

Financial Section

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annual management's discussion and analysis

As at March 12, 2009

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 53 week period ended January 3, 2009 (the "consolidated financial statements"). The fiscal year of the Company consists of a 52 or 53 week period ending on the Saturday closest to December 31.

Forward-looking Information and Statements

This 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, strategies, 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 sales expectations as set out under “Results of Operations – Fiscal 2008 – Sales” and “Selected Annual Information – Sales”, 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 financial 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 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 and the availability of manufacturer allowances, or changes to such laws and regulations that increase compliance costs; the risk of adverse changes to existing pharmacy reimbursement programs and the availability of manufacturer allowance funding; the risk of 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 the 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; 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; and the risk of damage to the reputation of brands promoted by the Company, or to the reputation of any supplier or manufacturer of these brands.

This is not an exhaustive list of the factors that may affect any of the Company's forward-looking information and statements. Investors and others should carefully consider these and other factors and not place undue reliance on the forward-looking information and statements. Further information regarding these and other risk factors is included in the Company's public filings with provincial securities regulatory authorities. The forward-looking information and statements contained in this 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 3, 2009, there were 1,119 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 30 medical clinic pharmacies operating under the name Shoppers Simply Pharmacy™ (Pharmaprix Simplement Santé^{MC} in Québec) and two 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 LifeBrand®, Quo®, Everyday Market®, Bio-Life®, Nativa® and Easypix®, among others, and value-added services such as the HealthWATCH® program, which offers patient counselling and advice on medications, disease management and health and wellness, and the Shoppers Optimum® program, one of the largest retail loyalty card programs in Canada. In fiscal 2008, the Company recorded consolidated sales in excess of \$9.4 billion.

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

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

The Company operates in Québec under the Pharmaprix® and Pharmaprix Simplement Santé^{MC} 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^{MC} stores and their Associates benefit from the same infrastructure and support provided to all other Shoppers Drug Mart® and Shoppers Simply PharmacyTM 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 66 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.

Strategies and Outlook

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

In the opinion of the Company, the demographic shift and aging population Canada is experiencing will continue to fuel strong 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, have been, and continue to be, primary contributors in 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 services and programs that aim to improve patient health outcomes. The development of a new retail pharmacy format, Shoppers Simply PharmacyTM, enhances 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 continues to establish itself as one of Canada's premier beauty destinations. Through the expansion of its BeautyBOUTIQUESTM within Shoppers Drug Mart® and Pharmaprix® stores, the addition of

exclusive skin care, cosmetics and fragrance brands, and a continued focus on training and development of its beauty staff, the Company believes it will increase customer satisfaction and brand loyalty. The Company believes its recent launch of Murale™, an innovative, stand-alone luxury beauty concept, showcases the powerful combination of health and beauty by offering customers access to exclusive beauty brands, as well as the expertise and professional advice of pharmacists.

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, thereby strengthening Shoppers Drug Mart®/Pharmaprix® stores' positioning 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 66 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. The Company also believes that it is well positioned to capitalize on consolidation opportunities in the fragmented Canadian retail drug store industry, given its strong balance sheet and financial position. In fiscal 2008, the Company opened or acquired 142 drug stores, 37 of which were relocations, and closed 13 smaller stores. In addition to this activity, the Company also completed 14 major drug store expansions during the year. The Company also added two home health care stores to its network and launched Murale™, with the opening of two stores, during fiscal 2008. As a result of this activity, the selling square footage of the retail store network increased by 11.6% during fiscal 2008. The Company intends to continue making significant investments in its store base, with the goal of increasing the number and average size of its stores. These large-format stores offer customers greater convenience and a broader selection of front store products, while maintaining the high level of service for which Shoppers Drug Mart® and Pharmaprix® stores are known. 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 2009, the Company plans to allocate approximately \$575 million to capital expenditures, with approximately 75% of this amount being invested in the store network, including acquisitions of drug stores, prescription files and land. This should result in an increase in retail selling square footage of approximately 10%. This will be accomplished through the addition of between 120 and 130 new drug stores, 35 to 40 of which will be relocations, and through the completion of up to 15 major drug store expansions.

See "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 the performance of the Canadian economy and financial market conditions in 2009, the Company is confident in its ability to execute upon its operating, investing and financing strategies in fiscal 2009 and beyond. The Company believes that the appropriate balance and successful implementation of these strategies and initiatives will result in long-term market share gains, while delivering continued growth in earnings per share. This in turn should provide superior returns to shareholders, through a combination of share price appreciation and dividends that are sustainable over time.

Overall Financial Performance

Key Operating, Investing and Financial Metrics

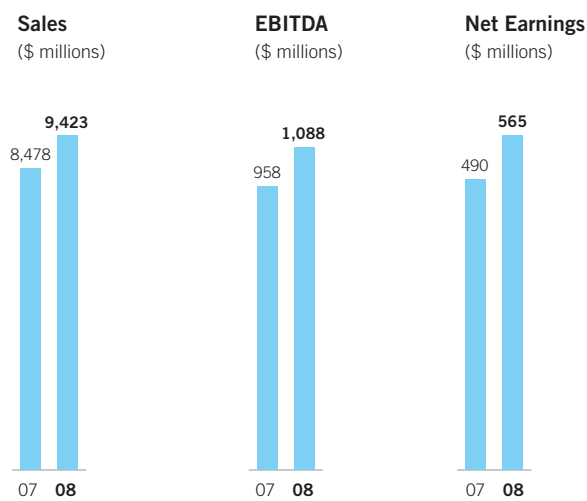
The following provides an overview of the Company's operating performance for the 53 week period ended January 3, 2009 compared to the 52 week period ended December 29, 2007, as well as certain other metrics with respect to investing activities for the 53 week period ended January 3, 2009 and financial position as at January 3, 2009.

- Sales of \$9.4 billion, an increase of 11.1%.
- Comparable store total sales growth (53 week basis), excluding tobacco⁽¹⁾, of 4.8%.
 - > Comparable store prescription sales growth of 5.4%.
 - > Comparable store front store sales growth of 4.3%.
- EBITDA⁽²⁾ of \$1.1 billion, an increase of 13.5%.
 - > EBITDA margin⁽³⁾ of 11.54%, an increase of 24 basis points.
- Net earnings of \$565 million or \$2.60 per share (diluted), an increase of 15.2%.
- Capital expenditure program of \$766 million, which includes the acquisition of the assets of the HealthAccess division of Calea Ltd. and 100% of the shares of Calea Ltd.'s wholly-owned subsidiary, Information Healthcare Marketing Corp. (\$89 million). This compares to \$535 million in the prior year, which included the acquisition of the assets of Centre d'Escomptes Racine (\$77 million).
 - > 142 new drug stores opened or acquired, 37 of which were relocations.
 - > 14 drug stores expanded and 71 drug stores renovated.
 - > Two new home health care stores opened and one home health care store expanded.
 - > Two new Murale™ luxury beauty stores opened.
 - > 11.6% increase in retail selling square footage to 10.9 million square feet.
- Maintained strong balance sheet and financial position.
 - > Net debt to equity ratio of 0.40:1 compared to 0.34:1 at the end of the prior year.
 - > Net debt to total capitalization ratio of 0.29:1 compared to 0.25:1 at the end of the prior year.
- Increased quarterly dividend payments by 34.4%.
 - > Declared four quarterly dividends of 21.5 cents per share.

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

⁽²⁾ Earnings before interest, taxes, depreciation and amortization. (See reconciliation to the most directly comparable GAAP measure under "Results of Operations – Fiscal 2008" in this Management's Discussion and Analysis.)

⁽³⁾ EBITDA divided by sales.



Results of Operations – Fiscal 2008

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

(\$000s, except per share data)	2008	2007	\$ Change	% Change
Sales	\$ 9,422,911	\$ 8,478,382	\$ 944,529	11.1%
Cost of goods sold and other operating expenses	8,335,038	7,520,033	(815,005)	(10.8%)
EBITDA ⁽¹⁾	1,087,873	958,349	129,524	13.5%
Amortization	205,371	172,075	(33,296)	(19.3%)
Operating income	882,502	786,274	96,228	12.2%
Interest expense	63,952	52,873	(11,079)	(21.0%)
Earnings before income taxes	818,550	733,401	85,149	11.6%
Income taxes	253,338	242,960	(10,378)	(4.3%)
Net earnings	\$ 565,212	\$ 490,441	\$ 74,771	15.2%
Per common share				
– Basic net earnings	\$ 2.60	\$ 2.27	\$ 0.33	
– Diluted net earnings	\$ 2.60	\$ 2.26	\$ 0.34	

⁽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 the new Murale™ stores and sales of the Company-owned home health care business, Shoppers Drug Mart Specialty Health Network Inc. and MediSystem Technologies Inc.

