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annual management's discussion and analysis

as at March 11, 2011

The following is a discussion of the consolidated financial condition and results of operations of Shoppers Drug Mart Corporation (the "Company") for the periods indicated and of certain factors that the Company believes may affect its prospective financial condition, cash flows and results of operations. This discussion and analysis should be read in conjunction with the consolidated audited financial statements of the Company and the notes thereto for the 52 week period ended January 1, 2011 (the "consolidated financial statements"). The fiscal year of the Company consists of a 52 or 53 week period ending on the Saturday closest to December 31.

Management's Discussion and Analysis

Forward-looking Information and Statements

This document contains forward-looking information and statements which constitute “forward-looking information” under Canadian securities law and which may be material regarding, among other things, the Company’s beliefs, plans, objectives, estimates, intentions and expectations. Forward-looking information and statements are typically identified by words such as “anticipate”, “believe”, “expect”, “estimate”, “forecast”, “goal”, “intend”, “plan”, “will”, “may”, “should”, “could” and similar expressions. Specific forward-looking information in this document includes, but is not limited to, statements with respect to the Company’s future operating and financial results, including its expectations with respect to sales, earnings and cash flows from operating activities as set out under “Strategies and Outlook”, its capital expenditure plans as set out under “Strategies and Outlook” and “Liquidity and Capital Resources – Cash Flows Used in Investing Activities”, its future dividend policy as set out under “Capitalization and Financial Position – Dividend Policy” and the ability to execute on its future operating, investing and financing strategies as set out under “Strategies and Outlook”.

The forward-looking information and statements contained herein are based on certain factors and assumptions, certain of which appear proximate to the applicable forward-looking information and statements contained herein. Inherent in the forward-looking information and statements are known and unknown risks, uncertainties and other factors beyond the Company’s ability to control or predict, which give rise to the possibility that the Company’s predictions, forecasts, expectations or conclusions will not prove to be accurate, that its assumptions may not be correct and that the Company’s plans, objectives and statements will not be achieved. Actual results or developments may differ materially from those contemplated by the forward-looking information and statements.

The material risk factors that could cause actual results to differ materially from the forward-looking information and statements contained herein include, without limitation: the risk of adverse changes to laws and regulations relating to prescription drugs and their sale, including pharmacy reimbursement programs and the availability of manufacturer allowances, or changes to such laws and regulations that increase compliance costs; the risk that the Company will be unable to implement successful strategies to manage the impact of the regulations enacted in 2010 in the Province of Ontario to amend the Ontario drug system, along with the impact of the new Pharmacy Services Agreement that came into effect in 2010 in the Province of British Columbia, as well as the impact of the proposed and/or announced drug system reform initiatives in these and other jurisdictions of Canada, principally the provinces of Alberta, Québec, Nova Scotia and Newfoundland and Labrador; the risk of adverse changes in economic and financial conditions in Canada and globally; the risk of increased competition from other retailers; the risk of an inability of the Company to manage growth and maintain its profitability; the risk of exposure to fluctuations in interest rates; the risk of material adverse changes in foreign currency exchange rates; the risk of an inability to attract and retain pharmacists and key employees; the risk of an inability of the Company’s information technology systems to support the requirements of the Company’s business; the risk of changes to estimated contributions of the Company in respect of its pension plans or post-employment benefit plans which may adversely impact the Company’s financial performance; the risk of changes to the relationships of the Company with third-party service providers; the risk that the Company will not be able to lease or obtain suitable store locations on economically favourable terms; the risk of adverse changes to the Company’s results of operations due to seasonal fluctuations; risks associated with alternative arrangements for sourcing generic drug products, including intellectual property and product liability risks; the risk that new, or changes to current, federal and provincial laws, rules and regulations, including environmental and privacy laws, rules and regulations, may adversely impact the Company’s business and operations; the risk that violations of law, breaches of Company policies or unethical behaviour may adversely impact the Company’s financial performance; property and casualty risks; the risk of injuries at the workplace or health issues; the risk that changes in tax law, or changes in the way that tax law is expected to be interpreted, may adversely impact the Company’s business and operations; the risk that new, or changes to existing, accounting pronouncements may adversely impact the Company; the risks associated with the performance of the Associate-owned store network; the risk of material adverse effects arising as a result of litigation; the risk of damage to the reputation of brands promoted by the Company, or to the reputation of any supplier or manufacturer of these brands; and the risk that events or series of events may cause business interruptions.

This is not an exhaustive list of the factors that may affect any of the Company's forward-looking information and statements. Investors and others should carefully consider these and other factors and not place undue reliance on the forward-looking information and statements. Further information regarding these and other risk factors is included in the Company's public filings with provincial securities regulatory authorities. The forward-looking information and statements contained in this document represent the Company's views only as of the date hereof. Forward-looking information and statements contained in this document about prospective results of operations, financial position or cash flows that are based upon assumptions about future economic conditions and courses of action are presented for the purpose of assisting the Company's shareholders in understanding management's current views regarding those future outcomes and may not be appropriate for other purposes. While the Company anticipates that subsequent events and developments may cause the Company's views to change, the Company does not undertake to update any forward-looking information and statements, except to the extent required by applicable securities laws.

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

Overview

The Company is the licensor of full-service retail drug stores operating under the name Shoppers Drug Mart® (Pharmaprix® in Québec). As at January 1, 2011, there were 1,182 Shoppers Drug Mart/Pharmaprix retail drug stores owned and operated by the Company's licensees ("Associates"). An Associate is a pharmacist-owner of a corporation that is licensed to operate a retail drug store at a specific location using the Company's trademarks. The Company's licensed stores are located in prime locations in each province and two territories, making Shoppers Drug Mart/Pharmaprix stores among the most convenient retail outlets in Canada. The Company also licenses or owns 59 medical clinic pharmacies operating under the name Shoppers Simply Pharmacy® (Pharmaprix Simplement Santé® in Québec) and eight luxury beauty destinations operating as Murale™.

The Company has successfully leveraged its leadership position in pharmacy and its convenient store locations to capture a significant share of the market in front store merchandise. Front store merchandise categories include over-the-counter medications ("OTC medications"), health and beauty aids ("HBA"), cosmetics and fragrances (including prestige brands), everyday household needs and seasonal products. The Company also offers a broad range of high-quality private label products marketed under the trademarks Life Brand®, Quo®, Etival™, Baléa®, Everyday Market®, Bio-Life®, Nativa®, Simply Food™ and Easypix®, among others, and value-added services such as the HealthWATCH® program, which offers patient counselling and advice on medications, disease management and health and wellness, and the Shoppers Optimum® program, one of the largest retail loyalty card programs in Canada. In fiscal 2010, the Company recorded consolidated sales of approximately \$10.4 billion.

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

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

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

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

The Company also owns and operates 63 Shoppers Home Health Care® stores. These retail stores are engaged in the sale and service of assisted-living devices, medical equipment, home-care products and durable mobility equipment to institutional and retail customers.

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

The majority of the Company’s sales are generated from its retail drug store network and the majority of the Company’s assets are used in the operations of these stores. As such, the Company presents one operating segment in its consolidated financial statement disclosures. The revenue generated by Shoppers Drug Mart Specialty Health Network Inc. and by MediSystem Technologies Inc. is included with the prescription sales of the Company’s retail drug stores. The revenue generated by the Shoppers Home Health Care® stores and the Murale™ stores is included with the front store sales of the Company’s retail drug stores.

Strategies and Outlook

The Company’s business strategies are designed to drive sales growth, maximize gross margin dollars and operating cash flow, leverage cost reduction opportunities and build customer loyalty. The Company believes that proper execution of its strategies will strengthen its position as the licensor of Canada’s leading drug store group, thereby generating increased revenue and profitability, which, in turn, should enhance long-term shareholder value.

In the opinion of the Company, the demographic shift and aging population Canada is experiencing will continue to fuel growth in the pharmacy, health and beauty markets. The Company believes that it remains well-positioned to capitalize on this projected growth given its strong brand recognition, the strength of its Associate-owned store network, its innovative product and service offerings in pharmacy, health and beauty, its convenient store locations and its investments in adjacent health and beauty businesses.

The dedication of the Company’s Associate-owners, combined with its ability to recruit, develop and retain talented pharmacists and technicians, has been, and continues to be, the primary contributor to the Company establishing itself as a leader in the practice of community pharmacy and health. Going forward, the Company intends to build upon this leadership position by continuing to deliver innovative pharmacy products, services and programs, including the introduction in 2010 of its own private label generic drug products marketed under the trademark SANIS™, that aim to improve patient health outcomes, build loyalty with patients and third-party payers, increase market share and enhance profitability. Additionally, the continued rollout of the Shoppers Simply Pharmacy® and Pharmaprix Simplement Santé® stores is expected to enhance convenience for patients by providing them with additional points of access to the Company’s national network, while enabling the Company to capture prescriptions at the point of origin, thus providing an additional platform for growth.

Given the expertise and talent of its beauty advisors, the Company has established itself as one of Canada's premier beauty destinations. Through the expansion of its BeautyBOUTIQUES™ within Shoppers Drug Mart® and Pharmaprix® stores, the addition of exclusive skin care, cosmetics and fragrance brands, and a continued focus on the training and development of its beauty staff, the Company believes it will increase customer satisfaction and loyalty, and build market share. The Company also believes that Murale™, its innovative, stand-alone luxury beauty concept showcasing the powerful combination of health and beauty and offering customers access to exclusive prestige brands and an elevated level of service, serves to strengthen its already well-established presence in the category.

The Company believes that its primary focus on pharmacy, health and beauty, along with a continued focus on operational excellence and enhanced merchandising, including the introduction of new products and the increased availability of private label and exclusive branded products, combined with the tactical use of its Shoppers Optimum® loyalty card program, will improve convenience and enhance the shopping experience and value proposition for consumers. This in turn should strengthen the positioning of Shoppers Drug Mart® and Pharmaprix® stores as a destination for the purchase of front store merchandise, including OTC medications, HBA, seasonal products and everyday household essentials.

The Company also believes that its presence in adjacent health markets provides it with additional channels through which to offer patient care and grow its business. Through Shoppers Drug Mart Specialty Health Network Inc., MediSystem Technologies Inc. and its 63 Shoppers Home Health Care® stores, the Company believes it has enhanced its ability to meet its customers' diverse health needs in different facets of their lives.

Sales growth is also being driven by the Company's store network investment program as it seeks to construct new stores, expand and remodel existing stores and relocate other stores to superior locations, albeit at a slower rate than in prior years in response to the drug system reform initiatives implemented in 2010 in a number of provincial jurisdictions. The Company continues to pursue attractive opportunities in the marketplace to acquire drug stores and prescription files, although this activity also slowed in fiscal 2010 relative to prior periods. In fiscal 2010, the Company opened or acquired 75 drug stores, 43 of which were relocations, and consolidated or closed 10 smaller drug stores. In addition to this activity, the Company also completed 27 major drug store expansions and opened two Murale™ stores during the year. As a result of this activity, retail selling space increased by 6.4% during fiscal 2010 to in excess of 12.7 million square feet at year end. The Company intends to continue making investments in its store base, with the goal of increasing the number and average size of its full-service drug stores. These large-format stores offer customers greater convenience and a broader selection of front store products, while maintaining the high level of service for which Shoppers Drug Mart® and Pharmaprix® stores are known. As well, the Company will continue to roll out its smaller format Shoppers Simply Pharmacy® and Pharmaprix Simplement Santé® drug stores. Historically, the Company's capital expenditures and acquisitions have been largely financed from internally generated cash flow, supplemented when necessary through the borrowing of additional debt.

In fiscal 2011, the Company expects total sales to increase by between 2.0% and 3.0%. This expectation is underpinned by anticipated same-store sales growth of between 2.0% and 3.0% in the front of the store and flat same-store sales growth in pharmacy. In pharmacy, it is expected that strong growth in the number of prescriptions filled will be largely offset by a continued reduction in average prescription value, with the decline in average value being mostly attributable to further reductions in generic prescription reimbursement rates as a result of recently implemented drug system reform initiatives in a number of provincial jurisdictions. Furthermore, it is anticipated that increasing generic prescription utilization rates will also serve as a contributing factor to the decline in average prescription value.

The Company plans to allocate \$360 million to capital expenditures in 2011, with approximately 75% of this amount to be invested in the store network, including any related investments to acquire drug stores, prescription files and land. This activity should result in an increase in retail selling square footage of approximately 4.5%. It is expected that this will be accomplished through the addition of between 50 and 55 new drug stores, approximately 35 of which will be relocations, and through the completion of between 25 and 30 major drug store expansions. The Company also plans to remodel up to 40 existing drug stores, converting these stores to smaller prototype formats consistent with the brand identification, product offering and consumer proposition offered by the Company's large-format drug stores.

Based on the above assumptions, the Company expects fiscal 2011 EBITDA (earnings before interest, taxes, depreciation and amortization) to be within the range of \$1.220 billion to \$1.250 billion. It is further assumed that the year-over-year rate of increase in the Company's amortization expense will decrease to approximately 12% in 2011, resulting in estimated earnings per share (diluted) of between \$2.80 and \$2.90, with the momentum in earnings growth expected to pick up in the second half of the year.

Commensurate with the Company's expected growth in sales and net earnings, along with the year-over-year reduction in its capital expenditure and investment program, it is anticipated that cash flows from operating activities will continue to increase and will be more than sufficient to fund the Company's investments and dividend payments, with the remaining balance available for share repurchases and/or the repayment of debt.

