 3855, “Financial Instruments – Recognition and Measurement” (“Section 3855”), adding and amending paragraphs regarding the application of the effective interest method to previously impaired financial assets and embedded prepayment options. The amendments are effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011, with early adoption permitted. The Company will adopt the amendments to Section 3855 in its 2011 fiscal year. The amendments are not expected to have a significant impact on the Company’s accounting for its financial instruments.

##### Financial Instruments – Disclosures

In June 2009, the CICA amended Section 3862, “Financial Instruments – Disclosures” (“Section 3862”), to adopt the amendments recently issued by the IASB to International Financial Reporting Standard 7, “Financial Instruments: Disclosures” (“IFRS 7”), in March 2009. These amendments are applicable to publicly accountable enterprises and those private enterprises, co-operative business enterprises, rate-regulated enterprises and not-for-profit organizations that choose to adopt Section 3862. The amendments were made to enhance disclosures about fair value measurements, including the relative reliability of the inputs used in those measurements, and about the liquidity risk of financial instruments.

The amendments are effective for annual financial statements for fiscal years ending after September 30, 2009, with early adoption permitted. To provide relief for preparers, and consistent with IFRS 7, the CICA decided that an entity need not provide comparative information for the disclosures required by the amendments in the first year of application. The Company will adopt these amendments in its 2009 annual consolidated financial statements. The impact of the amendments to the fair value measurement and liquidity risk disclosure requirements of the Company is not expected to be significant.

##### Multiple Deliverable Revenue Arrangements

In December 2009, the EIC issued a new abstract concerning multiple deliverable revenue arrangements, EIC 175 “Multiple Deliverable Revenue Arrangements” (“EIC 175”), which amended EIC 142 “Revenue Arrangements with Multiple Deliverables” (“EIC 142”). The objective of issuing this Abstract is to harmonize EIC 142 with amendments made to U.S. generally accepted accounting principles. These amendments require a vendor to allocate arrangement consideration at the inception of the arrangement to all deliverables using the relative selling price method, thereby eliminating the use of the residual value method. The amendments also change the level of evidence of the standalone selling price required to separate deliverables when more objective evidence of the selling price is not available. EIC 175 should be adopted prospectively to revenue arrangements entered into or materially modified in the first annual fiscal period beginning on or after January 1, 2011, with early adoption permitted. EIC 142 continues to be effective until that date.

# SHOPPERS DRUG MART CORPORATION

## Notes to the Consolidated Financial Statements

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### 3. INVENTORY

During the 12 and 52 weeks ended January 2, 2010, the Company recognized cost of inventory of \$1,521,818 and \$6,238,239 (2008 - \$1,558,194 and \$5,944,249), respectively, as an expense. This expense is included in cost of goods sold and other operating expenses in the consolidated statements of earnings for the period.

During the 12 and 52 weeks ended January 2, 2010 and the 13 and 53 weeks ended January 3, 2009, there were no significant write-downs of inventory as a result of net realizable values being lower than cost and no inventory write-downs recognized in previous years were reversed.

### 4. ACQUISITIONS

#### HealthAccess and Information Healthcare Marketing Corp.

On July 2, 2008, the Company acquired the specialty drug assets of the HealthAccess business of Calea Ltd. and 100% of the shares of Calea Ltd.'s wholly owned subsidiary, Information Healthcare Marketing Corp., which operates a related call centre business. The acquired business is based in Mississauga, Ontario, operates as Shoppers Drug Mart Specialty Health Network Inc. and provides comprehensive patient support services for specialty pharmaceutical needs. The assets acquired are composed primarily of goodwill, intangible assets and leasehold improvements at two locations. The operations of the acquired assets and business have been included in the Company's results of operations from the date of acquisition.

The total cost of the acquisition in cash, including costs incurred in connection with the acquisition, was \$88,742. The cost of the acquisition was allocated to the assets acquired on the basis of their fair values as follows:

Net working capital	\$	3,841
Property and equipment		162
Goodwill		70,739
Customer relationships <sup>(1)</sup>		14,000
Purchase price	\$	88,742

<sup>(1)</sup>The carrying value of the Company's customer relationships is included in intangible assets in the consolidated balance sheets.

#### Other Business Acquisitions

During the 12 and 53 weeks ended January 2, 2010, the Company acquired the assets or shares of a number of pharmacies, each of which is individually immaterial to the Company's total acquisitions. The total cost of acquisitions of \$5,265 and \$97,100 (2008 - \$45,617 and \$154,824), respectively, including costs incurred in connection with the acquisitions, is allocated primarily to goodwill and intangible assets based on their fair values. Certain purchase price allocations are preliminary and may change. The operations of the acquired pharmacies have been included in the Company's results of operations from the date of acquisition.