Sales in 2008 were \$9.423 billion compared to \$8.478 billion in 2007, an increase of \$945 million or 11.1%. During 2008, the Company continued to experience strong sales growth in all regions of the country, led by gains in Québec. The Company's capital investment program, which resulted in an 11.6% increase in selling space compared to a year ago, continues to have a positive impact on sales growth. The additional week in fiscal 2008 also contributed to the year-over-year increase in sales. Sales growth was also aided by the Company's efforts to acquire drug stores and prescription files, and by the third quarter acquisition of the assets of the HealthAccess division of Calea Ltd. and 100% of the shares of Calea Ltd.'s wholly-owned subsidiary, Information Healthcare Marketing Corp., which now operate as Shoppers Drug Mart Specialty Health Network Inc. Sales growth in 2008 also benefited from the inclusion of a full year's results from the assets of Centre d'Escomptes Racine, a seven store pharmacy chain in the Québec City region that was acquired in the third quarter of the prior year. On a same-store (53 week) basis excluding tobacco products, sales increased 4.8% in 2008.

Prescription sales were \$4.486 billion in 2008 compared to \$3.989 billion in 2007, an increase of \$497 million or 12.5%. In 2008, prescription sales accounted for 47.6% of the Company's sales mix compared to 47.0% in the prior year. On a same-store (53 week) basis, prescription sales increased 5.4% during the 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 2008, generic molecules represented 51.2% of prescriptions dispensed compared to 47.8% of units dispensed in the prior year, an increase of 7.1%. Moving forward, the Company expects this trend towards greater generic utilization to continue, with the rate of this shift slowing somewhat in 2009, then accelerating again in 2010.

Front store sales were \$4.937 billion in 2008 compared to \$4.489 billion in 2007, an increase of \$448 million or 10.0%, with the Company once again experiencing sales gains in all categories except tobacco, which is being phased out of its remaining stores in Western Canada that list these products. On a same-store (53 week) basis excluding tobacco products, front store sales increased 4.3% in 2008. The incremental selling space stemming from the Company's store network growth and revitalization program, along with effective merchandising and the continued maturation of the sales mix in these stores, continues to drive front store sales growth and market share gains. Additionally, the Company stepped up its promotional activities, particularly in the latter part of the year in the context of weaker economic conditions and in response to competition, in order to drive continued top-line growth in the front of the store. It is the Company's expectation that the softer market conditions experienced in the latter part of 2008 will prevail throughout 2009, limiting the rate of sales growth in its front store categories.

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 the new Murale™ stores and the cost of goods sold at the Company-owned 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 Company-owned home health care business, Shoppers Drug Mart Specialty Health Network Inc. and MediSystem Technologies Inc.

Total cost of goods sold and other operating expenses were \$8.335 billion in 2008 compared to \$7.520 billion in 2007, an increase of \$815 million or 10.8%, with the extra week in fiscal 2008 partially contributing to this year-over-year increase. Expressed as a percentage of sales, cost of goods sold declined by 79 basis points in 2008 compared to the prior year, reflecting an enhanced sales mix and the benefits from improved purchasing synergies. This improvement was partially offset by growth in other operating expenses, which increased by 55 basis points over the prior year when expressed as a percentage of sales. Higher operating expenses at store level, primarily in the form of increased occupancy, wages and benefits associated with the expansion of the store network, accounted for the bulk of this increase.

Amortization

Amortization of capital assets and other intangible assets was \$205 million in 2008 compared to \$172 million in 2007, an increase of \$33 million or 19.3%. Expressed as a percentage of sales, amortization increased by 15 basis points in 2008 compared to the prior year, reflecting the continued growth of the Company's capital investment and store development program.

Operating Income

Operating income was \$883 million in 2008 compared to \$786 million in 2007, an increase of \$97 million or 12.2%. As described above, top-line growth, an enhanced sales mix and improved purchasing synergies, partially offset by higher operating costs and increased amortization tied to the Company's strategic growth and store network expansion initiatives, resulted in a higher operating margin (operating income divided by sales). In 2008, operating margin improved by 10 basis points to 9.37% compared to 9.27% in 2007. The Company's EBITDA margin was 11.54% in 2008, a 24 basis point improvement over the EBITDA margin of 11.30% posted in 2007.

Interest Expense

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

Interest expense was \$64 million in 2008 compared to \$53 million in 2007, an increase of \$11 million or 21.0%. This increase over the prior year can be largely attributed to an increase in the amount of consolidated net debt outstanding, coupled with the Company's decision to extend the term on a portion of its floating rate, short-term debt obligations. These increases were partially offset by a market-driven decrease in short-term interest rates on the Company's remaining floating rate debt obligations. (See discussion under "Financing Activities" in this Management's Discussion and Analysis and note 4 to the consolidated financial statements of the Company.)

Income Taxes

The Company's effective income tax rate in 2008 was 30.9% compared to a rate of 33.1% 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 5 to the consolidated financial statements of the Company.)

Net Earnings

Net earnings were \$565 million in 2008 compared to \$490 million in 2007, an increase of \$75 million or 15.2%. On a diluted basis, earnings per share were \$2.60 in 2008 compared to \$2.26 in 2007.

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)	2008	2007
Cash	\$ (36,567)	\$ (27,588)
Bank indebtedness	240,844	225,152
Commercial paper	339,957	543,847
Short-term debt	197,845	–
Current portion of long-term debt	–	298,990
Long-term debt	647,250	–
Net debt	1,389,329	1,040,401
Shareholders' equity	3,459,413	3,075,710
Total capitalization	\$ 4,848,742	\$ 4,116,111
Net debt:Shareholders' equity	0.40:1	0.34:1
Net debt:Total capitalization	0.29:1	0.25:1
Net debt:EBITDA	1.28:1	1.09:1
EBITDA:Cash interest expense ⁽¹⁾	17.45:1	18.37:1

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

Financial Ratios and Credit Ratings

As measured by the ratios set out above, the Company maintained its strong balance sheet and financial position in 2008. The Company is comfortable with its existing capital structure and financial position and expects to maintain similar ratios in 2009.

The following table provides a summary of the Company's credit ratings at the end of 2008.

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

There were no changes to any of the Company's credit ratings during fiscal 2008.

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 217,326,595 common shares outstanding at March 12, 2009. As at this same date, the Company had issued options to acquire 995,365 of its common shares pursuant to its stock-based compensation plans, of which 761,675 were exercisable. (See notes 13 and 14 to the consolidated financial statements of the Company.)

Dividend Policy

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

The following table provides a summary of dividends declared by the Company in 2008:

Declaration Date	Record Date	Payment Date	Dividend per Share
February 5, 2008	March 31, 2008	April 15, 2008	\$ 0.215
April 29, 2008	June 30, 2008	July 15, 2008	\$ 0.215
July 16, 2008	September 30, 2008	October 15, 2008	\$ 0.215
November 6, 2008	December 31, 2008	January 15, 2009	\$ 0.215

Subsequent to year end, the Company announced, on February 12, 2009, that its Board of Directors had declared a dividend of 21.5 cents per common share, payable April 15, 2009 to shareholders of record as of the close of business on March 31, 2009. This represents an annualized dividend payment of 86 cents per common share, unchanged from the prior year, and equates to a dividend payout ratio, expressed as a percentage of fiscal 2008 net earnings, of 33%.

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 2008 and, unless otherwise indicated, all dividends to be paid by the Company subsequent to 2008, are designated as *eligible dividends* in accordance with subsection 89(14) of the *Income Tax Act* (Canada) and any applicable corresponding provincial provisions.

Normal Course Issuer Bid

On September 5, 2007, the Company announced that its Board of Directors authorized the purchase of up to 5,400,000 of its common shares, representing approximately 2.5% of its common shares then outstanding, by way of normal course purchases on the Toronto Stock Exchange. The Company was able to commence purchases under this program on September 10, 2007. During fiscal 2008, no purchases were made under this program. The program terminated on September 9, 2008 and was not renewed.

Financing Activities

On April 22, 2008, the Company completed an amendment to its existing bank credit facility which matures in June of 2011, increasing the size of the facility from \$550 million to \$800 million. The bank credit facility is available for general corporate purposes, including refinancing existing indebtedness, and to backstop the Company's commercial paper program. The Company's initial credit spread on bankers' acceptance borrowings under the amended credit facility is 50 basis points. In conjunction with this amendment, the Company increased its commercial paper program from \$300 million to \$500 million. The Company's commercial paper program retained its rating of R-1 (low) from Dominion Bond Rating Service Limited ("DBRS"). (See note 11 to the consolidated financial statements of the Company.)