See "Industry and Regulatory", "Economic and Financial Conditions" and "Real Estate" under the "Risks and Risk Management" section herein and "Capital Management and Liquidity Risk" under the "Risks Associated with Financial Instruments" section herein for discussions of certain risks in the normal course of the Company's business that have the potential to affect its ability to successfully implement its plans respecting sales growth and capital expenditures, including the continued growth and expansion of its retail network. Subject to these factors and to the performance of the Canadian economy and financial market conditions in 2011, the Company is confident in its ability to execute upon its operating, investing and financing strategies in fiscal 2011 and beyond. The Company believes that the appropriate balance and successful implementation of these strategies and initiatives will result in long-term market share gains and lead to enhanced shareholder value, through a combination of share price appreciation and dividends that are sustainable over time.

Overall Financial Performance

Key Operating, Investing and Financial Metrics

The following provides an overview of the Company's operating performance for the 52 week period ended January 1, 2011 compared to the 52 week period ended January 2, 2010, as well as certain other metrics with respect to investing activities for the 52 week period ended January 1, 2011 and financial position as at January 1, 2011.

- Sales of \$10.376 billion, an increase of 3.9%.
 - Comparable store total sales growth of 2.1%.
 - > Comparable prescription sales growth of 1.7%.
 - > Comparable front store sales growth of 2.5%.
- Prescription count growth of 4.7%.
 - > Comparable store prescription count growth of 3.0%.
- EBITDA⁽¹⁾ of \$1.184 billion. Adjusted EBITDA⁽²⁾ of \$1.194 billion, an increase of 4.3%.
 - > EBITDA margin⁽³⁾ of 11.41%. Adjusted EBITDA margin⁽⁴⁾ of 11.51%, an increase of 5 basis points.
- Net earnings of \$591 million or \$2.72 per share (diluted). Adjusted net earnings⁽⁵⁾ of \$598 million or \$2.75 per share (diluted), an increase of 2.2%.
- Capital expenditure program of \$484 million compared to \$593 million in the prior year.
 - > 75 new drug stores opened or acquired, 43 of which were relocations.
 - > 27 major drug store expansions.
 - > Two new Murale™ luxury beauty stores opened.
 - > 6.4% increase in retail selling space to in excess of 12.7 million square feet.
- Maintained desired capital structure and strengthened financial position.
 - > Net debt to equity ratio of 0.29:1 compared to 0.37:1 at the end of the prior year.
 - > Net debt to total capitalization ratio of 0.22:1 compared to 0.27:1 at the end of the prior year.
- Declared four quarterly dividends of 22.5 cents per share.

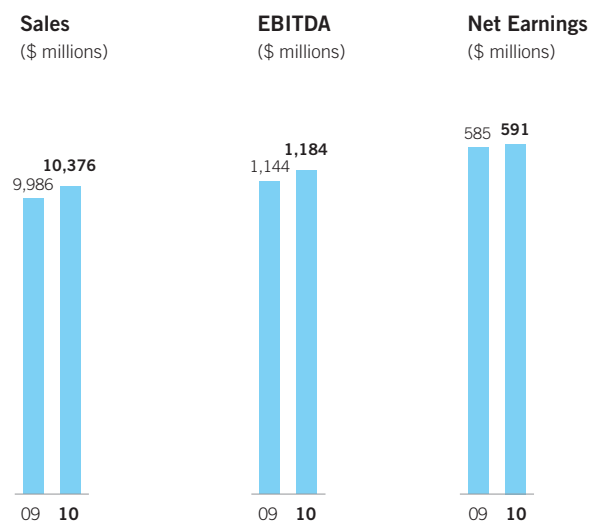
⁽¹⁾ Earnings before interest, taxes, depreciation and amortization, inclusive of a \$10 million (pre-tax) charge to settle a long-standing legal dispute related to a commercial arrangement with one of the Company's ancillary businesses. (See reconciliation to the most directly comparable GAAP measure under "Results of Operations – Fiscal 2010" in this Management's Discussion and Analysis.)

⁽²⁾ EBITDA, excluding the impact of the charge referred to in footnote (1) above.

⁽³⁾ EBITDA divided by sales.

⁽⁴⁾ Adjusted EBITDA divided by sales.

⁽⁵⁾ Net earnings, excluding the after-tax impact of the charge referred to in footnote (1) above.



Results of Operations – Fiscal 2010

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

| (\$000s, except per share data) | 2010 | 2009 | \$ Change | % Change |
|---|---------------|--------------|------------|----------|
| Sales | \$ 10,376,067 | \$ 9,985,600 | \$ 390,467 | 3.9% |
| Cost of goods sold and other operating expenses | 9,192,181 | 8,841,170 | (351,011) | (4.0%) |
| EBITDA ⁽¹⁾ | 1,183,886 | 1,144,430 | 39,456 | 3.4% |
| Amortization | 286,935 | 248,794 | (38,141) | (15.3%) |
| Operating income | 896,951 | 895,636 | 1,315 | 0.1% |
| Interest expense | 56,036 | 58,215 | 2,179 | 3.7% |
| Earnings before income taxes | 840,915 | 837,421 | 3,494 | 0.4% |
| Income taxes | 250,172 | 252,513 | 2,341 | 0.9% |
| Net earnings | \$ 590,743 | \$ 584,908 | \$ 5,835 | 1.0% |
| Per common share | | | | |
| – Basic net earnings | \$ 2.72 | \$ 2.69 | \$ 0.03 | |
| – Diluted net earnings | \$ 2.72 | \$ 2.69 | \$ 0.03 | |

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

Sales

Sales represent the combination of sales of the retail drug stores owned by the Associates, sales at Murale™ and sales of the home health care business, Shoppers Drug Mart Specialty Health Network Inc. and MediSystem Technologies Inc. The majority of the Company's sales are generated from its retail drug store network and the majority of the Company's assets are used in the operations of these stores. As such, the Company presents one operating segment in its consolidated financial statement disclosures. Sales at Murale™ and sales of the home health care business are included with front store sales of the Company's retail drug stores. Sales of Shoppers Drug Mart Specialty Health Network Inc. and MediSystem Technologies Inc. are included with prescription sales of the Company's retail drug stores.

Sales in 2010 were \$10.376 billion compared to \$9.986 billion in 2009, an increase of \$390 million or 3.9%. During 2010, the Company continued to experience sales growth in all regions of the country, led by strong gains in Western Canada and Québec. The Company's capital investment and store development program, which resulted in a year-over-year increase in selling space of 6.4%, continues to have a positive impact on sales growth. On a same-store basis, sales increased 2.1% in 2010.

Prescription sales were \$4.959 billion in 2010 compared to \$4.824 billion in 2009, an increase of \$135 million or 2.8%. On a same-store basis, prescription sales increased 1.7% during the year. A reduction in generic prescription reimbursement rates, the result of the drug system reform initiatives implemented in the second half of 2010, principally in Ontario, combined with greater generic prescription utilization rates, had a negative impact on sales dollar growth in pharmacy. Consistent with the prior year, prescription sales growth was driven by strong growth in the number of prescriptions filled, with total prescription counts increasing by 4.7% during 2010. On a same-store basis, prescription counts increased 3.0% during the year. Generic molecules represented 55.5% of prescriptions dispensed in 2010 compared to 53.0% of prescriptions dispensed in the prior year. In 2010, prescription sales accounted for 47.8% of the Company's sales mix compared to 48.3% in the prior year.

Front store sales were \$5.417 billion in 2010 compared to \$5.162 billion in 2009, an increase of \$255 million or 4.9%, with the Company posting sales gains in all core categories, led by food and confection, cosmetics and beverage. Sales gains in over-the-counter medications were also strong, a particularly impressive result given that this category also performed well in the prior year during which time sales benefited from customer and patient awareness of the H1N1 virus. On a same-store basis, front store sales increased 2.5% in 2010. In addition to square footage growth, the Company's investments in marketing, pricing and promotional activities throughout the year drove sales and market share gains in the front of the store.

Cost of Goods Sold and Other Operating Expenses

Cost of goods sold is comprised of the cost of goods sold at the retail drug stores owned by the Associates, the cost of goods sold at Murale™ and the cost of goods sold at the home health care business, Shoppers Drug Mart Specialty Health Network Inc. and MediSystem Technologies Inc. Other operating expenses include corporate selling, general and administrative expenses, operating expenses at the retail drug stores owned by the Associates, including Associates' earnings, operating expenses at Murale™ and operating expenses at the home health care business, Shoppers Drug Mart Specialty Health Network Inc. and MediSystem Technologies Inc.

Total cost of goods sold and other operating expenses, inclusive of a \$10 million charge to settle a long-standing legal dispute related to a commercial arrangement with one of the Company's ancillary businesses, were \$9.192 billion in 2010. Excluding the impact of this charge, the Company's adjusted cost of goods sold and other operating expenses were \$9.182 billion in 2010 compared to \$8.841 billion in 2009, an increase of \$341 million or 3.9%. Expressed as a percentage of sales, cost of goods sold declined by 93 basis points in 2010 compared to the prior year, reflecting the benefits of improved purchasing synergies, greater generic prescription utilization and the impact of reduced generic drug costs and reimbursement levels as a result of the drug system reform initiatives implemented in certain provinces in the second half of 2010, particularly Ontario. These benefits were offset somewhat by continued investments in pricing and promotional activities, including Shoppers Optimum® events, in order to drive sales growth and market share gains in the front of the store. Other operating expenses, expressed as a percentage of sales and excluding the impact of the \$10 million charge referred to above, increased by 88 basis points over the prior year, due in part to top-line deflation stemming from the above referenced drug system reform initiatives and greater generic prescription utilization, along with increased store-level expenses, primarily occupancy, Associate earnings, wages and benefits related to the growth of the store network. These increases were partially offset by front store productivity and efficiency gains resulting from the successful rollout and implementation of the Company's Project Infinity initiatives, together with reduced store opening costs due to a decrease in the number of stores opened during 2010 compared to the prior year.

Amortization

Amortization of capital assets and other intangible assets was \$287 million in 2010 compared to \$249 million in 2009, an increase of \$38 million or 15.3%. Expressed as a percentage of sales, amortization increased by 28 basis points in 2010 compared to the prior year, an increase which can be attributed to the Company's ongoing investments in its store network and supporting infrastructure.

Operating Income

Operating income, inclusive of the \$10 million charge referred to above, was \$897 million in 2010. Excluding the impact of this charge, the Company's adjusted operating income was \$907 million in 2010 compared to \$896 in 2009, an increase of \$11 million or 1.3%. As described above, this increase was driven by top-line growth, improved purchasing synergies and front store productivity and efficiency gains. These gains were partially offset by the negative impact of drug system reform initiatives implemented in the second half of 2010, increased amortization and higher operating costs at store level tied to the Company's strategic growth and expansion initiatives, along with continued investments in marketing and promotional activities. In 2010, adjusted operating margin (adjusted operating income divided by sales) declined by 23 basis points to 8.74% compared to 8.97% in 2009. The Company's EBITDA margin (EBITDA divided by sales), adjusted to exclude the impact of the charge referred to above, was 11.51% in 2010, a 5 basis point improvement over the EBITDA margin of 11.46% posted in 2009.

Interest Expense

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

Interest expense was \$56 million in 2010 compared to \$58 million in 2009, a decrease of \$2 million or 3.7%. Interest expense savings due to the Company having a lower average amount of consolidated net debt outstanding during the year were partially offset by a market-driven increase in short-term interest rates on the Company's floating rate debt obligations. (See discussion under "Financing Activities" in this Management's Discussion and Analysis and note 5 to the consolidated financial statements of the Company.)

Income Taxes

The Company's effective income tax rate in 2010 was 29.8% compared to a rate of 30.2% in the prior year. This decrease in the effective income tax rate can be attributed to a reduction in statutory rates. (See discussion on "Income and Other Taxes" under "Critical Accounting Estimates" in this Management's Discussion and Analysis and notes 1 and 6 to the consolidated financial statements of the Company.)

Net Earnings

Net earnings in 2010, inclusive of the aforementioned \$10 million (pre-tax) charge, were \$591 million and earnings per share (diluted) were \$2.72. Excluding the impact of this charge, the Company's adjusted net earnings were \$598 million in 2010 compared to \$585 million in 2009, an increase of \$13 million or 2.2%. On a diluted basis, adjusted earnings per share were \$2.75 in 2010 compared to \$2.69 in 2009.

Capitalization and Financial Position

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

| (\$000s) | 2010 | 2009 |
|---|--------------|--------------|
| Cash | \$ (64,354) | \$ (44,391) |
| Bank indebtedness | 209,013 | 270,332 |
| Commercial paper | 127,828 | 260,386 |
| Long-term debt | 943,412 | 946,098 |
| Net debt | 1,215,899 | 1,432,425 |
| Shareholders' equity | 4,223,903 | 3,826,110 |
| Total capitalization | \$ 5,439,802 | \$ 5,258,535 |
| Net debt:Shareholders' equity | 0.29:1 | 0.37:1 |
| Net debt:Total capitalization | 0.22:1 | 0.27:1 |
| Net debt:EBITDA | 1.03:1 | 1.25:1 |
| EBITDA:Cash interest expense ⁽¹⁾ | 20.16:1 | 19.59:1 |

⁽¹⁾ Cash interest expense excludes the amortization of deferred financing costs but includes capitalized interest.