# SHOPPERS DRUG MART CORPORATION

## Notes to the Consolidated Financial Statements

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(in thousands of dollars except per share amounts)

### 5. INTEREST EXPENSE

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

	<b>12 Weeks Ended</b>	13 Weeks Ended	<b>52 Weeks Ended</b>	52 Weeks Ended
	<b>January 2, 2010</b>	January 3, 2009	<b>January 2, 2010</b>	January 3, 2009
Interest on bank indebtedness	\$ 1,150	\$ 2,266	\$ 5,378	\$ 10,584
Interest on commercial paper	1,161	3,809	6,231	23,689
Interest on short-term debt	-	2,292	504	2,292
Interest on long-term debt	9,457	7,573	46,102	27,387
	<b>\$ 11,768</b>	<b>\$ 15,940</b>	<b>\$ 58,215</b>	<b>\$ 63,952</b>

### 6. BANK INDEBTEDNESS

Bank indebtedness is comprised of lines of credit borrowings by both the Company and the Associate-owned stores. The Associate-owned stores borrow under agreements guaranteed by the Company. The Company has entered into agreements with banks to guarantee a total of \$520,000 (2008 - \$425,000) of lines of credit. As at January 2, 2010, the Associate-owned stores have utilized \$254,332 (2008 - \$263,830) of the available lines of credit.

### 7. EMPLOYEE FUTURE BENEFITS

The net benefit expense included in the results for the 12 and 52 weeks ended January 2, 2010, for benefits provided under pension plans was \$1,082 and \$4,688 (2008 - \$1,355 and \$5,874), respectively, and for benefits provided under other benefit plans was \$1,012 and \$1,089 (2008 - \$632 and \$709), respectively.

### 8. DEBT REFINANCING

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

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

On June 22, 2009, the Company filed with the securities regulators in each of the provinces of Canada an amendment to its short form base shelf prospectus dated May 22, 2008 (the "Amended Prospectus") to increase the aggregate principal amount of medium-term notes to be issued from \$1,000,000 to \$1,500,000. Subject to the requirements of applicable law, the Company may issue medium-term notes under the Amended Prospectus for up to 25 months from May 22, 2008.

# SHOPPERS DRUG MART CORPORATION

## Notes to the Consolidated Financial Statements

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### 8. DEBT REFINANCING (continued)

As at January 2, 2010, the Company can issue an additional \$500,000 of medium-term notes under its Amended Prospectus.

### 9. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES RELATED TO FINANCIAL INSTRUMENTS

In the normal course of business, the Company is exposed to financial risks that have the potential to negatively impact its financial performance. The Company may use derivative financial instruments to manage certain of these risks. The Company does not use derivative financial instruments for trading or speculative purposes. These risks are discussed in more detail below:

#### Interest Rate Risk

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

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

The Company uses interest rate derivatives to manage this exposure and monitors market conditions and the impact of interest rate fluctuations on its fixed and floating rate debt instruments on an ongoing basis. The Company has interest rate derivative agreements converting an aggregate notional principal amount of \$100,000 of floating rate commercial paper debt into fixed rate debt.

As at January 2, 2010, the Company had \$466,630 (2008 - \$904,830) of unhedged floating rate debt. During the 12 and 52 weeks ended January 2, 2010, the Company's average outstanding unhedged floating rate debt was \$584,631 and \$600,562 (2008 - \$822,983 and \$671,423), respectively. Had interest rates been higher or lower by 50 basis points during the 12 and 52 weeks ended January 2, 2010, net earnings would have decreased or increased, respectively, by approximately \$464 and \$2,066 (2008 - \$708 and \$2,365), respectively, as a result of the Company's exposure to interest rate fluctuations on its unhedged floating rate debt.

Furthermore, the Company may be exposed to losses should any counterparty to its derivative agreements fail to fulfill its obligations. The Company has sought to minimize counterparty risk by transacting with counterparties that are large financial institutions. As at January 2, 2010 and January 3, 2009, there are no net exposures, as the interest rate derivative agreements are in a liability position.

