

SECOND QUARTER REPORT TO SHAREHOLDERS

For the 12 and 24 week periods ended June 20, 2009

Dear Fellow Shareholder:

We are pleased to report our financial results for the second quarter and first half of fiscal 2009, representing the 12 and 24 week periods ended June 20, 2009 respectively.

Second Quarter Results (12 Weeks)

Second quarter sales increased 8.5% to \$2.289 billion, with the Company continuing to experience strong sales growth in all regions of the country. On a same-store basis and excluding tobacco products, sales increased 5.7% during the quarter.

Prescription sales increased 9.8% in the second quarter to \$1.109 billion, accounting for 48.5% of the Company's sales mix compared to 47.9% in the same period last year. On a same-store basis, prescription sales increased 5.6%, driven by strong growth in the number of prescriptions filled, while increased generic utilization continued to have a deflationary impact on sales growth in the category. In the second quarter of 2009, generic molecules represented 52.7% of prescriptions dispensed compared to 50.9% of prescriptions dispensed in the second quarter of 2008.

Front store sales increased 7.4% in the second quarter to \$1.180 billion, with the Company continuing to experience sales gains in all categories except tobacco. On a same-store basis and excluding tobacco products, front store sales increased 5.8%. The Company estimates that the shift in the Easter selling season to the second quarter of this year from the first quarter last year had a positive impact on comparable front store sales growth of approximately 150 basis points.

Second quarter net earnings increased 7.5% to \$136 million or 63 cents per share (diluted) from \$127 million or 58 cents per share (diluted) a year ago. Net earnings growth was driven by strong top line performance, improved purchasing synergies and a continued emphasis on cost reduction, productivity and efficiency, the benefits of which were partially offset by increased amortization and higher expenses at store-level associated with the continued expansion of the store network, along with stepped-up investments in marketing and promotional activities.

First Half Results (24 weeks)

First half sales increased 8.5% to \$4.484 billion, with prescription sales up 10.7% and front store sales up 6.4%. On a same-store basis and excluding tobacco products, first half sales increased 4.8%, with prescription sales up 5.7% and front store sales up 4.0%. During the first half of 2009, prescription sales accounted for 49.0% of the Company's sales mix compared to 48.0% in the same period last year.

First half net earnings increased 6.9% to \$243 million or \$1.12 per share (diluted) from \$227 million or \$1.05 per share (diluted) a year ago.

Store Network Development

During the second quarter, 27 drug stores were opened or acquired, eight of which were relocations, and two smaller drug stores were closed. At quarter-end, there were 1,259 stores in the system, comprised of 1,191 drug stores (1,159 Shoppers Drug Mart/Pharmaprix stores and 32 Shoppers Simply Pharmacy/Pharmaprix Simplement Santé stores), 66 Shoppers Home Health Care stores and two Murale stores. Drug store selling space was approximately 11.3 million square feet at the end of the second quarter, an increase of 11.9% compared to a year ago.

Dividend

The Company also announced on July 22, 2009 that its Board of Directors declared a dividend of 21.5 cents per common share, payable October 15, 2009 to shareholders of record as of the close of business on September 30, 2009.

Board of Directors

The Company also announced that it has increased the size of its Board of Directors from ten to eleven members and that Sarah Raiss has been appointed to the Board effective July 21, 2009 and will serve as a member of the Compensation Committee. Ms. Raiss is currently Executive Vice President, Corporate Services at TransCanada Corporation, where she has been employed since 1999, having progressed through many senior management positions. Ms. Raiss attended the University of Michigan where she graduated with a B. Sc. (1979) and an M.B.A (1987).

We are pleased with our second quarter and first half results. In what remains a difficult and challenging economic environment, these results are a testament to the resiliency of our format, the strength of our brand and the dedication and commitment of our Associate-owners and their teams.