Financial Ratios and Credit Ratings

As measured by the ratios set out above, the Company strengthened its balance sheet and financial position in 2010. The Company is comfortable with its existing capital structure and financial position and expects to maintain similar ratios in 2011.

The following table provides a summary of the Company's credit ratings at the end of 2010.

| | Standard & Poor's | DBRS Limited |
|-------------------------|-------------------|--------------|
| Corporate credit rating | BBB+ | – |
| Senior unsecured debt | BBB+ | A (low) |
| Commercial paper | – | R-1 (low) |

There were no changes to any of the Company's credit ratings during fiscal 2010.

Outstanding Share Capital

The Company's outstanding share capital is comprised of common shares. An unlimited number of common shares is authorized and the Company had 217,473,716 common shares outstanding at March 11, 2011. As at this same date, the Company had issued options to acquire 964,963 of its common shares pursuant to its stock-based compensation plans, of which 811,031 were exercisable. (See notes 14 and 15 to the consolidated financial statements of the Company.)

Dividend Policy

On February 11, 2010, the Company announced that its Board of Directors had declared a dividend of 22.5 cents per common share, payable April 15, 2010 to shareholders of record as of the close of business on March 31, 2010. This represented an increase in the amount of the Company's quarterly dividend payments of 5.0%, resulting in an annualized dividend payment of 90 cents per common share, and equated to a dividend payout ratio, expressed as a percentage of fiscal 2009 net earnings, of 33%.

The following table provides a summary of dividends declared by the Company in 2010:

| Declaration Date | Record Date | Payment Date | Dividend per Share |
|-------------------|--------------------|------------------|--------------------|
| February 11, 2010 | March 31, 2010 | April 15, 2010 | \$ 0.225 |
| April 28, 2010 | June 30, 2010 | July 15, 2010 | \$ 0.225 |
| July 22, 2010 | September 30, 2010 | October 15, 2010 | \$ 0.225 |
| November 10, 2010 | December 31, 2010 | January 14, 2011 | \$ 0.225 |

Subsequent to year end, the Company announced, on February 10, 2011, that its Board of Directors had declared a dividend of 25 cents per common share, payable April 15, 2011 to shareholders of record as of the close of business on March 31, 2011. This represents an increase in the amount of the Company's quarterly dividend payments of 11%, resulting in an annualized dividend payment of \$1.00 per common share, and equates to a dividend payout ratio, expressed as a percentage of fiscal 2010 net earnings, of 37%.

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

All dividends paid by the Company in 2010 and, unless otherwise indicated, all dividends to be paid by the Company subsequent to 2010, are designated as *eligible dividends* in accordance with subsection 89(14) of the *Income Tax Act* (Canada) and any applicable corresponding provincial or territorial provisions.

Normal Course Issuer Bid

Subsequent to year end, the Company announced, on February 10, 2011, that its Board of Directors authorized the purchase of up to 8,700,000 of its common shares, representing approximately 4.0% of its common shares then outstanding, by way of normal course purchases effected through the facilities of the Toronto Stock Exchange (the "TSX"). The Company was able to commence purchases under this program on February 15, 2011. The program will terminate on February 14, 2012, or on such earlier date as the Company may complete its purchases pursuant to a Notice of Intention filed with the TSX. Purchases will be made by the Company in accordance with the requirements of the TSX, and the price which the Company will pay for any such common shares will be the market price of any such common shares at the time of acquisition, or such other price as may be permitted by the TSX. For purposes of the TSX rules, a maximum of 170,759 common shares may be purchased by the Company on any one day under the bid, except where purchases are made in accordance with the "block purchase exception" of the TSX rules. Common shares purchased by the Company will be cancelled. As at March 11, 2011, no purchases had been made under this program.

Financing Activities

On December 10, 2010, the Company announced that it had closed a \$750 million revolving term credit facility with a syndicate of banks. This credit facility, which matures December 10, 2014, replaces the Company's previously existing \$800 million revolving term credit facility that was to mature on June 6, 2011. Accordingly, the consolidated net debt position of the Company remained substantially unchanged as a result of this refinancing. The new credit facility, as was the case with the credit facility it replaces, is available for general corporate purposes, including backstopping the Company's \$500 million commercial paper program. (See notes 10 and 11 to the consolidated financial statements of the Company.)

Liquidity and Capital Resources

Sources of Liquidity

The Company has the following sources of liquidity: (i) cash provided by operating activities; (ii) cash available from a committed \$750 million revolving bank credit facility maturing December 10, 2014, less what is currently drawn and/or being utilized to support commercial paper issued and outstanding; and (iii) up to \$500 million in availability under its commercial paper program, less what is currently issued. The Company's commercial paper program is rated R-1 (low) by DBRS Limited. In the event that the Company's commercial paper program is unable to maintain this rating, the program is supported by the Company's \$750 million revolving bank credit facility. The Company does not currently foresee any reasonable circumstances under which this credit rating would not be maintained. At January 1, 2011, \$9 million of the Company's \$750 million revolving bank credit facility was utilized, all in respect of outstanding letters of credit. At the end of the prior year, \$10 million of the Company's then existing \$800 million revolving bank credit facility was utilized, \$9 million of which was in respect of outstanding letters of credit. At January 1, 2011, the Company had \$128 million of commercial paper issued and outstanding under its commercial paper program compared to \$261 million at the end of the prior year. (See notes 10 and 11 to the consolidated financial statements of the Company.)

The Company has also arranged for its Associates to obtain financing to facilitate their inventory purchases and fund their working capital requirements by providing guarantees to various Canadian chartered banks that support Associate loans. At the end of 2010, the Company's maximum obligation in respect of such guarantees was \$520 million, unchanged from the end of the prior year. At January 1, 2011, an aggregate amount of \$440 million in available lines of credit had been allocated to the Associates by the various banks compared to \$431 million at the end of the prior year. At January 1, 2011, Associates had drawn an aggregate amount of \$176 million against these available lines of credit compared to \$254 million at the end of the prior year. Any amounts drawn by the Associates are included in bank indebtedness on the Company's consolidated balance sheets. As recourse in the event that any payments are made under the guarantees, the Company holds a first-ranking security interest on all assets of Associate-owned stores, subject to certain prior-ranking statutory claims. As the Company is involved in allocating the available lines of credit to its Associates, it estimates that the net proceeds from secured assets would exceed the amount of any payments required in respect of the guarantees.

The Company has obtained additional long-term financing from the issuance of \$450 million of five-year medium-term notes maturing June 3, 2013, which bear interest at a fixed rate of 4.99% per annum (the "Series 2 Notes"), \$250 million of three-year medium-term notes maturing January 20, 2012, which bear interest at a fixed rate of 4.80% per annum (the "Series 3 Notes") and \$250 million of five-year medium-term notes maturing January 20, 2014, which bear interest at a fixed rate of 5.19% per annum (the "Series 4 Notes"). The Series 2 Notes were issued pursuant to a final short form base shelf prospectus dated May 22, 2008 (the "Prospectus"), as supplemented by a pricing supplement dated May 28, 2008. The Series 3 Notes and Series 4 Notes were issued pursuant to the Prospectus, as supplemented by pricing supplements dated January 14, 2009. The pricing supplements were filed by the Company with Canadian securities regulators in all of the provinces of Canada. At the time of issuance, the medium-term notes were assigned ratings of A (low) from DBRS Limited and BBB+ from Standard & Poor's. (See note 11 to the consolidated financial statements of the Company.)

Cash Flows from Operating Activities

Cash flows from operating activities were \$832 million in 2010, compared to \$693 million in the prior year. This increase is largely the result of growth in net earnings, adjusted for non-cash items, principally amortization, combined with a reduction in the amount invested in non-cash working capital balances compared to the prior year. The reduction in the amount invested in non-cash working capital balances can be largely attributed to a reduction in accounts receivable and an increase in accounts payable, offset somewhat by a shift in the timing of income tax payments. (See note 16 to the consolidated financial statements of the Company.)

Cash Flows Used in Investing Activities

Cash flows used in investing activities were \$430 million in 2010 compared to \$563 million in 2009, a decrease of \$133 million or 23.7%. Of these totals, purchases of property and equipment, net of proceeds from any dispositions, amounted to \$354 million in 2010 compared to \$431 million in 2009, as the Company continues to invest in its store network and related infrastructure projects in information technology and distribution, albeit at a slower rate. Included in the net purchases of property and equipment in 2010 was \$61 million of proceeds resulting from dispositions, \$57 million of which related to the sale/leaseback of certain real estate properties, compared to \$30 million and \$21 million, respectively, in the prior year. (See note 12 to the consolidated financial statements of the Company.) In 2010, the Company invested an additional \$13 million in business acquisitions and a combined \$64 million in the purchase and development of intangible and other assets compared to \$97 million and \$38 million, respectively, in 2009. Investments in business acquisitions relate primarily to acquisitions of drug stores and prescription files and, while the Company will continue to pursue attractive opportunities in the marketplace, this activity slowed in 2010 in response to drug system reform initiatives implemented in a number of provincial jurisdictions. During 2010, the balance of funds deposited and held in escrow in respect of outstanding offers to purchase drug stores and land decreased by \$2 million compared to a decrease of \$4 million in 2009.

During 2010, the Company opened or acquired 75 new drug stores, 43 of which were relocations, consolidated or closed 10 smaller drug stores and completed 27 major drug store expansions. The Company also opened two Murale™ stores in 2010. At the end of 2010, there were 1,312 retail stores in the Company's network, comprised of 1,241 drug stores (1,182 Shoppers Drug Mart®/Pharmaprix® stores and 59 Shoppers Simply Pharmacy®/Pharmaprix Simplement Santé® stores), 63 Shoppers Home Health Care® stores and eight Murale™ stores. During 2010, the retail selling space of the store network increased by 6.4% to in excess of 12.7 million square feet. At year end, the average selling space per drug store was approximately 10,100 square feet compared to 9,600 square feet at the end of the prior year.

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

| | 2010 | | 2009 | |
|---------------------------------|-------------|-------------------------|-------------|-------------------------|
| | Drug Stores | Home Health Care Stores | Drug Stores | Home Health Care Stores |
| Store count – beginning of year | 1,219 | 66 | 1,149 | 66 |
| Stores opened/acquired | 32 | – | 74 | – |
| Stores consolidated/closed | (10) | (3) | (4) | – |
| Store count – end of year | 1,241 | 63 | 1,219 | 66 |
| Stores relocated | 43 | – | 40 | – |
| Stores expanded | 27 | – | 22 | – |

The Company intends to continue making investments in its store base, with the goal of increasing the number and average size of its stores, albeit at a slower pace than in previous years in response to drug system reform initiatives implemented in 2010 in a number of provincial jurisdictions. In fiscal 2011, the Company plans to allocate approximately \$360 million to capital expenditures, with approximately 75% of this amount being invested in the store network, including any related investments to acquire drug stores, prescription files and land. This activity should result in an increase in retail selling square footage of approximately 4.5% in 2011. This will be accomplished through the addition of between 50 and 55 new drug stores, approximately 35 of which will be relocations, and through the completion of between 25 and 30 major drug store expansions. The Company will also remodel up to 40 existing drug stores, converting these stores to smaller prototype formats consistent with the brand identification, product offering and consumer proposition offered by the Company's large-format drug stores.

Cash Flows Used in Financing Activities

Cash flows used in financing activities were \$382 million in 2010, as cash outflows of \$392 million were partially offset by cash inflows of \$10 million. Cash outflows were comprised of a \$61 million decrease in bank indebtedness, a \$133 million decrease in the amount of commercial paper issued and outstanding by the Company under its commercial paper program, a \$1 million reduction in prime borrowings under the Company's revolving bank credit facility, \$3 million to fund costs associated with financing activities and \$194 million for the payment of dividends. Cash inflows were comprised of a \$9 million increase in the amount of Associate investment and \$1 million of proceeds received from the issuance of common shares and loan repayments under the Company's stock-based incentive plans. (See discussion on "Financing Activities" in this Management's Discussion and Analysis.)

In 2010, the net result of the Company's operating, investing and financing activities was an increase in cash balances of \$20 million.

Future Liquidity

The Company believes that its current credit facilities, commercial paper program and financing programs available to its Associates, together with cash generated from operating activities, will be sufficient to fund its operations, including the operations of its Associate-owned store network, investing activities and commitments for the foreseeable future. Historically, the Company has not experienced any major difficulty in obtaining additional short or long-term financing given its investment grade credit ratings. While the Company is committed to maintaining its investment grade credit ratings, credit ratings may be revised or withdrawn at any time by the rating agencies if, in their judgement, circumstances warrant.

Contractual Obligations

The following table presents a summary of the maturity periods of the Company's long-term contractual obligations as at the end of 2010.

| (\$000s) | Payments Due During 2011 | Payments Due in 2012 and 2013 | Payments Due in 2014 and 2015 | Payments Due After 2015 | Obligations with No Fixed Maturity | Total |
|---|--------------------------|-------------------------------|-------------------------------|-------------------------|------------------------------------|---------------------|
| Long-term debt | \$ — | \$ 700,000 | \$ 250,000 | \$ — | \$ — | \$ 950,000 |
| Employee future benefits ⁽¹⁾ | — | — | — | — | 8,997 | 8,997 |
| Other | 13,443 | 15,978 | 3,438 | 9,833 | 3,856 | 46,548 |
| Operating leases ⁽²⁾ | 383,847 | 787,101 | 741,922 | 2,593,216 | — | 4,506,086 |
| Capital leases ⁽³⁾ | 533 | 1,148 | 1,278 | 9,995 | — | 12,954 |
| Total | \$ 397,823 | \$ 1,504,227 | \$ 996,638 | \$ 2,613,044 | \$ 12,853 | \$ 5,524,585 |

⁽¹⁾ See discussion on "Employee Future Benefits" under "Critical Accounting Estimates" in this Management's Discussion and Analysis and note 13 to the consolidated financial statements of the Company.