#### Credit Risk

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

# SHOPPERS DRUG MART CORPORATION

## Notes to the Consolidated Financial Statements

(unaudited)

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### 9. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES RELATED TO FINANCIAL INSTRUMENTS (continued)

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

#### Liquidity Risk

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

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

The contractual maturities of the Company's financial liabilities as at January 2, 2010, are as follows:

	<b>Payments due in the next 90 days</b>	<b>Payments due between 90 days and less than a year</b>	<b>Payments due between 1 year and less than 2 years</b>	<b>Payments due after 2 years</b>	<b>Total</b>
Bank indebtedness	\$ 270,332	\$ -	\$ -	\$ -	\$ 270,332
Commercial paper	261,000	-	-	-	261,000
Accounts payable	885,497	47,133	-	-	932,630
Dividends payable	46,748	-	-	-	46,748
Medium-term notes	-	-	-	950,000	950,000
Revolving term facility	-	-	1,298	-	1,298
Other long-term liabilities	-	-	9,691	13,749	23,440
<b>Total</b>	<b>\$ 1,463,577</b>	<b>\$ 47,133</b>	<b>\$ 10,989</b>	<b>\$ 963,749</b>	<b>\$ 2,485,448</b>

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

# SHOPPERS DRUG MART CORPORATION

## Notes to the Consolidated Financial Statements

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

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### 10. FINANCIAL INSTRUMENTS

#### Interest Rate Derivatives

During the 12 and 52 weeks ended January 2, 2010, the Company had interest rate derivative agreements converting an aggregate notional principal amount of \$100,000 of floating rate commercial paper debt into fixed rate debt. The fixed rates payable by the Company under the derivative agreements range from 4.11% to 4.18%. An agreement covering \$50,000 of the notional principal amount matured in December 2009. The Company recorded a net loss of \$1,811 over the life of this agreement as interest expense on commercial paper (2008 – net gain of \$332). The remaining agreement for \$50,000 with a fixed rate payable of 4.18% matures in December 2010, with reset terms of one month.

Based on market values of the interest rate derivative agreements at January 2, 2010, the Company recognized a liability of \$1,645 (2008 - \$4,647), all of which (2008 - \$1,566) was presented in accounts payable and accrued liabilities (2008 - \$3,081 was also presented in other long-term liabilities). During the 12 and 52 weeks ended January 2, 2010, the Company assessed that the interest rate derivatives were an effective hedge for the floating interest rates on the associated commercial paper debt. During the 13 and 53 weeks ended January 3, 2009, the Company assessed that the interest rate derivatives were an effective hedge for the floating interest rates on the associated commercial paper debt. Market values were determined based on information received from the Company's counterparties to these agreements.

During the 12 and 52 weeks ended January 2, 2010, amounts previously recorded in accumulated other comprehensive loss of \$nil were recognized as income in earnings. During the 13 weeks ended January 3, 2009, amounts previously recorded in accumulated other comprehensive loss of \$186 were recognized as a loss in earnings. During the 53 weeks ended January 3, 2009, amounts previously recorded in accumulated other comprehensive income of \$186 were recognized as a loss in earnings.

#### Equity Forward Derivatives

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

Based on market values of the equity forward agreements at January 2, 2010, the Company recognized a net liability of \$910 (2008 - \$2,093), of which \$286 (2008 - \$nil) is presented in other assets, \$1,196 (2008 - \$1,006) is presented in accounts payable and accrued liabilities and \$nil (2008 - \$1,087) is presented in other long-term liabilities. During the 12 and 52 weeks ended January 2, 2010, the Company assessed that the percentage of the equity forward derivatives related to unearned units under the LTIP was an effective hedge for the common share price of the unearned units. During the 13 and 53 weeks ended January 3, 2009, the Company assessed that the percentage of the equity forward derivatives related to unearned units under the LTIP was an effective hedge for the common share price of the unearned units. Market values were determined based on information received from the Company's counterparties to these agreements.

# SHOPPERS DRUG MART CORPORATION

## Notes to the Consolidated Financial Statements

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(in thousands of dollars except per share amounts)

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### 10. FINANCIAL INSTRUMENTS (continued)

During the 12 and 52 weeks ended January 2, 2010, amounts previously recorded in accumulated other comprehensive loss of \$45 and \$294, respectively, were recognized as income in earnings. During the 13 weeks ended January 3, 2009, amounts previously recorded in accumulated other comprehensive loss of \$14 were recognized as a loss in earnings. During the 53 weeks ended January 3, 2009, amounts previously recorded in accumulated other comprehensive income of \$18 were recognized as a loss in earnings.

#### Fair Value of Financial Instruments

The fair value of a financial instrument is the estimated amount that the Company would receive or pay to settle the financial assets and financial liabilities as at the reporting date.