On April 23, 2008, the Company issued \$200 million of commercial paper and used the proceeds to purchase loans provided to Associates by an independent trust (the "Trust") whose activities were financed through the issuance of short-term, asset-backed notes. The purchase of these loans reduced the outstanding Trust loans to Associates from \$499 million to \$299 million. In conjunction with this reduction, the standby letter of credit provided by the Company to the Trust as a form of credit enhancement was reduced from \$50 million to \$30 million. On a consolidated basis, no incremental debt was incurred by the Company as a result of these refinancing activities.

On May 22, 2008, the Company filed, with the securities regulators in each of the provinces of Canada, a final short form base shelf prospectus (the "Prospectus") for the issuance of up to \$1 billion of medium-term notes. Subject to the requirements of applicable law, medium-term notes can be issued under the Prospectus for up to 25 months from the date of the final receipt. No incremental debt was incurred by the Company as a result of this filing.

On June 2, 2008, the Company issued \$450 million of five-year medium-term notes maturing June 3, 2013, which bear interest at a fixed rate of 4.99% per annum (the "Series 2 Notes"). The Series 2 Notes were issued pursuant to the Prospectus, as supplemented by a pricing supplement dated May 28, 2008, and filed by the Company with Canadian securities regulators in all of the provinces of Canada. At the time of issuance, the Series 2 Notes were assigned a rating of A (low) from DBRS and BBB+ from Standard & Poor's. The net proceeds from the issuance of the Series 2 Notes were used to purchase the remaining outstanding Trust loans to Associates, with the balance applied to reduce outstanding commercial paper issued by the Company. In conjunction with the purchase of all remaining Trust loans to Associates, the \$30 million standby letter of credit provided by the Company to the Trust as a form of credit enhancement was returned to the Company by the Trust and cancelled. The Trust itself was terminated on June 10, 2008. As a result of applying the net proceeds from the issuance of the Series 2 Notes to refinance existing indebtedness, the consolidated net debt position of the Company remained substantially unchanged. (See note 11 to the consolidated financial statements of the Company.)

On October 17, 2008, the Company entered into a new senior unsecured 364-day bank credit facility in the amount of up to \$200 million. This facility was available for a single drawdown to provide for a partial refinancing of the Company's \$300 million of medium-term notes maturing on October 24, 2008. On October 23, 2008, the Company elected to draw down all of this facility to refinance a portion of its \$300 million of maturing medium-term notes. The Company's credit spread on the initial \$200 million of prime rate borrowings under this facility was 75 basis points. The balance of funds required to complete the refinancing of the \$300 million of maturing medium-term notes was drawn from funds available under the Company's pre-existing \$800 million revolving term bank credit facility maturing June 6, 2011. On October 24, 2008, the \$300 million of maturing medium-term notes were repaid in full, along with all accrued and unpaid interest owing on the final semi-annual interest payment. On a consolidated basis, after giving effect to the repayment of the maturing medium-term notes, the net debt position of the Company remained substantially unchanged as a result of these refinancing activities. (See note 10 to the consolidated financial statements of the Company.)

On December 19, 2008, the Company amended the above referenced senior unsecured 364-day bank credit facility by increasing the amount available under the facility to \$300 million. The additional \$100 million was available for general corporate purposes on a non-revolving basis. In conjunction with this amendment, the credit spread on prime rate borrowings under the facility was increased to 150 basis points.

Subsequent to year end, on January 20, 2009, the Company issued \$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 3 Notes and Series 4 Notes were issued pursuant to the Prospectus, as supplemented by pricing supplements dated January 14, 2009, and filed by the Company with Canadian securities regulators in all of the provinces of Canada. At the time of issuance, the Series 3 Notes and Series 4 Notes were assigned ratings of A (low) from DBRS and BBB+ from Standard & Poor's. The net proceeds from the issuance of the Series 3 Notes and Series 4 Notes were used to refinance existing indebtedness, including repayment of all amounts outstanding under the Company's senior unsecured 364-day bank credit facility. The Company's senior unsecured 364-day bank credit facility was terminated on January 20, 2009. As a result of applying the net proceeds from the issuance of the Series 3 Notes and Series 4 Notes to refinance existing indebtedness, the consolidated net debt position of the Company remained substantially unchanged. (See note 19 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 \$800 million revolving bank credit facility maturing June 6, 2011, less what is currently drawn and/or being utilized to support commercial paper issued and outstanding; and (iii) up to \$500 million in availability under its commercial paper program, less what is currently issued. The Company's commercial paper program is rated R-1 (low) by DBRS. In the event that the Company's commercial paper program is unable to maintain this rating, the program is supported by the Company's \$800 million revolving bank credit facility. The Company does not currently foresee any reasonable circumstances under which this credit rating would not be maintained. (See note 11 to the consolidated financial statements of the Company.)

The Company has also arranged for its Associates to obtain financing to facilitate their purchase of inventory and fund their working capital requirements by providing guarantees to various Canadian chartered banks that support Associate loans. (See discussion on "Associate Loans Guarantees" under "Off-balance Sheet Arrangements" in this Management's Discussion and Analysis.)

The Company has obtained additional long-term financing from the issuance of the Series 2 Notes, the Series 3 Notes and the Series 4 Notes. The Series 2 Notes were issued pursuant to 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 and BBB+ from Standard & Poor's. (See notes 11 and 19 to the consolidated financial statements of the Company.)

At January 3, 2009, \$209 million of the Company's \$800 million revolving credit facility was utilized, including \$9 million in respect of outstanding letters of credit. At the end of the prior year, \$61 million of this facility was utilized, all in respect of outstanding letters of credit and trade finance guarantees. At January 3, 2009, the Company had \$341 million of commercial paper issued and outstanding under its commercial paper program compared to \$45 million at the end of the prior year. At January 3, 2009, Associates had drawn an aggregate amount of \$264 million in the form of Associate loans from various Canadian chartered banks compared to \$228 million at the end of the prior year. (See discussion on "Associate Loans Guarantees" under "Off-balance Sheet Arrangements" in this Management's Discussion and Analysis and note 11 to the consolidated financial statements of the Company.)

In addition to the above, MediSystem Technologies Inc., a subsidiary of the Company, has arranged for up to \$1 million of revolving demand bank credit facilities. At the end of 2008, no amounts were outstanding on these facilities, unchanged from the end of the prior year.

Cash Flows from Operating Activities

Cash flows from operating activities were \$479 million in 2008, compared to \$565 million in the prior year. This decrease is largely the result of growth in net earnings, adjusted for non-cash items, being more than offset by an increased investment in non-cash working capital balances in 2008 compared to the prior year. Growth in inventory and accounts receivable, tied largely to expansion of the store network and increased sales activity, comprised the bulk of this investment. A shift in the timing of tax payments also contributed to the growth in non-cash working capital balances in 2008. (See note 15 to the consolidated financial statements of the Company.)

Cash Flows Used in Investing Activities

Cash flows used in investing activities were \$665 million in 2008 compared to \$613 million in 2007, an increase of \$52 million or 8.5%. Of these totals, purchases of property and equipment, net of proceeds from any dispositions, amounted to \$497 million in 2008 compared to \$378 million in 2007, reflecting the continued growth of the Company's capital investment and store development program. In 2008, approximately 74% of the amount invested in property and equipment was allocated to the store network, compared to 77% in the prior year. In order to support the continued growth and expansion of the store network, the Company also allocated additional capital to certain infrastructure projects in information technology and distribution. In 2008, the Company completed and opened a new 175,000-square-foot distribution centre in Richmond, British Columbia to handle imported merchandise and manage bulk and fast-moving products for its store network in this region. In 2009, the Company will begin construction of a new 500,000-square-foot distribution centre in Cornwall, Ontario in order to increase its capacity and distribution capabilities in the Eastern Ontario and Québec markets. This distribution centre is scheduled to open in the first half of 2010.

In 2008, the Company invested an additional \$244 million in business acquisitions and \$12 million in other assets compared to \$140 million and \$2 million, respectively, in 2007. Of the \$244 million invested in business acquisitions in 2008, \$89 million was used to acquire the assets of the HealthAccess division of Calea Ltd. and 100% of the shares of Calea Ltd.'s wholly-owned subsidiary,

Information Healthcare Marketing Corp. The acquired businesses now operate as Shoppers Drug Mart Specialty Health Network Inc. and provide comprehensive patient support services for specialty pharmaceutical needs. Of the \$140 million invested in business acquisitions in 2007, \$78 million was used to acquire the assets of Centre d'Escomptes Racine, a seven store pharmacy chain in the Québec City region. (See note 3 to the consolidated financial statements of the Company.) Consistent with the Company's stated growth objectives, the balance of the amounts invested in business acquisitions in 2008 and 2007 consisted primarily of purchases of single drug store prescription files; however, in some instances, the Company will acquire a drug store and continue to operate it at its existing location as a Shoppers Drug Mart®/Pharmaprix® or Shoppers Simply Pharmacy™/Pharmaprix Simplement Santé^{MC} store. During 2008, the balance of funds deposited and held in escrow in respect of outstanding offers to purchase drug stores and land decreased by \$89 million compared to an increase of \$94 million in 2007, as a number of offers outstanding at the end of 2007 resulted in successful transactions, while others expired or were withdrawn. In 2009, the Company will continue to pursue attractive acquisition opportunities in Canada's fragmented retail drug store marketplace.