⁽²⁾ Represents the minimum lease payments under long-term leases for store locations and office space as at January 1, 2011. (See note 17 to the consolidated financial statements of the Company.)

⁽³⁾ Represents the minimum lease payments under capital leases for store locations as at January 1, 2011. (See note 17 to the consolidated financial statements of the Company.)

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

The Company has entered into an agreement with a third party to provide distribution services to the Company's store network. Under the terms of the distribution services agreement, which expires on December 31, 2012, the third party will charge the Company specified costs incurred to provide the distribution services, plus an annual management fee. In addition, the Company has entered into an agreement to outsource certain information services activities from a third party. The Company has committed to average annual payments of approximately \$7 million over the term of the information services agreement, which expires in 2011.

Selected Annual Information

The following table provides a summary of certain selected consolidated annual financial information for the Company. The Company's fiscal year consists of a 52 or 53 week period ending on the Saturday closest to December 31. This information has been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") and all figures are reported in Canadian dollars.

| (\$000s, except per share data) | 2010 (52 weeks) | 2009 (52 weeks) | 2008 (53 weeks) |
|-------------------------------------|----------------------------------|--------------------|--------------------|
| Sales | \$ 10,376,067 | \$ 9,985,600 | \$ 9,422,911 |
| Net earnings | \$ 590,743 | \$ 584,908 | \$ 554,145 |
| Per common share | | | |
| – Basic net earnings | \$ 2.72 | \$ 2.69 | \$ 2.55 |
| – Diluted net earnings | \$ 2.72 | \$ 2.69 | \$ 2.55 |
| Dividends declared per common share | \$ 0.90 | \$ 0.86 | \$ 0.86 |
| Total assets | \$ 7,122,210 | \$ 6,852,454 | \$ 6,364,223 |
| Total long-term liabilities | \$ 1,392,055 | \$ 1,336,907 | \$ 981,170 |

Sales

2010 Compared to 2009

Sales in 2010 were \$10.376 billion compared to \$9.986 billion in 2009, an increase of \$390 million or 3.9%. During 2010, the Company continued to experience sales growth in all regions of the country, led by strong gains in Western Canada and Québec. The Company's capital investment and store development program, which resulted in a year-over-year increase in selling space of 6.4%, continues to have a positive impact on sales growth. On a same-store basis, sales increased 2.1% in 2010.

Prescription sales were \$4.959 billion in 2010 compared to \$4.824 billion in 2009, an increase of \$135 million or 2.8%. On a same-store basis, prescription sales increased 1.7% during the year. A reduction in generic prescription reimbursement rates, the result of the drug system reform initiatives implemented in certain provinces in the second half of 2010, principally Ontario, combined with greater generic prescription utilization rates, had a negative impact on sales dollar growth in pharmacy. Prescription sales growth was driven by strong growth in the number of prescriptions filled, with total pharmacy counts increasing by 4.7% during 2010. On a same-store basis, pharmacy counts increased 3.0% during the year. Generic molecules represented 55.5% of prescriptions dispensed in 2010 compared to 53.0% of prescriptions dispensed in the prior year. In 2010, prescription sales accounted for 47.8% of the Company's sales mix compared to 48.3% in the prior year.

Front store sales were \$5.417 billion in 2010 compared to \$5.162 billion in 2009, an increase of \$255 million or 4.9%, with the Company posting sales gains in all core categories, led by food and confection, cosmetics and beverage. Sales gains in over-the-counter medications were also strong, a particularly impressive result given that this category also performed well in the prior year during which time sales benefited from customer and patient awareness of the H1N1 virus. On a same-store basis, front store sales increased 2.5% in 2010. In addition to square footage growth, the Company's investments in marketing, pricing and promotional activities throughout the year drove sales and market share gains in the front of the store.

2009 Compared to 2008

Sales in 2009 were \$9.986 billion compared to \$9.423 billion in 2008, an increase of \$563 million or 6.0%. During 2009, the Company continued to experience strong sales growth in all regions of the country, led by gains in Québec. The Company's capital investment and store development program, which resulted in a 9.9% increase in retail selling space over the prior year, had a positive impact on sales growth. Sales growth was also aided by the Company's efforts to acquire drug stores and prescription files, and by the inclusion of a full year's results from Shoppers Drug Mart Specialty Health Network Inc., a business that was acquired by the Company in the third quarter of 2008. On a same-store (52 week) basis, sales increased 4.8% in 2009 from the previous year.

Prescription sales were \$4.824 billion in 2009 compared to \$4.486 billion in 2008, an increase of \$338 million or 7.5%. In 2009, prescription sales accounted for 48.3% of the Company's sales mix compared to 47.6% in the prior year. On a same-store (52 week) basis, prescription sales increased 5.7% in 2009 from the previous year. Consistent with the prior year, pharmacy sales growth was driven by strong growth in the number of prescriptions filled, while greater generic utilization continued to have a deflationary impact on sales growth in the category. In 2009, generic molecules represented 53.0% of prescriptions dispensed compared to 51.2% of prescriptions dispensed in 2008, an increase of 3.5%.

Front store sales were \$5.162 billion in 2009 compared to \$4.937 billion in 2008, an increase of \$225 million or 4.6%, with the Company once again experiencing sales gains in all core categories. On a same-store (52 week) basis, front store sales increased 4.0% in 2009 from the previous year. Store network expansion and retail selling space growth, combined with effective merchandising and category management initiatives, drove front store sales growth during the year. Additionally, the Company invested aggressively in marketing, pricing and promotional activities throughout 2009 in order to drive top-line growth in its front store categories.

Net Earnings

2010 Compared to 2009

Net earnings in 2010, inclusive of a third quarter charge of \$10 million (pre-tax) to settle a long-standing legal dispute related to a commercial arrangement with one of the Company's ancillary businesses, were \$591 million or \$2.72 per share (diluted). Excluding the impact of this charge, the Company's adjusted net earnings were \$598 million in 2010 compared to \$585 million in 2009, an increase of \$13 million or 2.2%. On a diluted basis, adjusted earnings per share were \$2.75 in 2010 compared to \$2.69 in 2009. During 2010, the Company continued to deliver top-line growth, improved purchasing synergies and further gains in productivity and efficiency, the benefits of which were largely offset by increased amortization and higher operating expenses at store-level associated with the Company's network growth and expansion initiatives. Net earnings growth in 2010 also benefited from a modest reduction in interest expense and from a decline in the Company's effective income tax rate.

2009 Compared to 2008

Net earnings were \$585 million in 2009 compared to \$554 million in 2008, an increase of \$31 million or 5.6%. On a diluted basis, earnings per share were \$2.69 in 2009 compared to \$2.55 in 2008. Excluding the benefit of the extra week from the prior year's results, which the Company estimates to have been worth approximately 3 cents per share, net earnings increased by approximately 7% in 2009. Top-line growth, improved purchasing synergies and productivity and efficiency gains, partially offset by higher operating costs and increased amortization tied to the Company's strategic growth and store network expansion initiatives, resulted in a year-over-year increase in operating income. Net earnings growth in 2009 also benefited from a reduction in interest expense and from a decline in the Company's effective income tax rate.

Dividends Declared per Common Share

On February 11, 2010, the Company announced that its Board of Directors had declared a dividend of 22.5 cents per common share, payable April 15, 2010 to shareholders of record as of the close of business on March 31, 2010. This represented an increase in the amount of the Company's quarterly dividend payments of 5%, resulting in an annualized dividend payment of 90 cents per common share. Subject to financial results, capital requirements, available cash flow and any other factors that the Board of Directors may consider relevant, it is the intention of the Board of Directors to declare a comparable quarterly dividend on an ongoing basis.

The following table provides a summary of dividends declared by the Company in 2010 and 2009⁽¹⁾:

| Declaration Date | Record Date | Payment Date | Dividend per Share |
|-------------------|--------------------|------------------|--------------------|
| February 11, 2010 | March 31, 2010 | April 15, 2010 | \$ 0.225 |
| April 28, 2010 | June 30, 2010 | July 15, 2010 | \$ 0.225 |
| July 22, 2010 | September 30, 2010 | October 15, 2010 | \$ 0.225 |
| November 10, 2010 | December 31, 2010 | January 14, 2011 | \$ 0.225 |
| February 12, 2009 | March 31, 2009 | April 15, 2009 | \$ 0.215 |
| April 28, 2009 | June 30, 2009 | July 15, 2009 | \$ 0.215 |
| July 22, 2009 | September 30, 2009 | October 15, 2009 | \$ 0.215 |
| November 11, 2009 | December 31, 2009 | January 15, 2010 | \$ 0.215 |

⁽¹⁾ The cash dividends declared per share in 2009 were unchanged from the cash dividends declared per share in 2008.

Total Assets

2010 Compared to 2009

Total assets were \$7.122 billion at the end of 2010 compared to \$6.852 billion at the end of 2009, an increase of \$270 million or 3.9%. Higher current asset balances, primarily cash, inventory and income taxes recoverable, partially offset by a reduction in accounts receivable, accounted for \$94 million of this increase. Growth in inventory was tied largely to the continued expansion of the store network and increased sales activity. Accounts receivable declined as a result of timing of collections and a reduction in generic prescription reimbursement rates. In 2010, net property and equipment balances increased by \$144 million or 9.2% over the prior year, reflecting the Company's continued investment in its store network and related infrastructure. (See note 7 to the consolidated financial statements of the Company.) Combined, the net balances of goodwill and intangible assets accounted for an additional \$25 million of the increase in total assets in 2010, driven by software development costs, net of amortization, along with the acquisition of drug stores and prescription files. (See notes 4, 8 and 9 to the consolidated financial statements of the Company.)

2009 Compared to 2008

Total assets were \$6.852 billion at the end of 2009 compared to \$6.364 billion at the end of 2008, an increase of \$488 million or 7.7%. Of this increase, \$148 million can be attributed to higher current asset balances, primarily accounts receivable and inventory, tied largely to the continued growth and expansion of the store network. In 2009, net property and equipment balances increased by \$235 million or 17.6% over the prior year, as the Company continued to invest in the expansion and optimization of its store network and related infrastructure projects in information technology and distribution. (See note 7 to the consolidated financial statements of the Company.) Combined, the net balances of goodwill and intangible assets accounted for a further \$101 million of the increase in total assets in 2009, driven largely by the acquisitions of drug stores and prescription files, albeit at a slower pace than in 2008. (See notes 4, 8 and 9 to the consolidated financial statements of the Company.)

Total Long-term Liabilities

2010 Compared to 2009

Total long-term liabilities were \$1.392 billion at the end of 2010 compared to \$1.337 billion at the end of 2009, an increase of \$55 million or 4.1%. This increase can be primarily attributed to a \$52 million increase in other long-term liabilities, driven largely by an increase in deferred rent obligations at store level as the Company continues to invest in its store network, along with capital lease obligations and related deferred gains tied to sale-leaseback transactions completed during the year. (See note 12 to the consolidated financial statements of the Company.)

2009 Compared to 2008

Total long-term liabilities were \$1.337 billion at the end of 2009 compared to \$981 million at the end of 2008, an increase of \$356 million. This increase can be largely attributed to a \$299 million increase in long-term debt and a \$45 million increase in other long-term liabilities. Long-term debt increased as the Company issued \$250 million of three-year medium-term notes maturing January 20, 2012 and \$250 million of five-year medium-term notes maturing January 20, 2014, the proceeds of which were used to refinance existing indebtedness, including borrowings of \$200 million in the form of bankers' acceptances under its then existing revolving bank credit facility that was to mature on June 6, 2011. The \$45 million increase in other long-term liabilities was tied principally to a \$41 million increase in deferred rent obligations at store level, reflecting the Company's continued investments in its store network. (See note 12 to the consolidated financial statements of the Company.)

Quarterly Information

Reporting Cycle

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

Summary of Quarterly Results

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

| (\$000s, except per share data – unaudited) | Fourth Quarter | | Third Quarter | | Second Quarter | | First Quarter | |
|---|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
| | 2010 (12 Weeks) | 2009 (12 Weeks) | 2010 (16 Weeks) | 2009 (16 Weeks) | 2010 (12 Weeks) | 2009 (12 Weeks) | 2010 (12 Weeks) | 2009 (12 Weeks) |
| Sales | \$ 2,559,854 | \$ 2,488,544 | \$ 3,092,575 | \$ 3,013,007 | \$ 2,402,539 | \$ 2,288,789 | \$ 2,321,099 | \$ 2,195,260 |
| Net earnings | \$ 171,226 | \$ 171,060 | \$ 159,308 | \$ 170,894 | \$ 144,576 | \$ 136,112 | \$ 115,633 | \$ 106,842 |
| Per common share | | | | | | | | |
| – Basic net earnings | \$ 0.79 | \$ 0.79 | \$ 0.73 | \$ 0.79 | \$ 0.66 | \$ 0.63 | \$ 0.53 | \$ 0.49 |
| – Diluted net earnings | \$ 0.79 | \$ 0.79 | \$ 0.73 | \$ 0.79 | \$ 0.66 | \$ 0.63 | \$ 0.53 | \$ 0.49 |

The Company experienced growth in sales in each of the four most recent quarters when compared to the same quarters of the prior year. Net earnings increased in each of the first two quarters of 2010 when compared to the same quarters of the prior year. Net earnings decreased in the third quarter of 2010 when compared to the same quarter of the prior year due in part to the impact of the drug system reform initiatives implemented in certain jurisdictions of Canada, principally Ontario, which negatively impacted pharmacy reimbursement and margin rates, and also due to a charge of \$10 million (pre-tax) to settle a long-standing legal dispute related to a commercial arrangement with one of the Company's ancillary businesses. Net earnings in the fourth quarter of 2010 were essentially unchanged when compared to the same quarter of the prior year, as downward pressure on sales and margins in the dispensary was offset by strong performance in the front of the store, improved purchasing synergies and continued gains in productivity and efficiency across the store network and supporting infrastructure.