Sincerely,



Jürgen Schreiber
President and Chief Executive Officer

SHOPPERS DRUG MART CORPORATION

2009 SECOND QUARTER REPORT TO SHAREHOLDERS

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SHOPPERS DRUG MART CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS

As at July 14, 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 unaudited consolidated financial statements of the Company and the notes thereto for the 12 and 24 week periods ended June 20, 2009. The Company's unaudited interim period financial statements and the notes thereto have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and are reported in Canadian dollars. These financial statements do not contain all disclosures required by Canadian GAAP for annual financial statements and, accordingly, should be read in conjunction with the most recently prepared annual consolidated financial statements for the 53 week period ended January 3, 2009.

FORWARD-LOOKING INFORMATION AND STATEMENTS

This discussion of the consolidated financial condition and results of operations of the Company contains forward-looking information and statements which constitute "forward-looking information" under Canadian securities law and which may be material regarding, among other things, the Company's beliefs, plans, objectives, strategies, estimates, intentions and expectations. 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 discussion includes, but is not limited to, statements with respect to the Company's future operating and financial results, its capital expenditure plans, the ability to execute on its future operating, investing and financing strategies and the impact on the Company's financial results of the potential changes to the Ontario drug system.

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

The material risk factors that could cause actual results to differ materially from the forward-looking information and statements contained herein include, without limitation: the risk of adverse changes to laws and regulations relating to prescription drugs and their sale, including pharmacy reimbursement programs and the availability of manufacturer allowances, or changes to such laws and regulations that increase compliance costs; the risk 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 including, without limitation, the sections entitled "Risks and Risk Management" and "Risks Associated with Financial Instruments" in the Company's Management's Discussion and Analysis for the 53 week period ended January 3, 2009. The forward-looking information and statements contained in this discussion of the consolidated financial condition and results of operations of the Company represent the Company's views only as of the date hereof. Forward-looking information and statements contained in this Management's Discussion and Analysis about prospective results of operations, financial position or cash flows that are based upon assumptions about future economic conditions and courses of action are presented for the purpose of assisting the Company's shareholders in understanding management's current views regarding those future outcomes and may not be appropriate for other purposes. While the Company anticipates that subsequent events and developments may cause the Company's views to change, the Company does not undertake to update any forward-looking information and statements, except to the extent required by applicable securities laws.

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

OVERVIEW

The Company is the licensor of full-service retail drug stores operating under the name Shoppers Drug Mart[®] (Pharmaprix[®] in Québec). As at June 20, 2009, there were 1,159 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 32 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, health and beauty aids, cosmetics and fragrances (including prestige brands), everyday household needs and seasonal products. The Company also offers a broad range of high-quality private label products marketed under the trademarks Life Brand[®], Quo[®], Everyday Market[®], Bio-Life[®], Nativa[®] and Easypix[®], among others, and value-added services such as the HealthWatch[®] program, which offers patient counselling and advice on medications, 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 primarily 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 Pharmacy[™] stores and Associates.

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

OVERALL FINANCIAL PERFORMANCE

Key Operating, Investing and Financial Metrics

The following provides an overview of the Company's operating performance for the 12 and 24 week periods ended June 20, 2009 compared to the 12 and 24 week periods ended June 14, 2008, as well as certain other metrics with respect to investing activities for the 12 and 24 week periods ended June 20, 2009 and financial position as at that same date.