During 2008, 142 new drug stores were opened or acquired, 37 of which were relocations, 13 smaller drug stores were closed and 85 drug stores were expanded and/or renovated. The Company also opened two new home health care stores in 2008. In 2008, the Company also launched Murale™, an innovative stand-alone luxury beauty concept, with the opening of two stores. At the end of 2008, there were 1,217 retail stores in the Company's network, comprised of 1,149 drug stores (1,119 Shoppers Drug Mart®/Pharmaprix® stores and 30 Shoppers Simply Pharmacy™/Pharmaprix Simplement Santé^{MC} stores), 66 Shoppers Home Health Care® stores and two Murale™ stores. During 2008, the selling square footage of the retail store network increased by 11.6% to 10.9 million square feet. Consistent with the prior year, proportionately more square footage was added in Québec in 2008, a market in which the Company has been historically underrepresented. At year-end, the average selling space per drug store was approximately 9,300 square feet compared to 9,000 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.

	2008		2007	
	Drug Stores	Home Health Care Stores	Drug Stores	Home Health Care Stores
Store count – beginning of year	1,057	64	987	58
Stores opened/acquired	105	2	77	7
Stores closed	(13)	–	(7)	(1)
Store count – end of year	1,149	66	1,057	64
Stores relocated	37	–	44	2
Stores renovated/expanded	85	1	28	–

The Company intends to continue making significant investments in its store base, with the goal of increasing the number and average size of its stores. In fiscal 2009, the Company plans to allocate approximately \$575 million to capital expenditures, with approximately 75% of this amount being invested in the store network, including acquisitions of drug stores, prescription files and land. This should result in an increase in selling square footage of approximately 10%. This will be accomplished through the addition of between 120 and 130 new drug stores, 35 to 40 of which will be relocations, and through the completion of up to 15 major drug store expansions.

Cash Flows from Financing Activities

Cash flows from financing activities were \$195 million in 2008, as cash inflows of \$879 million were largely offset by cash outflows of \$684 million. Cash inflows were comprised of a \$16 million increase in bank indebtedness, \$200 million of prime rate borrowings under a new senior unsecured 364-day bank credit facility, \$450 million of proceeds from the issuance of five-year medium-term notes maturing June 3, 2013, \$200 million of bankers' acceptance borrowings under the Company's \$800 million revolving bank credit facility maturing June 6, 2011, a \$6 million increase in the amount of Associate investment and \$7 million of proceeds received from the issuance of common shares and loan repayments under the Company's stock-based incentive plans. Cash outflows were comprised of a \$203 million decrease in the amount of commercial paper issued and outstanding under the Company's commercial paper programs (a \$499 million decrease in the amount of commercial paper issued by the Trust, partially offset by a \$296 million increase in the amount of commercial paper issued and outstanding by the Company), \$300 million to repay medium-term notes that matured on October 24, 2008, \$6 million to fund costs associated with various financing activities and \$175 million for the payment of dividends. (See discussion on "Financing Activities" in this Management's Discussion and Analysis.)

In 2008, the net result of the Company's operating, investing and financing activities was an increase in cash balances of \$9 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. While credit markets in Canada and globally have tightened, causing credit spreads to widen and liquidity risk to intensify, the Company does not foresee any major difficulty in obtaining additional short- or long-term financing given its current credit ratings and past experiences in the capital markets.

Contractual Obligations

The following table presents a summary of the maturity periods of the Company's contractual obligations as at the end of 2008.

(\$000s)	Payments Due During 2009	Payments Due in 2010 and 2011	Payments Due in 2012 and 2013	Payments Due after 2013	Obligations with No Fixed Maturity	Total
Commercial paper	\$ 341,000	\$ –	\$ –	\$ –	\$ –	\$ 341,000
Short-term debt	200,000	–	–	–	–	200,000
Long-term debt	–	200,000	450,000	–	–	650,000
Employee future benefits ⁽¹⁾	–	–	–	–	16,879	16,879
Other	–	10,603	2,592	6,366	2,097	21,658
Operating leases ⁽²⁾	313,949	643,470	589,515	2,153,816	–	3,700,750
Total	\$ 854,949	\$ 854,073	\$ 1,042,107	\$ 2,160,182	\$ 18,976	\$ 4,930,287

⁽¹⁾ See discussion on "Employee Future Benefits" under "Critical Accounting Estimates" in this Management's Discussion and Analysis and note 12 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 3, 2009. (See note 16 to the consolidated financial statements of the Company.)

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

The Company has entered into an agreement with a third party to provide distribution services to the Company's store network. Under the terms of the distribution services agreement, which expires on December 31, 2009, the third party will charge the Company specified costs incurred to provide the distribution services, plus an annual management fee. In addition, the Company has entered into an agreement to outsource certain information services activities from a third party. The Company has committed to average annual payments of approximately \$7 million over the term of the information services agreement, which expires in 2011.

Off-balance Sheet Arrangements

Associate Loans Guarantees

The Company has provided guarantees to various Canadian chartered banks that support Associate loans. At the end of 2008, the Company's maximum obligation in respect of such guarantees was \$425 million compared to \$415 million at the end of the prior year. At January 3, 2009, an aggregate amount of \$398 million in available lines of credit had been allocated to the Associates by the various banks compared to \$356 million at the end of the prior year. At January 3, 2009, Associates had drawn an aggregate amount of \$264 million against these available lines of credit compared to \$228 million at the end of the prior year. Any amounts drawn by the Associates are included in bank indebtedness on the Company's consolidated balance sheets. As recourse in the event that any payments are made under the guarantees, the Company holds a first-ranking security interest on all assets of Associate-owned stores, subject to certain prior-ranking statutory claims. As the Company is involved in allocating the available lines of credit to its Associates, it estimates that the net proceeds from secured assets would exceed the amount of any payments required in respect of the guarantees.

Selected 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 and all figures are reported in Canadian dollars.

(\$000s, except per share data)	2008	2007	2006
	(53 weeks)	(52 weeks)	(52 weeks)
Sales	\$ 9,422,911	\$ 8,478,382	\$ 7,786,436
Net earnings	\$ 565,212	\$ 490,441	\$ 422,491
Per common share			
– Basic net earnings	\$ 2.60	\$ 2.27	\$ 1.97
– Diluted net earnings	\$ 2.60	\$ 2.26	\$ 1.95
Dividends declared per common share	\$ 0.86	\$ 0.64	\$ 0.48
Total assets	\$ 6,419,306	\$ 5,621,977	\$ 4,929,014
Total long-term liabilities	\$ 997,355	\$ 274,828	\$ 510,627

Sales

2008 Compared to 2007

Sales in 2008 were \$9.423 billion compared to \$8.478 billion in 2007, an increase of \$945 million or 11.1%. During 2008, the Company continued to experience strong sales growth in all regions of the country, led by gains in Québec. The Company's capital investment program, which resulted in an 11.6% increase in selling space compared to a year ago, continues to have a positive impact on sales growth. The additional week in fiscal 2008 also contributed to the year-over-year increase in sales. Sales growth was also aided by the Company's efforts to acquire drug stores and prescription files, and by the third quarter acquisition of the assets

of the HealthAccess division of Calea Ltd. and 100% of the shares of Calea Ltd.'s wholly-owned subsidiary, Information Healthcare Marketing Corp., which now operate as Shoppers Drug Mart Specialty Health Network Inc. Sales growth in 2008 also benefited from the inclusion of a full year's results from the assets of Centre d'Escomptes Racine, a seven store pharmacy chain in the Québec City region that was acquired in the third quarter of the prior year. On a same-store (53 week) basis excluding tobacco products, sales increased 4.8% in 2008.