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

Results of Operations – Fourth Quarter of Fiscal 2010

The Company released its unaudited financial statements and the notes thereto for the fourth quarter and fiscal year ended January 1, 2011 on February 10, 2011. This information can be found on the Canadian Securities Administrators' website at www.sedar.com.

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

| (\$000s, except per share data – unaudited) | Fourth Quarter Ended January 1, 2011 (12 weeks) | Fourth Quarter Ended January 2, 2010 (12 weeks) |
|---|--|--|
| Sales | \$ 2,559,854 | \$ 2,488,544 |
| Cost of goods sold and other operating expenses | 2,235,333 | 2,174,809 |
| EBITDA ⁽¹⁾ | 324,521 | 313,735 |
| Amortization | 68,184 | 58,343 |
| Operating income | 256,337 | 255,392 |
| Interest expense | 12,598 | 11,768 |
| Earnings before income taxes | 243,739 | 243,624 |
| Income taxes | 72,513 | 72,564 |
| Net earnings | \$ 171,226 | \$ 171,060 |
| Per common share | | |
| – Basic net earnings | \$ 0.79 | \$ 0.79 |
| – Diluted net earnings | \$ 0.79 | \$ 0.79 |

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

Sales

Driven by strong results in the front of the store, fourth quarter sales increased 2.9% to \$2.560 billion, with the Company continuing to experience sales growth in all regions of the country, led by strong gains in Alberta and Québec. On a same-store basis, sales increased 1.7% during the quarter.

Prescription sales decreased by 0.2% in the fourth quarter to \$1.146 billion, as strong growth in the number of prescriptions filled served to essentially offset a reduction in average prescription value. On a same-store basis, prescription sales decreased 0.5% during the fourth quarter of 2010. The decrease in average prescription value can be largely attributed to a reduction in generic prescription reimbursement rates, the result of recently implemented drug system reform initiatives, principally in Ontario, combined with increasing generic prescription utilization rates. Total prescription counts increased 3.2% during the fourth quarter of 2010. On a same-store basis, prescription counts increased 2.9% during the quarter. Generic molecules represented 56.7% of prescriptions dispensed in the fourth quarter of 2010 compared to 53.7% of prescriptions dispensed in the fourth quarter of last year. During the fourth quarter of 2010, prescription sales accounted for 44.8% of the Company's sales mix compared to 46.1% of the Company's sales mix in the same quarter of the prior year.

Front store sales increased 5.5% in the fourth quarter to \$1.414 billion, with the Company experiencing particularly strong sales gains in the beauty, confection and convenient food and beverage categories. The Company's store network development program, which resulted in a 6.4% increase in selling space compared to a year ago, continues to have a positive impact on sales growth, particularly in the front of the store. Front store sales growth was also aided by effective marketing campaigns and impactful promotions, strong seasonal programs and solid execution at store level. On a same-store basis, front store sales increased 3.7% during the fourth quarter of 2010.

Cost of Goods Sold and Other Operating Expenses

Cost of goods sold and other operating expenses were \$2.235 billion in the fourth quarter of 2010 compared to \$2.175 billion in the same period last year, an increase of \$60 million or 2.8%. Expressed as a percentage of sales, cost of goods sold declined by 75 basis points in the fourth quarter of 2010 versus the comparative prior year period, reflecting the benefits from improved purchasing synergies, greater generic prescription utilization and the impact of reduced generic drug costs and reimbursement levels as a result of the drug system reform initiatives implemented in certain provinces in the second half of 2010, particularly Ontario. Other operating expenses, expressed as a percentage of sales, increased by 68 basis points over the prior year period, due in part to top-line deflation resulting from the above-referenced drug system reform initiatives and greater generic prescription utilization, along with stepped-up marketing expenditures and increased store-level expenses associated with the continued growth and expansion of the store network, primarily occupancy and labour. These increases were offset somewhat by further gains in productivity and efficiency across the store network and supporting infrastructure.

Amortization

Amortization of capital assets and other intangible assets was \$68 million in the fourth quarter of 2010 compared to \$58 million in the same period last year, an increase of \$10 million or 16.9%. Expressed as a percentage of sales, amortization increased by 32 basis points in the fourth quarter of 2010 versus the comparative prior year period, which can be attributed to the Company's continued investment in its store network and supporting infrastructure.

Operating Income

Operating income was \$256 million in the fourth quarter of 2010, essentially flat to the comparative prior year period. As described above, in the fourth quarter of 2010, the Company continued to deliver top-line growth, improved purchasing synergies and productivity and efficiency gains. These benefits were partially offset by increased amortization and higher operating expenses at store level associated with the continued growth and expansion of the store network, and by further investments in pricing and promotional activities. As well, operating income and margin in the fourth quarter was negatively impacted by the drug system reform initiatives implemented in the second half of 2010 in several provincial jurisdictions. In the fourth quarter of 2010, the Company's operating margin (operating income divided by sales) was 10.01% compared to 10.26% in the fourth quarter of the prior year. The Company's EBITDA margin (EBITDA divided by sales) was 12.68% in the fourth quarter of 2010, a 7 basis point improvement over the EBITDA margin of 12.61% posted in the fourth quarter of 2009.

Interest Expense

Interest expense was \$13 million in the fourth quarter of 2010 compared to \$12 million in the same period last year, an increase of \$1 million or 7.1%. Interest expense savings due to the Company having a lower average amount of consolidated net debt outstanding were more than offset by a market-driven increase in short-term interest rates on the Company's floating rate debt obligations.

Income Taxes

The Company's effective income tax rate in the fourth quarter of 2010 was 29.8%, unchanged from the comparable period of a year ago.

Net Earnings

2010 fourth quarter net earnings were \$171 million or 79 cents per share (diluted), unchanged when compared to the same period last year.

Cash Flows

Cash flows from operating activities were \$243 million in the fourth quarter of 2010 compared to \$172 million in the same period last year, an increase of \$71 million or 41.7%. Cash flow from net earnings, adjusted for non-cash items, combined with a reduction in the amount invested in non-cash working capital balances versus the comparative quarter of the prior year, drove this increase.

Cash flows used in investing activities were \$118 million in the fourth quarter of 2010 compared to \$170 million in the same period last year, a decrease of \$52 million or 30.6%. Of these totals, purchases of property and equipment, net of proceeds of any dispositions, amounted to \$93 million in the fourth quarter of 2010 compared to \$149 million in the fourth quarter of 2009, as the Company has slowed the rate at which it continues to invest in its store network. In the fourth quarter of 2010, the Company was not active with respect to the acquisition of drug stores and prescription files. The Company invested an additional \$25 million in the purchase and development of intangible and other assets during the fourth quarter of 2010, primarily computer software, compared to \$15 million in the same period last year. During the fourth quarter of 2010, the Company opened 10 new drug stores, eight of which were relocations, and completed five major drug store expansions.

Cash flows used in financing activities were \$111 million in the fourth quarter of 2010, as cash outflows of \$123 million were partially offset by cash inflows of \$12 million. Cash outflows were comprised of a \$70 million decrease in bank indebtedness, a \$1 million decrease in the amount of commercial paper issued and outstanding by the Company under its commercial paper program, \$3 million to fund costs associated with financing activities and \$49 million for the payment of dividends. Cash inflows were comprised of a \$12 million increase in the amount of Associate investment.

In the fourth quarter of 2010, the net result of the Company's operating, investing and financing activities was an increase in cash balances of \$14 million.

Critical Accounting Estimates

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

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

Inventory

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

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

Shoppers Optimum®

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

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

Employee Future Benefits

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

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

| | 2010 | | | 2009 | | |
|--|--|---|-------------------------------------|--|---|-------------------------------------|
| | Registered Defined Benefit Pension Plans | Non-registered Defined Benefit Pension Plan | Other Post-employment Benefit Plans | Registered Defined Benefit Pension Plans | Non-registered Defined Benefit Pension Plan | Other Post-employment Benefit Plans |
| Accrued benefit obligation, end of period | | | | | | |
| Discount rate | 5.25% | 2.50% | 5.00% | 6.00% | 2.88% | 6.00% |
| Compensation increase | 4.00% | 4.00% | 4.00% | 4.00% | 4.00% | 4.00% |
| Benefit expense for the period | | | | | | |
| Discount rate | 6.00% | 2.88% | 5.25% | 6.75% | 3.25% | 6.75% |
| 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 discount rate is based on current market interest rates at the end of the Company's fiscal year, assuming a portfolio of corporate AA rated bonds with terms to maturity that, on average, match the terms of the accrued benefit plan obligations. A 1% increase in the assumed discount rate would decrease the amount of the Company's accrued benefit obligation and benefit expense in respect of its registered and non-registered defined benefit plans by \$17 million and \$2 million, respectively. Conversely, a 1% decrease in the assumed discount rate would increase the amount of the Company's accrued benefit obligation and benefit expense in respect of its registered and non-registered defined benefit plans by \$20 million and \$2 million, respectively.

The expected long-term rate of return on plan assets is based on the asset mix of invested assets and historical returns. A 1% increase in the assumed long-term rate of return on plan assets would decrease the amount of the Company's benefit expense in respect of its registered and non-registered defined benefit plans by \$1 million. Conversely, a 1% decrease in the assumed long-term rate of return on plan assets would increase the amount of the Company's benefit expense in respect of its registered and non-registered defined benefit plans by \$1 million. In calculating the benefit expense for its registered and non-registered defined benefit plans for 2010, the Company has assumed a long-term rate of return on plan assets of 7.5%.

A 1% increase in the assumed rate of compensation increases would increase the amount of the Company's accrued benefit obligation and benefit expense in respect of its registered and non-registered defined benefit plans by \$4 million and \$1 million, respectively. Conversely, a 1% decrease in the assumed rate of compensation increases would decrease the amount of the Company's accrued benefit obligation and benefit expense in respect of its registered and non-registered defined benefit plans by \$4 million and \$1 million, respectively.

The expected inflation rate of health care costs is based on historical trends and external data. The growth rate assumption used by the Company in determining its accrued benefit obligation and benefit expense in respect of its other post-employment benefit plans was 5.5% in 2010, unchanged from the prior year. This is also the assumed growth rate for future years. A 1% change in the assumed growth rate of health care costs would not have a significant impact on the Company's accrued benefit obligation and benefit expense in respect of its other post-employment benefit plans.

These assumptions may change in the future and any changes could have a material impact on the accrued benefit plan obligations of the Company and the cost of these plans, which is reflected in the Company's consolidated statements of earnings. However, the magnitude of any immediate impact on net earnings of the Company is mitigated by the fact that, in accordance with Canadian GAAP, the excess of any net accumulated actuarial gain or loss over 10% of the greater of the accrued benefit obligation and the fair value of plan assets is amortized, on a straight-line basis, over the expected average remaining service period of the active employees covered by the plans. At January 1, 2011, the expected average remaining service period of active employees covered by the Company's registered and non-registered defined benefit pension plans, and other post-employment benefit plans, was 11 and 7 years, respectively.

At January 1, 2011, the funded status of the Company's obligations under its registered and non-registered defined benefit pension plans and other post-employment benefit plans was a deficit of \$24 million, compared to a deficit of \$25 million at the end of the prior year. Included in other assets and other long-term liabilities on the Company's consolidated balance sheets at January 1, 2011 were amounts of \$4 million and \$9 million, respectively, in respect of the Company's plan assets and obligations under its registered and non-registered defined benefit pension plans and other post-employment benefit plans, compared to \$15 million in other long-term liabilities at the end of the prior year. As of this same date, the unamortized net actuarial loss in respect of the Company's obligations under its registered and non-registered defined benefit pension plans and other post-employment benefit plans was \$19 million, compared to \$10 million at the end of the prior year. (See note 13 to the consolidated financial statements of the Company.)

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

Income and Other Taxes

The Company accounts for income taxes using the liability method of accounting. Under the liability method, future income tax assets and liabilities are determined based on differences between the carrying amounts of balance sheet items and their corresponding tax values. The determination of the income tax provision requires management to interpret regulatory requirements and to make certain judgements. While income, capital and commodity tax filings are subject to audits and reassessments, management believes that adequate provisions have been made for all income and other tax obligations. However, changes in the interpretations or judgements may result in an increase or decrease in the Company's income, capital or commodity tax provisions in the future. The amount of any such increase or decrease cannot be reasonably estimated.

Goodwill and Intangible Assets

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

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

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 to 12 years |
| Customer relationships | 5 to 25 years |
| Computer software | 3 to 10 years |
| Other | Lease term or 3 years |

New Accounting Pronouncements

Transition to International Financial Reporting Standards

The Accounting Standards Board (the “AcSB”) is requiring all publicly accountable enterprises to report under International Financial Reporting Standards (“IFRS”) for years beginning on or after January 1, 2011.