- Second quarter sales of \$2.289 billion, an increase of 8.5%.
 - First half sales of \$4.484 billion, an increase of 8.5%.
- Second quarter comparable store sales growth, excluding tobacco products, of 5.7%, comprised of comparable prescription sales growth of 5.6% and comparable front store sales growth, excluding tobacco products of 5.8%.
 - First half comparable store sales growth, excluding tobacco products, of 4.8%, comprised of comparable prescription sales growth of 5.7% and comparable front store sales growth, excluding tobacco products, of 4.0%.
- Second quarter EBITDA⁽¹⁾ of \$266 million, an increase of 8.6%.
 - First half EBITDA of \$489 million, an increase of 8.8%.
- Second quarter EBITDA margin⁽²⁾ of 11.61%, an increase of 1 basis point.
 - First half EBITDA margin of 10.92%, an increase of 4 basis points.
- Second quarter net earnings of \$136 million or \$0.63 per share (diluted), an increase of 7.5%.
 - First half net earnings of \$243 million or \$1.12 per share (diluted), an increase of 6.9%.
- Second quarter capital expenditure program of \$129 million compared to \$97 million in the prior year. Opened or acquired 27 new drug stores, eight of which were relocations.
 - First half capital expenditure program of \$240 million compared to \$244 million in the prior year. Opened or acquired 67 new drug stores, 22 of which were relocations.
 - Year-over-year increase in drug store selling space of 11.9%.
- Maintained desired capital structure and financial position.
 - Net debt to total capitalization ratio of 0.29:1 at June 20, 2009 compared to 0.27:1 a year ago.

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

⁽²⁾ EBITDA divided by sales.

Results of Operations

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

(\$000s, except per share data)	12 Weeks Ended		24 Weeks Ended	
	June 20, 2009	June 14, 2008	June 20, 2009	June 14, 2008
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Sales	\$ 2,288,789	\$ 2,109,308	\$ 4,484,049	\$ 4,133,107
Cost of goods sold and other operating expenses ⁽¹⁾	2,023,150	1,864,620	3,994,572	3,683,287
EBITDA ⁽²⁾	265,639	244,688	489,477	449,820
Amortization	56,279	46,324	111,882	91,095
Operating income	209,360	198,364	377,595	358,725
Interest expense	13,881	14,152	28,387	27,912
Earnings before income taxes	195,479	184,212	349,208	330,813
Income taxes	59,367	57,619	106,254	103,480
Net earnings	\$ 136,112	\$ 126,593	\$ 242,954	\$ 227,333
Per common share				
- Basic net earnings	\$ 0.63	\$ 0.58	\$ 1.12	\$ 1.05
- Diluted net earnings	\$ 0.63	\$ 0.58	\$ 1.12	\$ 1.05

⁽¹⁾ Reflects the impact of the retrospective application of the new accounting standard concerning Goodwill and Other Intangible Assets – CICA Handbook Section 3064. (See discussion on “Accounting Standards Implemented in 2009” under “New Accounting Pronouncements” in this Management’s Discussion and Analysis and in note 2 to the accompanying unaudited consolidated financial statements of the Company.)

⁽²⁾ 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 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 the second quarter were \$2.289 billion compared to \$2.109 billion in the same period last year, an increase of \$180 million or 8.5%, with the Company continuing to experience strong sales growth in all regions of the country. The Company's capital investment program, which resulted in an 11.9% increase in selling square footage compared to a year ago, continues to have a positive impact on sales growth. On a same-store basis and excluding tobacco products, sales increased 5.7% during the second quarter of 2009. Year-to-date, sales increased 8.5% to \$4.484 billion. On a same-store basis and excluding tobacco products, sales increased 4.8% during the first half of 2009.

Prescription sales were \$1.109 billion in the second quarter compared to \$1.010 billion in the second quarter of 2008, an increase of \$99 million or 9.8%. During the second quarter of 2009, prescription sales accounted for 48.5% of the Company's sales mix compared to 47.9% in the same period last year. On a same-store basis, prescription sales increased 5.6% during the second quarter of 2009, driven by strong growth in the number of prescriptions filled, while increased generic utilization continued to have a deflationary impact on sales growth in the category. In the second quarter of 2009, generic molecules represented 52.7% of prescriptions dispensed compared to 50.9% of prescriptions dispensed in the second quarter of 2008. Year-to-date, prescription sales increased 10.7% to \$2.195 billion and accounted for 49.0% of the Company's sales mix. On a same-store basis, prescription sales increased 5.7% during the first half of 2009.