Prescription sales were \$4.486 billion in 2008 compared to \$3.989 billion in 2007, an increase of \$497 million or 12.5%. In 2008, prescription sales accounted for 47.6% of the Company's sales mix compared to 47.0% in the prior year. On a same-store (53 week) basis, prescription sales increased 5.4% during the 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 2008, generic molecules represented 51.2% of prescriptions dispensed compared to 47.8% of units dispensed in the prior year, an increase of 7.1%. Moving forward, the Company expects this trend towards greater generic utilization to continue, with the rate of this shift slowing somewhat in 2009, then accelerating again in 2010.

Front store sales were \$4.937 billion in 2008 compared to \$4.489 billion in 2007, an increase of \$448 million or 10.0%, with the Company once again experiencing sales gains in all categories except tobacco, which is being phased out of its remaining stores in Western Canada that list these products. On a same-store (53 week) basis and excluding tobacco products, front store sales increased 4.3% in 2008. The incremental selling space stemming from the Company's store network growth and revitalization program, along with effective merchandising and the continued maturation of the sales mix in these stores, continues to drive front store sales growth and market share gains. Additionally, the Company stepped up its promotional activities, particularly in the latter part of the year in the context of weaker economic conditions and in response to competition, in order to drive continued top-line growth in the front of the store. It is the Company's expectation that the softer market conditions experienced in the latter part of 2008 will prevail throughout 2009, limiting the rate of sales growth in its front store categories.

2007 Compared to 2006

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

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

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

Net Earnings

2008 Compared to 2007

Net earnings were \$565 million in 2008 compared to \$490 million in 2007, an increase of \$75 million or 15.2%. On a diluted basis, earnings per share were \$2.60 in 2008 compared to \$2.26 in 2007. Top-line growth, an enhanced sales mix and improved purchasing synergies, partially offset by higher operating costs and increased amortization tied to the Company's strategic growth and store network expansion initiatives, resulted in a year-over-year increase in operating income of 12.2%. Net earnings growth in 2008 also benefited from a decline in the Company's effective income tax rate to 30.9% from 33.1% in 2007, a decrease that can be attributed to a reduction in statutory rates, which was partially offset by higher interest expense.

2007 Compared to 2006

Net earnings were \$490 million in 2007 compared to \$422 million in 2006, an increase of \$68 million or 16.1%. On a diluted basis, earnings per share were \$2.26 in 2007 compared to \$1.95 in 2006. Sales growth, an enhanced mix and improved purchasing synergies, partially offset by higher operating costs and increased amortization tied to the Company's strategic growth and store network expansion initiatives, resulted in higher operating income and net earnings.

Dividends Declared per Common Share

On February 5, 2008, the Company announced that its Board of Directors had declared a dividend of 21.5 cents per common share, payable April 15, 2008 to shareholders of record as of the close of business on March 31, 2008. This represented an increase in the amount of the Company's quarterly dividend payments of 34.4%, resulting in an annualized dividend payment of 86 cents per common share. Subject to financial results, capital requirements, available cash flow and any other factors that the Board of Directors may consider relevant, it is the intention of the Board of Directors to declare a comparable quarterly dividend on an ongoing basis.

The following table provides a summary of dividends declared by the Company in 2008 and 2007:

Declaration Date	Record Date	Payment Date	Dividend per Share	
February 5, 2008	March 31, 2008	April 15, 2008	\$	0.215
April 29, 2008	June 30, 2008	July 15, 2008	\$	0.215
July 16, 2008	September 30, 2008	October 15, 2008	\$	0.215
November 6, 2008	December 31, 2008	January 15, 2009	\$	0.215
February 8, 2007	March 30, 2007	April 13, 2007	\$	0.16
April 30, 2007	June 29, 2007	July 13, 2007	\$	0.16
July 18, 2007	September 28, 2007	October 15, 2007	\$	0.16
November 6, 2007	December 31, 2007	January 15, 2008	\$	0.16

Total Assets

2008 Compared to 2007

Total assets were \$6.419 billion at the end of 2008 compared to \$5.622 billion at the end of 2007, an increase of \$797 million or 14.2%. Higher current asset balances, primarily accounts receivable and inventory, partially offset by a reduction in prepaid expenses and deposits, accounted for \$234 million of this increase. Growth in accounts receivable and inventory was tied largely to the continued expansion of the store network and increased sales activity. Prepaid expenses and deposits declined as funds deposited and held in escrow in respect of outstanding offers to purchase drug stores and land decreased as a number of such offers resulted in successful transactions, while others expired or were withdrawn during the course of the year. (See note 3 to the consolidated

financial statements of the Company.) In 2008, net property and equipment balances increased by \$316 million or 28.0% over the prior year, reflecting a further step-up in the Company's capital investment and store revitalization program. (See note 6 to the consolidated financial statements of the Company.) Combined, the net balances of goodwill and other intangible assets accounted for a further \$222 million of the increase in total assets in 2008, driven in large part by the acquisitions of drug stores and prescription files, and by the acquisition of the assets of the HealthAccess division of Calea Ltd. and 100% of the shares of Calea Ltd.'s wholly-owned subsidiary, Information Healthcare Marketing Corp., in the second quarter of 2008. (See notes 3, 8 and 9 to the consolidated financial statements of the Company.)

2007 Compared to 2006

Total assets were \$5.622 billion at the end of 2007 compared to \$4.929 billion at the end of 2006, an increase of \$693 million or 14.1%. Of this increase, \$329 million can be attributed to higher current asset balances, primarily accounts receivable, inventory and prepaid expenses and deposits. The increase in accounts receivable and inventory was tied largely to growth in the store network and increased sales activity, while the increase in prepaid expenses and deposits was largely attributable to funds deposited and held in escrow in respect of outstanding offers to purchase drug stores and prescription files. (See note 3 to the consolidated financial statements of the Company.) In 2007, net property and equipment balances increased by \$219 million or 24.1% over the prior year, reflecting the Company's stepped-up capital investment and store revitalization program. (See note 6 to the consolidated financial statements of the Company.) Combined, the net balances of goodwill and other intangible assets accounted for a further \$136 million of the increase in total assets in 2007, driven largely by the acquisitions of drug stores and prescription files, including the acquisition of the assets of Centre d'Escomptes Racine in the third quarter of that year. (See notes 3, 8 and 9 to the consolidated financial statements of the Company.)

Total Long-term Liabilities

2008 Compared to 2007

Total long-term liabilities were \$997 million at the end of 2008 compared to \$275 million at the end of 2007, an increase of \$722 million. This increase can be largely attributed to a \$647 million increase in long-term debt and a \$58 million increase in other long-term liabilities. Long-term debt increased as the Company extended the term on a portion of its floating rate, short-term debt by issuing \$450 million of five-year medium-term notes maturing June 3, 2013, and by borrowing \$200 million in the form of bankers' acceptances under its revolving bank credit facility maturing June 6, 2011. (See discussion under "Financing Activities" and discussion under "Cash Flows from Financing Activities" under "Liquidity and Capital Resources" in this Management's Discussion and Analysis.) The \$58 million increase in other long-term liabilities was tied principally to a \$53 million increase in deferred rent obligations at store-level, reflecting the continued growth of the Company's capital investment and store revitalization program. (See notes 1 and 12 to the consolidated financial statements of the Company.)

2007 Compared to 2006

Total long-term liabilities were \$275 million at the end of 2007 compared to \$511 million at the end of 2006, a decrease of \$236 million or 46.2%. This decrease was largely attributable to the reclassification of \$300 million of medium-term notes due in October of 2008 from long-term debt to current portion of long-term debt, partially offset by a \$56 million increase in other long-term liabilities. The \$56 million increase in other long-term liabilities was driven largely by a \$43 million increase in deferred rent obligations at store level, stemming from the Company's stepped-up capital investment and store revitalization program. (See notes 1 and 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)	2008 (13 Weeks)	Fourth Quarter 2007 (12 Weeks)	2008 (16 Weeks)	Third Quarter 2007 (16 Weeks)	2008 (12 Weeks)	Second Quarter 2007 (12 Weeks)	2008 (12 Weeks)	First Quarter 2007 (12 Weeks)
Sales	\$ 2,496,799	\$ 2,168,822	\$ 2,793,005	\$ 2,542,671	\$ 2,109,308	\$ 1,928,094	\$ 2,023,799	\$ 1,838,795
Net earnings	\$ 173,051	\$ 151,331	\$ 162,511	\$ 141,672	\$ 128,317	\$ 112,154	\$ 101,333	\$ 85,284
Per common share								
– Basic net earnings	\$ 0.80	\$ 0.70	\$ 0.75	\$ 0.65	\$ 0.59	\$ 0.52	\$ 0.47	\$ 0.40
– Diluted net earnings	\$ 0.80	\$ 0.70	\$ 0.75	\$ 0.65	\$ 0.59	\$ 0.52	\$ 0.47	\$ 0.39