The Company has performed its review of the IFRS standards. The Company’s policy assessments and choices and an explanation of the financial impacts are provided below.

The Company’s review was based on IFRS as they currently exist. The Company’s reporting under IFRS for its 2011 fiscal year will be based on the standards that are effective at the end of 2011. The Company is monitoring changes to IFRS. Certain standards, including the standards on consolidation and leases, have exposure drafts issued. As at the date of this Management’s Discussion and Analysis, there are no IFRS exposure drafts that are expected to create a change during the Company’s transition to IFRS.

The Company has made preliminary determinations relating to certain IFRS policies, as discussed below. The financial impacts, as provided below, are considered preliminary and should not be regarded as a complete description of the changes that will result from the transition to IFRS. Readers are cautioned that the determinations and financial impacts are based on preliminary IFRS 1 elections and exemptions and IFRS policy choices and may be subject to change.

Opening Balance Sheet – IFRS 1 Elections and Accounting Policy Changes

IFRS 1 Elections

IFRS 1, “First-time Adoption of International Financial Reporting Standards” (“IFRS 1”), allows for certain elections upon initial adoption of IFRS. The election options that are relevant to the Company and the Company’s decisions with respect to those options, along with the resulting financial impact, are discussed in the table below. The discussion of deferred income taxes refers to the Company’s previously reported future income tax balances.

| Standard/Topic | Options | Expected Financial Impact on the Company’s January 3, 2010 Opening Balance Sheet (unaudited) |
|-----------------------|---|--|
| Business Combinations | <ul style="list-style-type: none"> When adopting IFRS, an entity would normally apply IFRS 3, “Business Combinations” (“IFRS 3”), as if it had always been applied and therefore assess all previous business combinations for compliance with IFRS and make any necessary adjustments. A first-time adopter can elect under IFRS 1 to apply IFRS 3 prospectively to business combinations that occurred before a chosen date that is no later than the date of transition. | <p>The Company elected under IFRS 1 to not apply IFRS 3 retrospectively. The primary impact of this election is with respect to certain transaction costs incurred in historical acquisitions which were capitalized under Canadian Generally Accepted Accounting Principles (“GAAP”) that would have been expensed under IFRS.</p> <p>As a result, no adjustment is required to the carrying values on the Company’s opening balance sheet.</p> |

| Standard/Topic | Options | Expected Financial Impact on the Company's January 3, 2010 Opening Balance Sheet (unaudited) |
|--|---|---|
| Employee Benefits | <ul style="list-style-type: none"> • IFRS 1 allows first-time adopters to recognize previously unrecognized actuarial gains and losses on defined benefit pension plans in retained earnings at the date of transition. • If this election is not taken, an entity is required to account for each plan as if IFRS had been applied since plan inception. | <p>The Company has chosen to take this election, resulting in the recognition of previously unrecognized actuarial losses as a charge to opening retained earnings and an increase in the liability for employee future benefits.</p> <p>Upon implementation of IFRS, the Company expects the impact to be an increase in other long-term liabilities of \$8.2 million, a decrease in deferred income tax liabilities of \$2.3 million and an after-tax charge to opening retained earnings of \$5.9 million.</p> |
| Fair Value or Revaluation as Deemed Cost | <ul style="list-style-type: none"> • A first-time adopter may elect to measure an item of property, plant and equipment, intangible asset or investment property at the transition date at its fair value and use that fair value as deemed cost at that date. | <p>The Company has chosen to continue to use historical cost for items of property and equipment, intangible assets and investment properties.</p> |

Accounting Policy Changes

There are several differences between IFRS requirements and the Company's existing Canadian GAAP accounting policies. IFRS 1 requires that entities reflect the adoption of IFRS as if they had always been applying IFRS. As a result, most accounting policy changes that the Company has identified will require an opening balance sheet adjustment in order to reflect the impact of applying IFRS to pre-2010 transactions and balances. The adjustments to the Company's January 3, 2010 opening balance sheet are described below:

| Standard | Comparison between Canadian GAAP and IFRS | Expected Financial Impact on the Company's January 3, 2010 Opening Balance Sheet (unaudited) |
|---|---|---|
| IFRIC 13, "Customer Loyalty Programmes" ("IFRIC 13") – Shoppers Optimum® loyalty card program | <p>GAAP – When points are earned by a program member, 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. When points are redeemed, the actual costs of redemptions are charged against the liability account. Points are valued at cost.</p> <p>IFRS – When points are earned by a program member, the Company will defer a portion of the revenue associated with the sales transaction equivalent to the fair value of the points issued to the customer (retail value of the points). When points are redeemed, the redemption value of the award is charged against the deferred revenue balance and the revenue is recognized. Points are valued at fair value.</p> | <p>Upon implementation of IFRS, the Company expects the impact to be an increase in accounts payable and accrued liabilities of \$15.5 million, a decrease in deferred income tax liabilities of \$4.4 million and an after-tax charge to opening retained earnings of \$11.1 million.</p> <p>The increase in the liability primarily represents the change in the valuation of the points expected to be redeemed from a cost basis to a fair value basis.</p> |
| IAS 16, "Property, Plant and Equipment" ("IAS 16") – Rent during the fixturing period | <p>GAAP – The Company capitalized rent during the fixturing period.</p> <p>IFRS – Rent incurred during the fixturing period will no longer be capitalized but, instead, be treated as occupancy expense in the period in which it was incurred.</p> | <p>Upon implementation of IFRS, the Company expects the impact to be a decrease in property and equipment of \$48.2 million, a decrease in deferred income tax liabilities of \$12.3 million, a decrease in other long-term liabilities of \$1.4 million and an associated after-tax charge to opening retained earnings of \$34.5 million.</p> |

| Standard | Comparison between Canadian GAAP and IFRS | Expected Financial Impact on the Company's January 3, 2010 Opening Balance Sheet (unaudited) |
|---|---|--|
| IAS 36, "Impairment of Assets" ("IAS 36") – Long-lived assets | <p>GAAP – The Company tests long-lived assets or asset groups 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 carrying values of long-lived assets (or asset groups) exceed their fair values. The Company reviews long-lived assets for impairment at least annually.</p> <p>IFRS – IFRS uses the cash-generating unit as the level at which assets must be tested for impairment. A cash-generating unit ("CGU") is the smallest identifiable group of assets that generates cash flows that are largely independent of the cash inflows from other assets or groups of assets. The Company has determined for parts of the business that the CGU level is different from the asset groupings previously used under GAAP.</p> | <p>Under IFRS, the Company reviewed its long-lived assets for indicators of impairment at the level of a CGU. The Company determined that a test for impairment was necessary on certain of its store assets, which resulted in the identification of an impairment under IFRS as at January 3, 2010. Accordingly, the Company expects to record an opening balance sheet impairment charge to retained earnings.</p> <p>Upon implementation of IFRS, the Company expects the impact to be a decrease in property and equipment of \$21.4 million, an increase in deferred income tax assets of \$5.7 million and an associated after-tax charge to opening retained earnings of \$15.7 million.</p> |
| IAS 17, "Leases" ("IAS 17") – Sale-leaseback transactions | <p>GAAP – Any gains on sale-leaseback transactions are deferred and recognized over the term of the lease. Any losses are recognized in earnings immediately.</p> <p>IFRS – When sale-leaseback transactions result in operating leases, gains or losses on sale-leaseback transactions that are considered to be conducted at fair value are to be recognized in earnings immediately. When sale-leaseback transactions result in capital leases, the gains are deferred and recognized over the term of the lease. Losses are recognized in earnings immediately.</p> | <p>The Company has assessed that its historical sale-leaseback transactions resulting in operating leases took place at fair value and, therefore, under IFRS, gains would have been recognized in earnings immediately. As a result, on the adoption of IFRS, the remaining unamortized deferred gains will be recognized in opening retained earnings.</p> <p>Upon implementation of IFRS, the Company expects the impact to be a decrease in other long-term liabilities of \$14.1 million, an increase in deferred income tax liabilities of \$2.7 million and an associated after-tax increase to opening retained earnings of \$11.4 million.</p> |

| Standard | Comparison between Canadian GAAP and IFRS | Expected Financial Impact on the Company's January 3, 2010 Opening Balance Sheet (unaudited) |
|--|--|--|
| IAS 19, "Employee Benefits" ("IAS 19") – Pensions | <p>GAAP – Actuarial gains and losses related to defined benefit obligations are amortized to earnings using a 10% corridor approach.</p> <p>IFRS – Actuarial gains and losses related to defined benefit obligations can be recorded as under GAAP or be immediately recognized in other comprehensive income.</p> | <p>The Company has adopted the policy of recognizing actuarial gains and losses in other comprehensive income in the period in which they occur.</p> <p>Upon implementation of IFRS, the Company expects no impact to the opening balance sheet or retained earnings as a result of this policy choice (note, this policy choice is in addition to the IFRS 1 election already described).</p> |

Summary of Opening Retained Earnings Impacts

The following is a summary of the above noted expected impacts to the Company's opening IFRS retained earnings as at January 3, 2010 based on preliminary IFRS 1 elections and exemptions and IFRS policy choices:

| (\$000s – unaudited) | Opening Retained Earnings Increase (Decrease) After-Tax |
|---|--|
| Shoppers Optimum® loyalty card program | \$ (11,106) |
| Rent during the fixturing period | (34,526) |
| Impairment of long-lived assets | (15,663) |
| Sale-leaseback transactions | 11,368 |
| IFRS 1 – employee benefits – recognition of unrecognized actuarial gains and losses | (5,932) |
| Preliminary decrease in retained earnings | \$ (55,859) |

Other IFRS Considerations

Balance Sheet

The Company has identified a number of balance sheet presentation changes that have no significant retained earnings impact. These changes include the recognition of certain store leases as financing leases, the reclassification of future income tax current assets to non-current deferred tax assets and liabilities, the restatement of changes to the purchase price allocations and the separate identification on the balance sheet of investment properties (from property and equipment) and provisions (from accounts payable and accrued liabilities and other long-term liabilities).

2010 Interim Financial Results Impact

The expected impacts of the above adjustments and policy choices on the Company's 2010 interim and full-year net earnings and diluted earnings per share are presented below.

| (\$000s, except per share data – unaudited) | 12 Weeks Ended March 27, 2010 | 12 Weeks Ended June 19, 2010 | 16 Weeks Ended October 9, 2010 | 12 Weeks Ended January 1, 2011 | 52 Weeks Ended January 1, 2011 |
|---|--|---------------------------------------|---|---|---|
| Shoppers Optimum® loyalty card program | \$ (248) | \$ 76 | \$ (2,893) | \$ (1,217) | \$ (4,282) |
| Rent during the fixturing period | (1,810) | (349) | (3,618) | 2,792 | (2,985) |
| Impairment of long-lived assets | (738) | (312) | 595 | (6,722) | (7,177) |
| Sale-leaseback transactions | 11,982 | 82 | (1,136) | (574) | 10,354 |
| Employee benefits – ongoing recognition of pension expense | 276 | (303) | (18) | (15) | (60) |
| Total adjustments, pre-tax | 9,462 | (806) | (7,070) | (5,736) | (4,150) |
| Income taxes | (2,815) | 240 | 2,103 | 1,706 | 1,234 |
| Preliminary net earnings impact | \$ 6,647 | \$ (566) | \$ (4,967) | \$ (4,030) | \$ (2,916) |
| Preliminary net earnings per common share (diluted) impact | \$ 0.03 | \$ nil | \$ (0.02) | \$ (0.02) | \$ (0.02) |

Impact on Other Business Activities

The impact of the transition to IFRS on other business activities including information technology systems, contracts and covenants, disclosure controls and procedures and internal controls over financial reporting has been assessed and the Company has not identified material changes.

The Company has assessed that while the disclosures covered by the Company's disclosure controls and procedures program have changed, the Company's processes and procedures with respect to those disclosures have not changed. The Company has assessed that there have been no changes to the processes, procedures and activities underlying the Company's internal control over financial reporting as a result of implementing IFRS.

Future Accounting Standards

Financial Instruments – Disclosures

The IASB has issued an amendment to IFRS 7, "Financial Instruments: Disclosures" ("IFRS 7 amendment"), requiring incremental disclosures regarding transfers of financial assets. The IFRS 7 amendment is effective for annual periods beginning on or after July 1, 2011. The Company will apply the IFRS 7 amendment at the beginning of its 2012 fiscal year and does not expect the implementation to have a significant impact on the Company's disclosures.

Financial Instruments

The IASB has issued a new standard, IFRS 9, "Financial Instruments" ("IFRS 9"), which will ultimately replace IAS 39, "Financial Instruments: Recognition and Measurement" ("IAS 39"). The replacement of IAS 39 is a multi-phase project with the objective of improving and simplifying the reporting for financial instruments and the issuance of IFRS 9 is part of the first phase. IFRS 9 becomes effective on January 1, 2013. The Company has yet to assess the impact of IFRS 9 on its results of operations, financial position and disclosures.