Front store sales were \$1.180 billion in the second quarter compared to \$1.099 billion in the second quarter of 2008, an increase of \$81 million or 7.4%, with the Company continuing to experience sales gains in all categories except tobacco. On a same-store basis and excluding tobacco products, front store sales increased 5.8% during the second quarter of 2009. The Company estimates that the shift in the Easter selling season to the second quarter of this year from the first quarter last year had a positive impact on comparable front store sales growth of approximately 150 basis points. Year-to-date, front store sales increased 6.4% to \$2.289 billion. On a same-store basis and excluding tobacco products, front store sales increased 4.0% during the first half of 2009.

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 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 the Murale™ stores 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 \$2.023 billion in the second quarter compared to \$1.865 billion in the same period last year, an increase of \$158 million or 8.5%. Expressed as a percentage of sales, cost of goods sold declined by 66 basis points in the second quarter of 2009 versus the comparative prior year period, reflecting an enhanced sales mix and the benefits from improved buying synergies. Offsetting this improvement were higher operating expenses which, when expressed as a percentage of sales, increased by 65 basis points over the prior year period. Operating expenses were higher due in large part to increased store-level expenses, primarily occupancy, wages and benefits associated with the continued growth and expansion of the store network.

Year-to-date, total cost of goods sold and other operating expenses increased by 8.5% to \$3.995 billion. Expressed as a percentage of sales, cost of goods sold declined by 62 basis points in the first half of 2009 versus the comparative prior year period, while other operating expenses increased by 58 basis points.

Amortization

Amortization of capital assets and other intangible assets was \$56 million in the second quarter compared to \$46 million in the same period last year, an increase of \$10 million or 21.5%. Expressed as a percentage of sales, amortization increased 26 basis points in the second quarter of 2009 versus the comparative prior year period, reflecting the continued growth of the Company's capital investment and store development program.

Year-to-date, amortization of capital assets and other intangible assets increased 22.8% to \$111.9 million. Expressed as a percentage of sales, amortization increased 30 basis points in the first half of 2009 versus the comparative prior year period.

Operating Income

Operating income was \$209 million in the second quarter of 2009 compared to \$198 million in the same period last year, an increase of \$11 million or 5.5%. This increase was driven by strong top line growth, improved purchasing synergies and a continued emphasis on cost reduction, productivity and efficiency, the benefits of which were partially offset by increased amortization and higher expenses at store-level associated with the continued expansion of the store network, along with stepped-up investments in marketing and promotional activities. In 2009, second quarter operating margin (operating income divided by sales) declined by 25 basis points to 9.15% compared to 9.40% in the second quarter of last year. The Company's EBITDA margin (EBITDA divided by sales) was 11.61% in the second quarter of 2009, a one basis point improvement over the EBITDA margin of 11.60% posted in the second quarter of last year.

Year-to-date, operating income increased 5.3% to \$378 million and operating margin declined by 26 basis points to 8.42%. During the first half of 2009, EBITDA margin was 10.92%, a four basis point improvement over the EBITDA margin of 10.88% posted during the first half of 2008.

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 \$14 million in the second quarter of 2009 and \$28 million year-to-date, essentially unchanged from the amounts recorded in the same periods last year. Growth in the amount of consolidated net debt outstanding and the Company's decision to extend the term on a portion of its floating rate, short-term debt obligations, along with higher amortization of deferred financing costs related to the Company's financing activities in 2008 and the first quarter of 2009, were offset by a market-driven decrease in short-term interest rates on the Company's remaining floating rate debt obligations. (See note 5 to the accompanying unaudited consolidated financial statements of the Company.)

Income Taxes

The Company's effective income tax rate in the second quarter and first half of 2009 was 30.4% compared to 31.3% in the same periods last year. This decrease in the effective income tax rate can be attributed to a reduction in statutory rates.