The fair values of cash, accounts receivable, deposits, bank indebtedness, commercial paper, short-term debt, accounts payable and dividends payable, fair value approximates their carrying values due to their short-term maturities. The fair values of long-term receivables, revolving term facility and other long-term liabilities approximate their carrying values due to the current market rates associated with these instruments; and the fair value of the medium-term notes at January 2, 2010 is approximately \$1,007,522 compared to a carrying value of \$950,000 (excluding transaction costs) due to decreases in market interest rates for similar instruments (2008: the fair value of long-term debt approximated its carrying value).

The interest rate and equity forward derivatives are recognized at fair value, which is determined based on current market rates and on information received from the Company's counterparties to these agreements.

### 11. CAPITAL MANAGEMENT

The Company's primary objectives when managing capital are to profitably grow its business while maintaining adequate financing flexibility to fund attractive new investment opportunities and other unanticipated requirements or opportunities that may arise. Profitable growth is defined as earnings growth commensurate with the additional capital being invested in the business in order that the Company earns an attractive rate of return on that capital. The primary investments undertaken by the Company to drive profitable growth include additions to the selling square footage of its store network via the construction of new, relocated and expanded stores, including related leasehold improvements and fixtures, the purchase of sites for future store construction, as well as through the acquisition of independent drug stores or their prescription files. In addition, the Company makes capital investments in information technology and its distribution capabilities to support an expanding store network. The Company also provides working capital to its Associates via loans and/or loan guarantees. The Company largely relies on its cash flow from operations to fund its capital investment program and dividend distributions to its shareholders. This cash flow is supplemented, when necessary, through the borrowing of additional debt. No changes were made to these objectives during the period.

# SHOPPERS DRUG MART CORPORATION

## Notes to the Consolidated Financial Statements

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### 11. CAPITAL MANAGEMENT (continued)

The Company considers its total capitalization to be bank indebtedness, commercial paper, short-term debt, long-term debt (including the current portion thereof) and shareholders' equity, net of cash. The Company also gives consideration to its obligations under operating leases when assessing its total capitalization. The Company manages its capital structure with a view to maintaining investment grade credit ratings from two credit rating agencies. In order to maintain its desired capital structure, the Company may adjust the level of dividends paid to shareholders, issue additional equity, repurchase shares for cancellation or issue or repay indebtedness. The Company has certain debt covenants and is in compliance with those covenants as at January 2, 2010 and January 3, 2009.

The Company monitors its capital structure principally through measuring its net debt to shareholders' equity and net debt to total capitalization ratios, and ensures its ability to service its debt and meet other fixed obligations by tracking its interest and other fixed charges coverage ratios.

The following table provides a summary of certain information with respect to the Company's capital structure and financial position as at the dates indicated.

	<b>January 2, 2010</b>	January 3, 2009
Cash	\$ (44,391)	\$ (36,567)
Bank indebtedness	270,332	240,844
Commercial paper	260,386	339,943
Short-term debt	-	197,845
Long-term debt	946,098	647,250
Net debt	<b>1,432,425</b>	1,389,315
Shareholders' equity	<b>3,826,110</b>	3,420,529
Total capitalization	<b>\$ 5,258,535</b>	\$ 4,809,844
Net debt:Shareholders' equity	<b>0.37:1</b>	0.41:1
Net debt:Total capitalization	<b>0.27:1</b>	0.29:1
EBITDA:Cash interest expense <sup>(1)(2)</sup>	<b>19.59:1</b>	17.05:1

<sup>(1)</sup> For purposes of calculating the ratios, EBITDA is comprised of EBITDA for the 52 week and 53 week periods ended January 2, 2010 and January 3, 2009, respectively. EBITDA (earnings before interest, taxes, depreciation and amortization) is a non-GAAP financial measure. Non-GAAP financial measures do not have standardized meanings prescribed by GAAP and therefore may not be comparable to similar measures presented by other reporting issuers.

<sup>(2)</sup> Cash interest expense is also a non-GAAP measure and is comprised of interest expense for the 52 week and 53 week periods ended January 2, 2010 and January 3, 2009, respectively, and excludes the amortization of deferred financing costs and includes capitalized interest.

As measured by the ratios set out above, the Company maintained its desired capital structure and financial position during the period.

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

The following table provides a summary of the Company's credit ratings at January 2, 2010:

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

There were no changes to the Company's credit ratings during the 12 and 52 weeks ended January 2, 2010.

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

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

52 Weeks Ended January 2, 2010

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Earnings coverage on long-term debt obligations	19.16 times
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The earnings coverage ratio on long-term debt (including any current portion) is equal to earnings (before interest and income taxes) divided by interest expense on long-term debt (including any current portion). Interest expense excludes any amounts in respect of amortization and includes amounts capitalized to property and equipment that were included in and excluded from, respectively, interest expense as shown in the consolidated statement of earnings of the Company for the period.