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

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

Results of Operations – Fourth Quarter of Fiscal 2008

The Company released its unaudited financial statements and the notes thereto for the fourth quarter and fiscal year ended January 3, 2009 on February 12, 2009. 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)	January 3, 2009	Fourth Quarter Ended December 29, 2007
	(13 weeks)	(12 weeks)
Sales	\$ 2,496,799	\$ 2,168,822
Cost of goods sold and other operating expenses	2,181,389	1,888,377
EBITDA ⁽¹⁾	315,410	280,445
Amortization	50,477	41,323
Operating income	264,933	239,122
Interest expense	15,940	14,185
Earnings before income taxes	248,993	224,937
Income taxes	75,942	73,606
Net earnings	\$ 173,051	\$ 151,331
Per common share		
– Basic net earnings	\$ 0.80	\$ 0.70
– Diluted net earnings	\$ 0.80	\$ 0.70

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

Sales

Sales in the fourth quarter (13 weeks) were \$2.497 billion compared to \$2.169 billion in the fourth quarter of 2007 (12 weeks), an increase of \$328 million or 15.1%, with the Company once again experiencing strong sales growth in all regions of the country. The Company's capital investment program, which resulted in an 11.6% increase in selling space compared to a year ago, together with the benefit of the additional week in fiscal 2008, drove this top-line growth. On a same-store (13 week) basis excluding tobacco products, sales increased 3.6% during the fourth quarter of 2008.

Prescription sales were \$1.154 billion in the fourth quarter compared to \$975 million in the fourth quarter of 2007, an increase of \$179 million or 18.3%. During the fourth quarter of 2008, prescription sales accounted for 46.2% of the Company's sales mix compared to 45.0% in the same period last year. On a same-store (13 week) basis, prescription sales increased 5.0% during the fourth quarter of 2008, 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 the fourth quarter of 2008, generic molecules represented 52.2% of prescriptions dispensed compared to 48.9% of units dispensed in the fourth quarter of the prior year.

Front store sales were \$1.343 billion in the fourth quarter compared to \$1.194 billion in the fourth quarter of 2007, an increase of \$149 million or 12.5%, with the Company continuing to experience sales and market share gains in all categories except tobacco, which is being phased out of its remaining stores in Western Canada that list these products. On a same-store (13 week) basis excluding tobacco products, front store sales increased 2.4% during the fourth quarter of 2008. The incremental selling space stemming from the Company's store network growth and revitalization program, combined with effective merchandising and the continued maturation of the sales mix in these stores, drove continued growth in front store sales. Sales growth in the fourth quarter was also driven by stepped-up investments in promotional pricing in response to softer market conditions, inclement weather and increased promotional efforts on the part of other retailers.

Cost of Goods Sold and Other Operating Expenses

Cost of goods sold and other operating expenses were \$2.181 billion in the fourth quarter of 2008 compared to \$1.888 billion in the same period last year, an increase of \$293 million or 15.5%, with the extra week in fiscal 2008 factoring into this increase. Expressed as a percentage of sales, cost of goods sold declined by 31 basis points in the fourth quarter of 2008 versus the comparative prior year period, reflecting an enhanced sales mix and the benefits from improved buying synergies. More than offsetting this improvement were higher fourth quarter operating expenses which, when expressed as a percentage of sales, increased by 61 basis points over the prior year period. Operating expenses were higher due in large part to increased store-level expenses associated with the continued growth and expansion of the store network, primarily occupancy and labour, as well as due to additional costs incurred during the extra week in the period.

Amortization

Amortization of capital assets and other intangible assets was \$50 million in the fourth quarter of 2008 compared to \$41 million in the same period last year, an increase of \$9 million or 22.2%. Expressed as a percentage of sales, amortization increased by 11 basis points in the fourth quarter of 2008 versus the comparative prior year period, reflecting the continued growth of the Company's capital investment and store development program.

Operating Income

Operating income was \$265 million in the fourth quarter of 2008 compared to \$239 million in the same period last year, an increase of \$26 million or 10.8%. In the fourth quarter of 2008, the Company's operating margin (operating income divided by sales) was 10.61%, a 41 basis point decline when compared to the operating margin of 11.02% posted in the fourth quarter of 2007. The Company's EBITDA margin (EBITDA divided by sales) was 12.63% in the fourth quarter of 2008, a 30 basis point decline when compared to the EBITDA margin of 12.93% posted in the fourth quarter of 2007. The operating margin and EBITDA margin declines experienced in the fourth quarter of 2008 are primarily a function of the inclusion of an additional week in the quarter, one that is historically a labour-intensive and low-margin sales week that includes an extra statutory holiday. This result is consistent with what the Company experienced in the fourth quarter of fiscal 2003 when the Company last reported on a 53 week fiscal year basis. On a full year (53 week) basis, operating margin improved by 10 basis points in 2008 to 9.37% compared to 9.27% in 2007. The Company's full year (53 week) EBITDA margin was 11.54% in 2008, a 24 basis point improvement over the EBITDA margin of 11.30% posted in 2007.

Interest Expense

Interest expense was \$16 million in the fourth quarter of 2008 compared to \$14 million in the same period last year, an increase of \$2 million or 12.4%. This increase versus the comparative prior year period can be attributed to an increase in the amount of consolidated net debt outstanding, partially offset by a decrease in average interest rates.

Income Taxes

The Company's effective income tax rate in the fourth quarter of 2008 was 30.5% compared to 32.7% in the same period last year. This decrease in the effective income tax rate can be attributed to a reduction in statutory rates.

Net Earnings

Fourth quarter net earnings were \$173 million in 2008 compared to \$151 million in the same period last year, an increase of \$22 million or 14.4%. On a diluted basis, earnings per share were \$0.80 in the fourth quarter of 2008 compared to \$0.70 in the same period last year.

Cash Flows

Cash flows from operating activities were \$156 million in the fourth quarter of 2008 compared to \$220 million in the same period last year, a decrease of \$64 million or 29.2%, as growth in net earnings, adjusted for non-cash items, was more than offset by additional investments in non-cash working capital balances. Growth in inventory and accounts receivable, which is tied to store network growth and increased sales, partially offset by an increase in accounts payable, accounted for the bulk of the investment in non-cash working capital in the fourth quarter of 2008.

Cash flows used in investing activities were \$216 million in the fourth quarter of 2008 compared to \$174 million in the same period last year, an increase of \$42 million or 24.2%. Of these totals, purchases of property and equipment, net of proceeds of any dispositions, amounted to \$198 million in the fourth quarter of 2008 compared to \$135 million in the fourth quarter of 2007, reflecting the continued growth of the Company's capital investment and store development program. The Company also invested \$46 million in business acquisitions during the fourth quarter of 2008, primarily drug store and prescription file buys, compared to \$19 million in the same period last year. During the fourth quarter of 2008, the balance of funds deposited and held in escrow in respect of outstanding offers to purchase drug stores and land decreased by \$29 million compared to an increase of \$19 million in the same period last year. During the fourth quarter of 2008, 28 new drug stores were opened or acquired, seven of which were relocations, and four smaller drug stores were closed. In the fourth quarter of 2008, the Company also launched Murale™, an innovative stand-alone luxury beauty concept, with the opening of two stores.

Cash flows from financing activities were \$47 million in the fourth quarter of 2008, as cash inflows of \$419 million were partially offset by cash outflows of \$372 million. Cash inflows were comprised of \$200 million of prime rate borrowings under a new senior unsecured 364-day bank credit facility, \$200 million of bankers' acceptance borrowings under the Company's \$800 million revolving bank credit facility maturing June 6, 2011, a \$16 million increase in the amount of Associate investment and \$2 million of proceeds received from the issuance of common shares and loan repayments under the Company's stock-based incentive plans. Cash outflows were comprised of a \$19 million reduction in bank indebtedness, a \$4 million decrease in the amount of commercial paper issued and outstanding under the Company's commercial paper program, \$300 million to repay medium-term notes that matured on October 24, 2008, \$3 million to fund costs associated with various financing activities and \$47 million for the payment of dividends. (See discussion on "Financing Activities" in this Management's Discussion and Analysis.)

In the fourth quarter of 2008, the net result of the Company's operating, investing and financing activities was a decrease in cash balances of \$13 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^{MC}, 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.

	2008			2007		
	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	6.75%	3.25%	6.75%	5.25%	2.63%	5.25%
Compensation increase	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
Benefit expense for the period						
Discount rate	5.25%	2.63%	5.25%	5.00%	2.50%	5.00%
Expected return on assets	7.50%	3.75%	N/A	7.50%	3.75%	N/A
Compensation increase	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%

The discount rate is based on current market interest rates at the end of the Company's fiscal year, assuming a portfolio of corporate AA-rated bonds with terms to maturity that, on average, match the terms of the accrued benefit plan obligations. A 1% increase in the assumed discount rate would decrease the amount of the Company's accrued benefit obligation and benefit expense in respect of its registered and non-registered defined benefit plans by \$12 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 \$15 million and \$3 million, respectively.