Risks and Risk Management

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

Industry and Regulatory

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

Federal and provincial laws and regulations that establish the public drug plans typically regulate prescription drug coverage, patient eligibility, pharmacy reimbursement, drug product eligibility, drug pricing and may also regulate manufacturer allowance funding that may be provided to or received by pharmacy or pharmacy suppliers. With respect to pharmacy reimbursement, such laws and regulations typically regulate the allowable drug cost of a prescription drug product, the permitted mark-up on a prescription drug product and the professional or dispensing fees that may be charged on prescription drug sales to patients eligible under the public drug plan. With respect to a drug product eligibility, such laws and regulations typically regulate the requirements for listing the manufacturer's products as a benefit or partial benefit under the applicable governmental drug plan, drug pricing and, in the case of generic prescription drug products, the requirements for designating the product as interchangeable with a branded prescription drug product. In addition, other federal, provincial, territorial and local laws and regulations govern the approval, packaging, labeling, sale, marketing, advertising, handling, storage, distribution, dispensing and disposal of prescription drugs.

Sales of prescription drugs, pharmacy reimbursement and drug prices may be affected by changes to the health care industry, including legislative or other changes that impact patient eligibility, drug product eligibility, the allowable cost of a prescription drug product, the mark-up permitted on a prescription drug product, the amount of professional or dispensing fees paid by third-party payers or the provision or receipt of manufacturer allowances by pharmacy and pharmacy suppliers.

The majority of prescription drug sales are reimbursed or paid by third-party payers, such as governments, insurers or corporate employers. These third-party payers have pursued and continue to pursue measures to manage the costs of their drug plans. Some provincial jurisdictions have implemented legislation directed towards managing pharmacy service costs and controlling increasing drug costs incurred by public drug plans and private payers. In addition to legislative changes, other measures to control drug costs have been implemented by certain government payers, including restricting the number of interchangeable prescription drug products which are eligible for reimbursement under provincial drug plans, which may impact pharmacy reimbursement levels and manufacturer allowances. Since the start of 2010, the following legislative changes or other regulatory initiatives, which are intended to lower overall costs incurred by the public drug plans, have been implemented or announced in the following jurisdictions:

British Columbia – In 2010, the British Columbia Ministry of Health Services executed an agreement with the British Columbia Pharmacy Association and the Canadian Association of Chain Drug Stores which lowered the cost of generic prescription drug products in the province. As of October 15, 2010, new generic prescription drug products, generally those generic prescription drug products where the first generic version of the product was listed on British Columbia's public drug plan formulary on or after November 1, 2008, are priced at 42% of the cost of the corresponding original brand name drug and other generic prescription drug products that are not new generic prescription drug products are priced at 50% of the cost of the corresponding original brand name drug. The cost of both new generic prescription drug products and other generic prescription drug products will be further reduced to 40% and 35% of the cost of the corresponding original brand name drug on July 4, 2011 and April 2, 2012, respectively. In British Columbia, the pricing for generic prescription drug products is uniform for both public and private payers.

As of July 28, 2010, the maximum dispensing fee reimbursed by the British Columbia public drug plan was increased by \$0.50 to \$9.10. On October 15, 2010, the maximum dispensing fee was increased by an additional \$0.50 to \$9.60. The dispensing fee will further increase by \$0.40 on July 4, 2011 to \$10.00 and will reach \$10.50 on April 2, 2012. Also, on October 1, 2010, the permitted mark-up on the price of prescription drug products reimbursed by the British Columbia public drug plan was increased from 7% to 8%.

The British Columbia government has committed, beginning April 1, 2012, to invest \$35 million into new clinical pharmacy services.

Alberta – In April 2010, prices for all existing generic prescription drugs (existing generic prescription drug products are generic prescription drugs already included on the Alberta Drug Benefit List as of October 1, 2009) were reduced from the then current 75% of the equivalent brand name price to 56% of such price. With respect to new generic prescription drugs (any generic prescription drug added to the Alberta Drug Benefit List after October 1, 2009), the price was reduced to 45% of the equivalent brand name price in October of 2009.

As part of the implementation of phase two of the Alberta Pharmaceutical Strategy, on January 28, 2010, the Alberta Ministry of Health and Wellness (the "Alberta Ministry") announced that a new reimbursement model would be developed and implemented for pharmacy that is intended to shift pharmacy reimbursement from its current focus on dispensing services toward more expanded professional services such as patient consultations, medication reviews and immunizations. While the Alberta Ministry initially indicated that the new reimbursement model would be introduced in July of 2010, the Alberta Ministry is continuing to work with pharmacists, pharmacies and industry to define the new reimbursement model.

Ontario – On May 18, 2010, the Government of Ontario passed amendments to the *Ontario Drug Benefit Act* (the "ODBA") and the *Drug Interchangeability and Dispensing Fee Act* (the "DIDFA"), and on June 7, 2010, filed amendments to Ontario Regulation 201/96 (the "ODBA Regulations") and Regulation 935 (the "DIDFA Regulations") (collectively, the "Ontario Regulatory Amendments"). Significant elements of the Ontario Regulatory Amendments included:

- (i) *The lowering of the cost of most generic prescription drugs by at least 50%, to 25% of the cost of the corresponding original brand name drug* – For Ontario's public drug system, this cost reduction occurred on July 1, 2010. For private payers, as of July 1, 2010, the cost of most generic prescription drug products was limited to a maximum of 50% of the cost of the original brand name drug and the cost will be further limited to a maximum of 35% on April 1, 2011 and to a maximum of 25% on April 1, 2012. After April 1, 2012, there will be parity with the drug benefit price under the public drug system.
- (ii) *The elimination of professional allowances from Ontario's public drug system as of July 1, 2010 and the phase-out of professional allowances from the private payer system by April 1, 2013* – On July 1, 2010, professional allowance funding for sales of interchangeable prescription drug products reimbursed under Ontario's public drug program was eliminated and, on private sector sales, a cap on professional allowance funding equal to 50% of sales of interchangeable prescription drug products that are not reimbursed under Ontario's public drug program was imposed. The cap on professional allowance funding in the private sector will be reduced to 35% on April 1, 2011 and will be further reduced to 25% on April 1, 2012. Professional allowance funding will be eliminated in the private sector by April 1, 2013.
- (iii) *Increasing the dispensing fees paid to pharmacy operators under Ontario's public drug plan, with larger increases for those operators in rural communities and underserved areas* – On July 1, 2010, dispensing fees paid under Ontario's public drug plan to most pharmacy operators increased from \$7.00 to \$8.00, while the dispensing fee for certain rural pharmacy operators in underserved areas increased from \$7.00 to between \$9.00 and \$12.00. The dispensing fees paid under Ontario's public drug plan will increase annually over the next four years, ultimately reaching \$8.83 for most pharmacy operators and up to \$13.25 for certain pharmacy operators in underserved and rural areas by April 1, 2014.

- (iv) *Provision of transitional support fees* – To support the transition to a pharmacy reimbursement model aimed at supporting professional services, a transition fee is being provided to pharmacy operators. Beginning on July 1, 2010, a transition fee, in the form of an additional \$1.00 on top of the dispensing fees paid under Ontario’s public drug plan, is being provided to pharmacy operators. The transition fee is intended to provide support to pharmacy operators until pharmacy operators can offer additional professional services, which have yet to be defined. This transition fee will decrease to \$0.65 on April 1, 2011 and to \$0.35 on April 1, 2012 and will be eliminated after March 31, 2013.
- (v) *Allowances for ordinary commercial terms* – The Ontario Regulatory Amendments allow manufacturers to provide a benefit to pharmacies in accordance with ordinary commercial terms provided that the benefit meets certain specified conditions including, for interchangeable prescription drug products, that the benefit is a prompt payment discount, a volume discount or a distribution service fee and is provided in the ordinary course of business. In addition, the total value of any benefits provided in accordance with ordinary commercial terms for interchangeable prescription drug products cannot exceed: (i) for the purposes of Ontario’s public drug system, 10% of the value of the listed drug products based on the drug benefit price and the number of units dispensed by a pharmacy and reimbursed under the ODBA; and (ii) for the purposes of the private system, 10% of the value of the interchangeable prescription drug products not supplied to an eligible person under the ODBA based on the number of units dispensed by a pharmacy at each product’s regulated price. For prescription drug products that are not interchangeable, only a prompt payment discount may be provided.
- (vi) *Prohibition on private label products* – The Ontario Regulatory Amendments provide that a prescription drug product that falls under the definition of a “private label product” will not be designated as an interchangeable prescription drug product or as a listed drug product for the Ontario Drug Benefit Program. Designation as an interchangeable prescription drug product is generally necessary for market adoption of generic prescription drug products and designation as a listed drug product for the Ontario Drug Benefit Program is necessary for public reimbursement. The Company pursued a legal challenge to the validity of the prohibition under the current legislation. On February 3, 2011, the Ontario Divisional Court released its decision in respect of the Company’s application for judicial review of the prohibition on “private label products” under the Ontario Regulatory Amendments. In its decision, the Ontario Divisional Court found in favour of the Company and Katz Group Canada Inc. (the applicant in a parallel application) and declared the regulatory restrictions in respect of “private label products” to be invalid. The Government of Ontario has since filed its Notice of Motion seeking leave to appeal the decision of the Ontario Divisional Court to the Court of Appeal.

Québec – In Québec, legislation provides that the selling price for prescription drug products for the public drug program must not be higher than the selling price granted by the manufacturer for the same prescription drug under other provincial health programs (“Canada’s best price”). On November 25, 2010, Québec announced that, with respect to the obligation to provide Canada’s best price, pricing reductions on generic prescription drugs would be phased in over a three-year period. After November 25, 2010, if Canada’s best price established for a generic prescription drug product is equal to or less than 37.5% of the price of the brand name drug in Québec, then generic prescription drug pricing in Québec may not be greater than 37.5% of the brand name drug. Beginning in April 2011, prices for generic prescription drugs will be reduced to not greater than 30% of the brand name drug in Québec if Canada’s best price for generic prescription drug products is equal to or less than 30% of the price of the brand name drug in Québec. Beginning in April 2012, prices for generic prescription drug products in Québec may not be higher than any selling prices granted by the manufacturer for the same prescription drug under other provincial health programs.

On December 22, 2010, notice of amendments to Québec’s “Regulations respecting benefits for pharmacists” were published in the *Gazette Officielle du Québec*. The proposed amendments will reduce the percentage that establishes the maximum amount of professional allowances that may be provided to an owner pharmacist by generic prescription drug manufacturers from the current level of 20% of the total value of the manufacturer’s generic prescription drug sales to an owner pharmacist to 16.5% on April 1, 2011, and subsequently to 15% on April 1, 2012.

On January 12, 2011, notice of amendments to Québec's "Conditions governing the accreditation of manufacturers and wholesalers of medications" were published in the *Gazette Officielle du Québec*. The proposed amendments will raise the maximum limit on the profit margin for accredited wholesalers of prescription drug products from the current level of 6% to 6.25% on April 1, 2011, and subsequently to 6.5% on April 1, 2012. Shoppers Drug Mart Inc. is an accredited wholesaler of prescription drug products in Québec.

Nova Scotia – On September 20, 2010, the Nova Scotia Department of Health and Wellness announced its intention to gather input on its plan to achieve better prices for prescription drugs reimbursed under the Nova Scotia public drug program. As part of the process, the Nova Scotia government intends to meet with pharmacists, pharmacy owners, prescription drug manufacturers, doctors, medical staff at district health authorities and the public for their input on the plan. As part of the plan, the following five measures are being considered by the Nova Scotia government:

- (i) *Setting a cap on generic prescription drug prices* – Set a cap on the price of generic prescription drugs based on a percentage of the price of the equivalent brand name drug.
- (ii) *Limiting pharmacy rebates* – Require generic prescription drug manufacturers to report the rebates they pay to community pharmacies for stocking their generic prescription drug products, and limit the amount of these rebates.
- (iii) *Tendering for one or more prescription drugs* – Establish a competitive process in which the province asks manufacturers for a better price for one or more prescription drugs and list the prescription drug or prescription drugs that come in at that price for coverage under the public drug program.
- (iv) *Establishing rules around price increases for generic prescription drug products.*
- (v) *Defining the price paid to pharmacies for prescription drugs* – Establish a clearly defined price paid by the government to community pharmacies for brand name drugs.

In addition, the Nova Scotia government is in the process of establishing a Drug Management Policy Unit that will focus on reducing pricing and making efficient use of prescription drugs.

As an interim measure, the Nova Scotia government issued a request for proposal for atorvastatin, the generic form of Lipitor®. As a result of the request for proposal, as of December 1, 2010, new lower pricing for atorvastatin was implemented under the Nova Scotia public drug program.

Newfoundland and Labrador – The previously announced decision to reduce the maximum allowable cost for a prescription drug product to the Ontario public drug program price has not yet been implemented.

Where legislative or other measures that appear to be effective in reducing prescription drug costs are implemented in one jurisdiction, governments in other provincial jurisdictions are looking or may look to implement similar measures. In some provincial jurisdictions, elements of the laws and regulations that impact pharmacy reimbursement and manufacturer allowances for sales to the public drug plans may be extended by legislation to sales in the private sector. Also, private third-party payers (such as corporate employers and their insurers) are looking or may look to benefit from any measures implemented by government payers to reduce prescription drug costs for public plans by attempting to extend these measures to prescription drug plans they own or manage. Accordingly, changes to pharmacy reimbursement and manufacturer allowances for a public drug plan could also impact pharmacy reimbursement and manufacturer allowances for private sector sales. In addition, private third-party payers could reduce pharmacy reimbursement for prescription drugs provided to their members.