Net Earnings

Second quarter net earnings were \$136 million compared to \$127 million in the same period last year, an increase of \$9 million or 7.5%. On a diluted basis, earnings per share were \$0.63 in the second quarter of 2009 compared to \$0.58 in the same period last year.

Year-to-date, net earnings increased 6.9% to \$243 million. On a diluted basis, earnings per share were \$1.12 in the first half of 2009 compared to \$1.05 in the same period last year.

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)	June 20, 2009	January 3, 2009
Cash	\$ (26,059)	\$ (36,567)
Bank indebtedness	277,617	240,844
Commercial paper	240,148	339,943
Short-term debt	-	197,845
Long-term debt	943,809	647,250
Net debt	1,435,515	1,389,315
Shareholders' equity ⁽¹⁾	3,575,032	3,420,529
Total capitalization	<u>\$ 5,010,547</u>	<u>\$ 4,809,844</u>
Net debt:Shareholders' equity	0.40:1	0.41:1
Net debt:Total capitalization	0.29:1	0.29:1
Net debt:EBITDA ⁽²⁾	1.29:1	1.30:1
EBITDA:Cash interest expense ⁽²⁾⁽³⁾	17.86:1	17.21:1

⁽¹⁾ Reflects the impact of the retrospective application of the new accounting standard concerning Goodwill and Other Intangible Assets – CICA Handbook Section 3064. (See discussion on "Accounting Standards Implemented in 2009" under "New Accounting Pronouncements" in this Management's Discussion and Analysis and in note 2 to the accompanying unaudited consolidated financial statements of the Company.)

⁽²⁾ For purposes of calculating the ratios, EBITDA is comprised of EBITDA for each of the 53 week periods then ended and reflects the impact of the new accounting standard concerning Goodwill and Other Intangible Assets – CICA Handbook Section 3064.

⁽³⁾ Cash interest expense is comprised of interest expense for each of the 53 week periods then ended and excludes the amortization of deferred financing costs.

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 217,393,945 common shares outstanding at July 14, 2009. As at this same date, the Company had issued options to acquire 928,015 of its common shares pursuant to its stock-based compensation plans, of which 705,142 were exercisable.

Financing Activities

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 a final short form base shelf prospectus dated May 22, 2008 (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 Limited 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 then existing senior unsecured 364-day bank credit facility. 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 8 to the accompanying unaudited consolidated financial statements of the Company.)

Subsequent to the end of the second quarter, on June 22, 2009, the Company filed with the securities regulators in all of the provinces of Canada, an amendment (the “Amendment”) to the Prospectus (as amended, the “Amended Prospectus”) increasing the aggregate principal amount of medium-term notes that can be issued from time to time pursuant to the Amended Prospectus to \$1.5 billion from \$1.0 billion. To date, the Company has issued an aggregate principal amount of \$950 million of medium-term notes pursuant to the Prospectus. No incremental debt was incurred by the Company as a result of filing the Amendment.

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 Limited. In the event that the Company’s commercial paper program is unable to maintain this rating, the program is supported by the Company’s \$800 million revolving bank credit facility. The Company does not currently foresee any reasonable circumstances under which this credit rating would not be maintained.

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 \$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 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 Limited and BBB+ from Standard & Poor’s.

At the end of the second quarter of 2009, \$8 million of the Company's \$800 million revolving bank credit facility was utilized, all in respect of outstanding letters of credit. At January 3, 2009, \$209 million of this facility was utilized, including \$9 million in respect of outstanding letters of credit. At June 20, 2009, the Company had \$241 million of commercial paper issued and outstanding under its commercial paper program compared to \$341 million at the end of 2008. At the end of the second quarter of 2009, Associates had drawn an aggregate amount of \$293 million in the form of Associate loans from various Canadian chartered banks compared to \$264 million at the end of the 2008. (See discussion on "Associate Loans Guarantees" under "Off-balance Sheet Arrangements" in this Management's Discussion and Analysis.)