The expected long-term rate of return on plan assets is based on the asset mix of invested assets and historical returns. A 1% increase in the assumed long-term rate of return on plan assets would decrease the amount of the Company's benefit expense in respect of its registered and non-registered defined benefit plans by \$1 million. Conversely, a 1% decrease in the assumed long-term rate of return on plan assets would increase the amount of the Company's benefit expense in respect of its registered and non-registered defined benefit plans by \$1 million. In calculating the benefit expense for its registered and non-registered defined benefit plans for 2008, 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 \$5 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 \$5 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 2008, 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 3, 2009, the expected average remaining service period of active employees covered by the Company's registered and non-registered defined benefit pension plans, and other post-employment benefit plans, was 14 and 10 years, respectively.

At January 3, 2009, 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 \$21 million, compared to a deficit of \$25 million at the end of the prior year. Included in other long-term liabilities on the Company's consolidated balance sheets at January 3, 2009, was an amount of \$17 million in respect of the Company's obligations under its registered and non-registered defined benefit pension plans and other post-employment benefit plans, compared to \$15 million at the end of the prior year. As of this same date, the unamortized net actuarial loss in respect of the Company's obligations under its registered and non-registered defined benefit pension plans and other post-employment benefit plans was \$4 million, compared to \$10 million at the end of the prior year. (See note 12 to the consolidated financial statements of the Company.)

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

Income and Other Taxes

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

Goodwill and Other Intangible Assets

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

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

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

Prescription files	7 to 12 years
Developed technology	3 years
Customer relationships	5 to 25 years
Other	Indefinite

New Accounting Pronouncements

Accounting Standards Implemented in 2008

Capital Disclosures

In 2006, the Canadian Institute of Chartered Accountants (the “CICA”) issued a new accounting standard concerning Capital Disclosures (“Section 1535”), which requires the disclosure of both quantitative and qualitative information that enables users of financial statements to evaluate the entity’s objectives, policies and processes for managing capital. Section 1535 also requires an entity to disclose if it has complied with any capital requirements and, if it has not complied, the consequences of such non-compliance. The standard is effective for interim and annual financial statements for fiscal years beginning on or after October 1, 2007. The Company applied the new accounting standard at the beginning of its current fiscal year and its implementation did not have an impact on the Company’s results of operations or financial position. The resulting disclosures from implementation are presented in the Company’s annual financial statements.

Financial Instruments

The Company adopted two new accounting standards concerning financial instruments: CICA Handbook Section 3862, “Financial Instruments – Disclosures” (“Section 3862”) and CICA Handbook Section 3863, “Financial Instruments – Presentation” (“Section 3863”). These standards were issued in December 2006 and replaced Section 3861, “Financial Instruments, Disclosure and Presentation”. The new disclosure standard increased the emphasis on the risks associated with financial instruments and how those risks are managed. The new presentation standard carried forward the former presentation requirements under the replaced CICA Handbook Section 3861. The new accounting standards are effective for interim and annual financial statements for fiscal years beginning on or after October 1, 2007. The Company applied the new accounting standards at the beginning of its current fiscal year and their implementation did not have an impact on the Company’s results of operations or financial position. The resulting disclosures from implementation are presented in the Company’s annual financial statements and this Management’s Discussion and Analysis.

Inventories

The CICA issued a new accounting standard concerning Inventories (“Section 3031”), in June 2007, which is based on the International Accounting Standards Board’s International Accounting Standard 2 and replaced CICA Handbook Section 3030, “Inventories”. The new standard provides guidance on the determination of the cost of inventory and the subsequent recognition of inventory as an expense, as well as requiring additional associated disclosures. The new standard also allows for the reversal of any write-downs previously recognized. The new standard is effective for interim and annual financial statements for fiscal years beginning on or after January 1, 2008. The Company applied the new accounting standard retrospectively at the beginning of its current fiscal year, with restatement of prior periods.

The results for the year ended December 29, 2007 reflect an increase in cost of goods sold and other operating expenses and a decrease in operating income of \$3.7 million and a decrease in net earnings of \$3.2 million, resulting in a decrease of \$0.01 in basic and diluted net earnings per share, as a result of adoption of this new standard.

The implementation of the new standard has resulted in a reduction to 2008 and 2007 opening retained earnings of \$21.3 million and \$18.2 million, respectively. The impact on balances as at December 29, 2007 was a decrease in inventory of \$31.9 million, an increase in future income tax asset of \$9.9 million and a decrease in income taxes payable of \$0.7 million.

Going Concern

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

Determining Whether a Contract Is Routinely Denominated as a Single Currency

In January 2008, the Emerging Issues Committee of the CICA (the "EIC") issued EIC-169, "Determining Whether a Contract Is Routinely Denominated as a Single Currency", which provides additional guidance on the interpretation of the term "routinely denominated" in CICA Handbook Section 3855, "Financial Instruments – Recognition and Measurement". The new guidance is effective for interim and annual financial statements issued on or after March 15, 2008. The Company applied the new guidance retrospectively at the beginning of its 2008 fiscal year and its implementation did not have a significant impact on the Company's results of operations, financial position or disclosures.

Future Accounting Standards

Goodwill and Intangible Assets

In February 2008, the CICA issued a new accounting standard concerning Goodwill and Intangible Assets ("Section 3064"), which is based on the International Accounting Standards Board's International Accounting Standard 38, "Intangible Assets". The new section replaces the existing guidance on goodwill and other intangible assets, and research and development costs. The objective of the new standard is to eliminate the practice of deferring costs that do not meet the definition and recognition criteria of assets. The standard is effective for interim and annual financial statements for fiscal years beginning on or after October 1, 2008. The Company will apply the new accounting standard retrospectively at the beginning of its 2009 fiscal year, with restatement of prior periods. Intangible assets recognized prior to the Company's fiscal 2009 year that no longer meet the new recognition or measurement criteria and the definition of an asset will be removed from the consolidated balance sheets in accordance with CICA Handbook Section 1506, "Accounting Changes". The balance of any such deferred costs as at the end of 2008 will be reflected as a charge to opening retained earnings.

The impact for the year ended January 3, 2009 will be an increase in cost of goods sold and operating expenses and a decrease in operating income of approximately \$15 million and a decrease in net earnings of approximately \$11 million, resulting in a decrease of approximately \$0.05 in basic and diluted net earnings per share. The adjustment relates to previously deferred costs that no longer qualify for recognition as an asset, primarily store opening costs.

The implementation of the new standard will result in a reduction to the Company's 2009 and 2008 fiscal years' opening retained earnings of approximately \$39 million and \$28 million, respectively. The impact on balances as at January 3, 2009 will be an increase in future income tax expense of approximately \$18 million, a decrease in prepaid expenses and deposits of approximately \$5 million, a decrease in deferred costs of approximately \$47 million and a decrease in other assets of approximately \$5 million. In addition, certain computer software costs currently included in property and equipment will be reclassified to other intangible assets.

Financial Statement Concepts

In February 2008, the CICA issued amendments to CICA Handbook Section 1000, "Financial Statement Concepts" ("Section 1000"), to clarify the criteria for recognition of an asset and the timing of expense recognition. The new requirements are effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2008. The Company will apply the amendments to Section 1000 at the beginning of its 2009 fiscal year and does not expect the implementation to have a significant impact on the Company's results of operations, financial position and disclosures.

Business Combinations

In January 2009, the CICA issued new accounting standards concerning Business Combinations ("Section 1582"), Non-controlling Interests ("Section 1602") and Consolidated Financial Statements ("Section 1601"), which are based on the International Accounting Standards Board's International Financial Reporting Standard 3, "Business Combinations". The new standards replace the existing guidance on business combinations and consolidated financial statements. The objective of the new standards is to harmonize Canadian accounting for business combinations with the international and U.S. accounting standards. The new standards are to be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011, with earlier application permitted. Assets and liabilities that arose from business combinations whose acquisition dates preceded the application of the new standards shall not be adjusted upon application of these new standards. The non-controlling interests standard should be applied retrospectively except for certain items.

The Company is assessing whether it will apply the new accounting standards at the beginning of its 2011 fiscal year or elect to early adopt the new accounting standards at the beginning of its 2010 fiscal year in order to minimize the amount of restatement when the Company adopts International Financial Reporting Standards ("IFRS"). The impact of the new standards on the Company's results of operations, financial position and disclosures will be assessed as part of the Company's transition to IFRS.