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

Economic and Financial Conditions

Adverse changes to the economic and financial conditions in Canada and globally could impact the Company's ability to execute upon its operating, investing and financing strategies, which could have a material adverse impact on its business, sales, profitability and financial position. General uncertainty on the timing of a recovery from recent financial market volatility may continue to create a challenging operating environment, thus limiting sales growth and the Company's ability to maximize gross margin dollars, operating cash flow and profits.

Competition

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

Ability to Manage Growth and Maintain Profitability

The Company may make acquisitions of other businesses from time to time. Acquisitions, if they occur, may increase the size of operations as well as increase the amount of indebtedness that may have to be serviced by the Company. This growth and expansion will also place demands on the Company's management resources. To manage growth effectively, the Company must maintain efficiency and performance and must continue to enhance its operational, financial and management systems and attract, train, motivate and manage its employees and Associates. Although the Company has put systems in place to manage this expansion, there is no assurance that the Company will be able to successfully integrate any future acquisitions, and its failure to do so could adversely affect its business, operating results and financial condition.

Ability to Attract and Retain Pharmacists

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

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

Reliance on Key Personnel

The continued success of the business of the Company will depend upon the abilities, experience and personal efforts of senior management of the Company, including their ability to attract and retain skilled employees. The loss of the services of such key personnel could have an adverse effect on the business, financial condition and future prospects of the Company.

Reliance on Information Systems and Technology

The Company's business relies upon information technology systems to support its distribution and merchandise management systems, to service pharmacy customers in the dispensary, for real-time approval of credit and debit card transactions and for the adjudication, approval and payment of third-party prescriptions. Its information technology systems may be vulnerable to unauthorized access, computer viruses, system failures, human error, natural disasters, fire, power loss or acts of fraud, sabotage or terrorism. If a significant disruption or repeated failure were to occur, the Company's revenue and reputation could be adversely affected. There may also be significant costs incurred as a result of such disruptions or failures.

Employee Future Benefits

The Company has certain obligations under its registered and non-registered defined benefit pension plans and other post-employment benefit plans. New regulations and market-driven changes may result in changes in the discount rates and other variables, which would result in the Company being required to make contributions in the future that differ significantly from estimates. The Company's current pension plan contributions are based on actuarial valuations that made certain assumptions as to, among other things, market rates of return. An extended period of depressed capital markets and low interest rates could mean the actual performance of the Company's pension plan assets would not be as favourable as had been forecast. Subsequent valuations may require the Company to make contributions to these plans in excess of those currently contemplated, which could have an adverse impact on the financial performance of the Company.

Third-party Service Providers

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

Real Estate

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

Seasonality

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

Alternative Arrangements for Sourcing Generic Drug Products

As the utilization rate of generic prescription drugs increases, the Company is pursuing alternative sourcing and procurement models for generic prescription drug products. As part of this alternative sourcing and procurement initiative, the Company has entered into contracts for the fabrication of private label generic prescription drug products. These alternative sourcing and procurement models contain certain additional risks beyond those associated with the Company's conventional procurement strategy. The most significant of these additional risks are product liability and intellectual property infringement. Product liability claims may arise in the event that the use of the Company's products cause, or are alleged to have caused, any injury to consumers. Intellectual property infringement claims may arise in the event that the Company's products infringe or violate, or are alleged to infringe or violate, the patents or other intellectual property rights of any third parties, including the brand manufacturer. Both product liability and intellectual property infringement claims could be costly to defend and could result in significant liabilities and monetary damages. The Company has sought and will seek to manage these risks through a combination of product selection, insurance and contractual indemnities in its agreements with its contract fabricators.

In addition, the market for generic prescription drug products and eligibility for reimbursement from governmental and other third-party payers will depend on the extent to which the products are designated as interchangeable with the branded products and are included as a benefit on the public drug plans in Canada. These interchangeability designations and benefit listings are highly regulated and will be dependent on the products and the procurement model meeting the regulatory requirements.

Environmental Compliance

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

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

Ethical Business Conduct

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

Property and Casualty Exposures

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

Workplace Health and Safety

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

Legal, Tax and Accounting

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

Compliance with Privacy Laws

In Canada, the *Personal Information Protection and Electronic Documents Act* ("PIPEDA") was passed into law by the federal government effective as of January 1, 2001. Currently, this law applies to all organizations that collect, use or disclose personal information in the course of commercial activities, except to the extent that provincial privacy legislation has been enacted and declared substantially similar to the federal legislation. To date, the provinces of Québec, British Columbia and Alberta have enacted substantially similar private sector privacy legislation. In addition, Ontario has enacted comprehensive personal health information protection legislation substantially similar to PIPEDA. Other provinces, including Alberta, Saskatchewan and Manitoba, have also passed personal health information protection legislation, but these laws have not yet been declared substantially similar to PIPEDA. As a result, both PIPEDA and these provincial statutes may apply to private sector organizations

in relation to personal health information in these three provinces. The federal privacy legislation, PIPEDA, also regulates the inter-provincial collection, use and disclosure of personal information. Applicable Canadian privacy laws create certain obligations on organizations that handle personal information, including obligations relating to obtaining appropriate consent, limitations on use and disclosure of personal information and ensuring appropriate security safeguards are in place. In the course of its business, the Company maintains records containing sensitive information identifying or relating to individual customers and employees. Although the Company has implemented systems to comply with applicable privacy laws in connection with the collection, use and disclosure of such personal information, if a significant failure of such systems were to occur, the Company's business and reputation could be adversely affected.

Associate-owned Store Network

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

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

Supplier and Brand Reputations

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

Business Continuity

Events or series of events may cause business interruptions which could potentially impact sales, profitability, colleague safety, reputation and customer service. The Company has business continuity programs which are being continually matured. However, there can be no assurance that the existence of business continuity programs will ensure that the Company responds appropriately in the event of any such business interruptions.

Litigation

From time to time, the Company is named as a defendant in legal actions or may commence legal actions against other parties arising in the normal course of business. Such matters may include employee claims relating to termination, compensation and/or working conditions; claims relating to products including claims by customers regarding product pricing, quality, safety and/or efficacy; claims involving our suppliers (including contractors who fabricate and/or manufacture products sold under the Company's private label brands); and other claims incidental to the business of the Company involving stakeholders and business partners. In addition, from time to time, the Company faces claims from Associates regarding alleged breaches of contractual and other duties (including alleged non-compliance with applicable laws and regulations) relating to the collecting, receiving and/or retaining of funds and/or benefits in excess of what is permitted to be collected, received and/or retained by the applicable agreements (which is presently the subject of a proposed Ontario class proceeding against the Company), the wrongful termination of operating or license agreements and other matters arising in connection with the Company's relationship with its Associates. In the opinion of management, the resolution and/or settlement of such matters will not have a significant effect on the Company's financial position or results of operations. To the extent that management's assessment of the Company's exposure in respect of such matters is either incorrect or changes as a result of any determinations made by judges or other finders of fact, the Company's exposure could exceed management's current expectations, which could have a material adverse effect on its business, financial condition and results of operations.

Other

The Company's operating and financial performance may also be affected by other specific risks, including the risks set out under "Risks Associated with Financial Instruments" in this Management's Discussion and Analysis, and risks that may be highlighted from time to time in other public filings of the Company available on the Canadian Securities Administrators' website at www.sedar.com.

Risks Associated with Financial Instruments

The Company is exposed to a number of risks associated with financial instruments that have the potential to affect its operating and financial performance. The Company's primary financial instrument risk exposures are interest rate risk and liquidity risk. The Company's exposures to foreign currency risk, credit risk and other price risk are not considered to be material. The Company may use derivative financial instruments to manage certain of these risks but it does not use derivative financial instruments for trading or speculative purposes.

Exposure to Interest Rate Fluctuations

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

The Company monitors market conditions and the impact of interest rate fluctuations on its fixed and floating rate debt instruments on an ongoing basis and may use interest rate derivatives to manage this exposure. In 2010, the Company used an interest rate derivative agreement to convert an aggregate notional principal amount of \$50 million (2009 – \$100 million) of floating rate debt into fixed rate debt. The fixed rate payable by the Company under this agreement was 4.18% (2009 – two agreements with a range between 4.11% and 4.18%) and contained reset terms of one month. This agreement matured in December 2010.

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. There was no unrecognized exposure as at January 1, 2011, as the Company was not party to any interest rate derivative agreements as at that date.

As at January 1, 2011, the Company had \$304 million (2009 – \$467 million) of unhedged floating rate debt. During the 52 weeks ended January 1, 2011, the Company's average outstanding unhedged floating rate debt was \$538 million (2009 – \$601 million). Had interest rates been higher or lower by 50 basis points during the period, net earnings would have decreased or increased, respectively, by approximately \$1.9 million (2009 – \$2.1 million) as a result of the Company's exposure to interest rate fluctuations on its unhedged floating rate debt.

Foreign Currency Exchange Risk

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

Credit Risk

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

Other Price Risk

The Company uses cash-settled equity forward agreements to limit its exposure to future changes in the market price of its common shares by virtue of its obligations under its long-term incentive plan ("LTIP") and restricted share unit plan ("RSU Plan"). The income or expense arising from the use of these instruments is included in cost of goods sold and other operating expenses.

Based on market values of the equity forward agreements in place at January 1, 2011, the Company recognized a liability of \$2.3 million, of which \$0.7 million was presented in accounts payable and accrued liabilities and \$1.6 million was presented in other long-term liabilities. Based on market values of the equity forward agreements in place at January 2, 2010, the Company recognized a net liability of \$0.9 million, of which \$0.3 million was presented in other assets and \$1.2 million was presented in accounts payable and accrued liabilities. During the 52 week periods ended January 1, 2011 and January 2, 2010, the Company assessed that the percentages of the equity forward agreements in place related to unearned units under the LTIP and RSU Plan were effective hedges for its exposure to future changes in the market price of its common shares in respect of the unearned units. Market values were determined based on information received from the Company's counterparty to these equity forward agreements.

Capital Management and Liquidity Risk

The Company's primary objectives when managing its 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 acquisition of sites as part of a land bank program, as well as through the acquisition of independent drug stores or their prescription files. In addition, the Company makes capital investments in information technology and its distribution capabilities to support an expanding store network. The Company also provides working capital to its Associates via loans and/or loan guarantees. The Company largely relies on its cash flow from operations to fund its capital investment program and dividend distributions to its shareholders. This cash flow is supplemented, when necessary, through the borrowing of additional debt. No changes were made to these objectives during the period.

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.

The Company monitors its capital structure principally through measuring its net debt to shareholders' equity ratio and net debt to total capitalization ratio, and ensures its ability to service its debt and meet other fixed obligations by tracking its interest and other fixed charges coverage ratios. (See discussion under "Capitalization and Financial Position" in this Management's Discussion and Analysis.)

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 credit 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.

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

The contractual maturities of the Company's financial liabilities as at January 1, 2011 are as follows:

| (\$000s) | Payments Due in the Next 90 Days | Payments Due Between 90 Days and Less Than a Year | Payments Due Between 1 Year and Less Than 2 Years | Payments Due After 2 Years | Total |
|--|----------------------------------|---|---|----------------------------|---------------------|
| Bank indebtedness | \$ 209,013 | \$ – | \$ – | \$ – | \$ 209,013 |
| Commercial paper | 128,000 | – | – | – | 128,000 |
| Accounts payable and accrued liabilities | 930,684 | 6,917 | – | – | 937,601 |
| Dividends payable | 48,927 | – | – | – | 48,927 |
| Medium-term notes | 12,488 | 34,943 | 291,430 | 730,690 | 1,069,551 |
| Other long-term liabilities | – | – | 17,222 | 36,390 | 53,612 |
| Total | \$ 1,329,112 | \$ 41,860 | \$ 308,652 | \$ 767,080 | \$ 2,446,704 |

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 in the chart above exclude certain liabilities that are not considered financial liabilities.

Disclosure Controls and Procedures

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

Management, with the participation of the CEO and CFO and members of the Company's Disclosure Committee, has evaluated the effectiveness of the Company's disclosure controls and procedures as of January 1, 2011 and has concluded that the disclosure controls and procedures are designed and operating effectively to provide reasonable assurance that information required to be disclosed relating to the Company, including its consolidated subsidiaries and Associate-owned store network, is recorded, processed, summarized and reported to the CEO and CFO by others within the Company, particularly during the period in which the annual filings were being prepared.

Internal Controls over Financial Reporting

The CEO and CFO have designed, or caused to be designed under their supervision, internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP.

The Company's internal controls over financial reporting include policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of the Company;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with Canadian GAAP, and that receipts and expenditures of the Company are made only in accordance with authorizations of management and directors of the Company; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be designed effectively can provide only reasonable assurance with respect to financial reporting and financial statement preparation.

Management, with the participation of the CEO and CFO, has evaluated the effectiveness of the Company's internal controls over financial reporting as at January 1, 2011 and has concluded that internal controls over financial reporting are designed and operating effectively to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. Management's assessment was based on the framework established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

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

Non-GAAP Financial Measures

The Company reports its financial results in accordance with Canadian GAAP. However, the foregoing contains references to non-GAAP financial measures, such as adjusted cost of goods sold and other operating expenses, operating margin, adjusted operating margin, EBITDA (earnings before interest, taxes, depreciation and amortization), adjusted EBITDA, EBITDA margin, adjusted EBITDA margin, adjusted net earnings, adjusted earnings per share and cash interest expense. Non-GAAP financial measures do not have standardized meanings prescribed by GAAP and, therefore, may not be comparable to similar measures presented by other reporting issuers.

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

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