Cash Flows from Operating Activities

Cash flows from operating activities were \$210 million in the second quarter of 2009 compared to \$160 million in the same period last year. This increase can be largely attributed to growth in net earnings adjusted for non-cash items, principally amortization, combined with a reduction in the amount invested in non-cash working balances versus an increased investment in the comparative quarter.

Year-to-date, the Company has generated \$282 million of cash from operating activities compared to \$153 million in the first half of 2008.

Cash Flows Used in Investing Activities

Cash flows used in investing activities were \$122 million in the second quarter of 2009 compared to \$99 million in the same period last year. Of these totals, investments in property and equipment, net of proceeds from any dispositions, amounted to \$77 million in the second quarter of this year compared to \$78 million in the same period last year, as the Company continues to invest in the expansion and optimization of its store network. The Company also invested \$33 million in business acquisitions and a combined \$10 million in the purchase and development of intangible and other assets during the second quarter of 2009 compared to \$10 and \$6 million, respectively, in the same period last year. Consistent with the Company's stated growth objectives, these investments relate primarily to acquisitions of drug stores and prescription files, as the Company continues to pursue attractive opportunities in the marketplace. During the second quarter of 2009, the balance of funds deposited and held in escrow in respect of outstanding offers to purchase drug stores and land increased by \$2 million compared to an increase of \$5 million in the same period last year.

Year-to-date, cash flows used in investing activities were \$227 million compared to \$201 million in the first half of 2008. Of these totals, investments in property and equipment, net of proceeds from any dispositions, amounted to \$153 million in the first half of 2009 compared to \$135 million in the same period last year. Investments in business acquisitions and in the purchase and development of intangible and other assets were \$60 million and \$12 million, respectively, in the first half of 2009 compared to \$87 million and \$17 million, respectively, in the same period last year. During the first half of 2009, the balance of funds deposited and held in escrow in respect of outstanding offers to purchase drug stores and land increased by \$1 million compared to a decrease of \$39 million in the same period last year.

During the second quarter of 2009, 27 new drug stores were opened or acquired, eight of which were relocations, and two smaller drug stores were closed. Year-to-date, 67 new drug stores have been opened or acquired, 22 of which were relocations, and three smaller drug stores were closed. As a result of this activity, drug store selling space increased by 11.9% compared to a year ago. At the end of the second quarter of 2009, there were 1,259 stores in the Company's retail network, comprised of 1,191 drug stores (1,159 Shoppers Drug Mart/Pharmaprix stores and 32 Shoppers Simply Pharmacy/Pharmaprix Simplement Santé stores), 66 Shoppers Home Health Care® stores and two Murale™ stores.

Cash Flows Used in Financing Activities

Cash flows used in financing activities were \$89 million in the second quarter of 2009, as cash inflows of \$14 million were more than offset by cash outflows of \$103 million. Cash inflows were comprised of a \$13 million increase in the amount of bank indebtedness and \$1 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 \$53 million decrease in the amount of commercial paper issued and outstanding by the Company under its commercial paper program, a \$3 million reduction in the amount of Associate investment and \$47 million for the payment of dividends.

In the second quarter of 2009, the net result of the Company's operating, investing and financing activities was a decrease in cash balances of less than \$1 million.

Year-to-date, cash flows used in financing activities was \$66 million and the net result of the Company's operating, investing and financing activities was a decrease in cash of \$11 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.

NEW ACCOUNTING PRONOUNCEMENTS

Accounting Standards Implemented in 2009

Financial Statement Concepts

In February 2008, the Canadian Institute of Chartered Accountants (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; specifically deleting the guidance permitting the deferral of costs. The new requirements are effective for interim and annual financial statements relating to fiscal years beginning on or after October 1, 2008. The Company applied the amendments to Section 1000 at the beginning of its current fiscal year in conjunction with CICA Handbook Section 3064, “Goodwill and Intangible Assets”.