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

The Emerging Issues Committee of the CICA issued a new abstract on January 20, 2009 concerning the measurement of financial assets and financial liabilities (the "Abstract"). There has been diversity in practice as to whether an entity's own credit risk and the credit risk of the counterparty are taken into account in determining the fair value of financial instruments. The EIC reached a consensus that these risks should be taken into account in the measurement of financial assets and financial liabilities. The Abstract is effective for all financial assets and financial liabilities measured at fair value in interim and annual financial statements issued for periods ending on or after the date of issuance of the Abstract, with retrospective application without restatement of prior periods. The Company will be applying the new Abstract at the beginning of its 2009 fiscal year.

The Company is currently assessing the impact of the Abstract on the measurement of its financial assets and financial liabilities; however, the Company does not expect the implementation of the Abstract to have a significant impact on the Company's results of operations, financial position and disclosures.

Transition to International Financial Reporting Standards

In January 2006, the Accounting Standards Board (the "AcSB") announced its decision to require all publicly accountable enterprises to report under International Financial Reporting Standards ("IFRS") for years beginning on or after January 1, 2011. As a result, financial reporting by Canadian publicly accountable enterprises will change significantly from current Canadian generally accepted accounting principles to IFRS.

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

The Company launched its IFRS transition project in 2008 with a high-level assessment of the key areas where conversion to IFRS may have a significant impact or present a significant challenge. To date, the Company has engaged an external advisor and established a working team, completed a high level assessment, substantially completed the identification of differences between the Company's current policies and those under IFRS, delivered an initial training program and prepared an initial transition plan. The initial transition plan has been designed to guide the Company towards its reporting deadlines.

Where differences exist, the Company is assessing the information technology and data system impacts, the resource requirements and timing of transition activities. The options under IFRS 1, First-time Adoption of International Reporting Standards, have been identified and will be further analyzed as the Company progresses through its detailed assessment of the individual standards. The impact on other business activities, disclosure controls and procedures and internal controls over financial reporting will be assessed once the impacts of the standards as a whole are identified.

Risks and Risk Management

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

Industry and Regulatory

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

Federal and provincial laws and regulations that establish the public drug plans regulate prescription drug coverage, patient eligibility, and pharmacy reimbursement and may also regulate manufacturer allowances that may be provided 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. 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 and pharmacy reimbursement may be affected by changes to the health care industry, including legislative or other changes that impact patient eligibility, the allowable cost 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 jurisdictions have implemented legislation directed towards managing pharmacy service costs and controlling increasing drug costs incurred by public drug plans. 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 that are eligible for reimbursement under provincial drug plans, which may impact pharmacy reimbursement levels and manufacturer allowances. In 2008, the following legislative changes or other regulatory initiatives intended to lower drug costs incurred by the public drug plans were implemented in the following jurisdictions:

Ontario – In mid-2008, a competitive bid process was implemented by the government through a call for applications for three multi-source, high-volume prescription drugs. Under the call for applications, both brand and generic manufacturers were provided with the opportunity to compete for preferential formulary listings for their products for reimbursement under Ontario's public drug programs. For drug products subject to a call for applications, in consideration of, among other things, volume discounts to be provided directly from the manufacturer to the government, the number of interchangeable drug products eligible for reimbursement under the Ontario public drug program will be limited to the winning bidder or bidders including the brand product. Any call for applications will not affect the number of interchangeable generic drug products in the private system.

While the initial call for applications by the government was limited to three products (initially four products but one product was removed) and so far only one tender has been awarded, the government has indicated that this may be the first in a series of calls for applications for preferential listing on the formulary for multi-source high volume prescription drugs identified as less expensive in jurisdictions outside of Canada. The volume discounts provided to the government pursuant to the bid process may decrease the amount of professional allowance funding available in the system for public sector sales.

Québec – Pursuant to the listing requirement that a manufacturer provide the Province of Québec with the lowest available price provided to any other province, the price of many prescription drug products in Québec was lowered to match the Ontario public drug program price.

British Columbia – An interim agreement, which is effective from January 1, 2009 until January 1, 2010, was entered into between the Province and the British Columbia Pharmacy Association. Under the interim agreement, pharmacies will be remunerated for clinical services associated with prescriptions, renewals and substitutions and a frequency of dispensing policy will be implemented. As well, until decisions are made on a permanent pricing policy for generic drugs, an interim pricing policy will be implemented pursuant to which reimbursement to pharmacies for new multi-source generic prescription drugs added to the formulary will not exceed 50% of the brand price. As existing multi-source generic drugs are not affected by this interim pricing policy, the policy will not apply to many generic prescription drugs. However, some of the new generic prescription drugs that will be subject to the interim pricing policy may be high-volume drugs.

Under the frequency of dispensing policy, a dispensing fee will only be payable if the pharmacist dispenses the total quantity of drug specified by the prescriber in the prescription or the maximum days' supply allowed by government policy. Dispensing fees will not be paid for dispensing less than 28 days' supply, except in the circumstances outlined in the frequency of dispensing policy and then subject to the maximums described in this policy.

A new long-term agreement between the Province and the British Columbia Pharmacy Association relating to the pricing of generic drug products and a fee schedule for services provided by pharmacies is anticipated by the parties to be agreed to by September 30, 2009.

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 is anticipated to be implemented on July 1, 2009.

Alberta – The government announced a new pharmaceutical strategy and, while the specifics are not yet detailed, the government has indicated that the strategy will include more effective drug purchasing to decrease costs.

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

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

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, in turn, could have a material adverse impact on its business, sales, profitability and financial position. Continued financial market volatility and general uncertainty on the timing of a recovery will 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 more pharmacy students and interns to ensure a source of supply of new graduates in future years. In recent years, the Company has made a number of enhancements to its pharmacist compensation and benefit plans in order to further improve its retention rate of existing pharmacists.

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, in turn, 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.

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 its 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.

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 following discussion provides certain of the required disclosure under CICA Handbook Section 3862, "Financial Instruments – Disclosures" related to the nature and extent of risks arising from financial instruments, as permitted by the standard. Therefore, this section forms an integral part of the consolidated financial statements of the Company for the year ended January 3, 2009.

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 positively or negatively impact the financial performance of the Company.

The Company uses interest rate derivatives to manage this exposure and monitors market conditions and the impact of interest rate fluctuations on its fixed and floating rate debt instruments on an ongoing basis. The Company has interest rate derivative agreements converting an aggregate notional principal amount of \$100 million (2007 – \$250 million) of floating rate debt into fixed rate debt. The fixed rates payable by the Company under these agreements range from 4.11% to 4.18% (2007 – 4.03% to 4.18%). These agreements mature as follows: \$50 million in December 2009 and \$50 million in December 2010, with reset terms of one month.

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 is no unrecognized exposure as at January 3, 2009, as the interest rate derivative agreements are in a liability position. At December 29, 2007, the maximum exposure was equal to the carrying value of the interest rate derivative agreements of \$0.4 million.

As at January 3, 2009, the Company had \$905 million of unhedged floating rate debt. During the 53 weeks ended January 3, 2009, the Company's average outstanding unhedged floating rate debt was \$485 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 \$1.7 million as a result of the Company's exposure to interest rate fluctuations on its unhedged floating rate debt.

Foreign Currency Exchange Risk

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

Credit Risk

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

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"). 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 3, 2009, the Company recognized a liability of \$2.1 million, of which \$1.0 million is presented in accounts payable and accrued liabilities and \$1.1 million is presented in other long-term liabilities. Based on market values of the equity forward agreements in place at December 29, 2007, the Company recognized an asset of \$0.3 million in other assets. During the 53 and 52 week periods ended January 3, 2009 and December 29, 2007, respectively, the Company assessed that the percentage of the equity forward agreements in place related to unearned units under the LTIP was an effective hedge 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, and the acquisition of sites as part of a land bank program, as well as 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 requirements 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 3, 2009 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	\$ 240,844	\$ –	\$ –	\$ –	240,844
Commercial paper	341,000	–	–	–	341,000
Short-term debt	–	200,000	–	–	200,000
Accounts payable	964,059	18,876	–	–	982,935
Medium-term notes	–	–	–	450,000	450,000
Revolving term facility	–	–	–	200,000	200,000
Other long-term liabilities	48,806	–	12,573	11,157	72,536
Total	\$ 1,594,709	\$ 218,876	\$ 12,573	\$ 661,157	\$ 2,487,315

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 3, 2009 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 are 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 control over financial reporting includes 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 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 control over financial reporting as at January 3, 2009 and has concluded that internal control over financial reporting is 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 Organization of the Treadway Commission.

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

Non-GAAP Financial Measures

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

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

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