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 (the “IASB”) International Accounting Standard 38, “Intangible Assets”. The new section replaced the existing guidance on goodwill and other intangible assets and research and development costs. The objective of 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 applied the new accounting standard retrospectively at the beginning of its current fiscal year, with restatement of prior periods. Intangible assets recognized prior to the Company’s current fiscal year that no longer meet the new recognition or measurement criteria and the definition of an asset were removed from the consolidated balance sheets in accordance with CICA Handbook Section 1506, “Accounting Changes”. The balance of such deferred costs as at the end of the Company’s 2007 and 2008 fiscal years was reflected as a charge to opening retained earnings.

The implementation of the new standard has resulted in a reduction to the Company’s 2009 and 2008 fiscal years’ opening retained earnings of \$38.9 million and \$27.8 million, respectively. The impacts on other balances are described in the following paragraphs.

The impact for the year ended January 3, 2009 is an increase in cost of goods sold and other operating expenses and a decrease in operating income of \$15.3 million and a decrease in net earnings of \$11.1 million, resulting in a decrease of \$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 impact for the 12 and 24 week periods ended June 14, 2008 is an increase in cost of goods sold and other operating expenses and a decrease in operating income of \$2.4 million and \$3.2 million, respectively, and a decrease in net earnings of \$1.7 million and \$2.3 million, respectively, resulting in a decrease in basic and diluted earnings per share of \$0.01 and \$0.02, respectively. The adjustment relates to previously deferred costs that no longer qualify for recognition as an asset, primarily store opening costs.

The impact on balances as at January 3, 2009 was primarily an increase in net future income tax assets of \$17.7 million, a decrease in prepaid expenses and deposits of \$4.7 million, a decrease in property and equipment of \$110.8 million, a decrease in deferred costs of \$47.2 million, an increase in intangible assets of \$114.5 million and a decrease in other assets of \$8.3 million. The increase in intangible assets and decrease in property and equipment primarily reflects the reclassification of certain computer software costs previously included in property and equipment.

The impact on balances as at June 14, 2008 was primarily an increase in net future income tax assets of \$14.3 million, a decrease in prepaid expenses and deposits of \$3.4 million, a decrease in property and equipment of \$84.8 million, a decrease in deferred costs of \$36.2 million, an increase in intangible assets of \$86.9 million and a decrease in other assets of \$6.9 million. The increase in intangible assets and decrease in property and equipment primarily reflects the reclassification of certain computer software costs previously included in property and equipment.

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

Intangible assets are amortized on a straight-line basis over the estimated useful lives of the assets. Intangible assets are tested for impairment at least on an annual basis. In the event of impairment, the excess of the carrying amount over the fair value of intangible assets would be charged to earnings.

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

The Emerging Issues Committee of the CICA (the “EIC”) issued a new abstract on January 20, 2009 concerning the measurement of financial assets and financial liabilities (“EIC-173 – Credit Risk and the Fair Value of Financial Assets and Financial Liabilities”) (the “Abstract”). There had been diversity in practice as to whether an entity’s own credit risk and the credit risk of the counterparty were 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 applied the new Abstract at the beginning of its current fiscal year. The implementation did not have a significant impact on the Company’s results of operations, financial position and disclosures.

Financial Instruments – Disclosures

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

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

Future Accounting Standards

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 IASB’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. Section 1602 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 IFRS transition project.

Financial Instruments – Recognition and Measurement

On April 29, 2009, the CICA amended CICA Handbook Section 3855, “Financial Instruments – Recognition and Measurement”, adding and amending paragraphs regarding the application of the effective interest method to previously impaired financial asset and embedded prepayment options. The amendments are effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011, with early adoption permitted. The amendments are not expected to have a significant impact on the Company’s accounting for its financial instruments.

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. The Company has engaged an external advisor, established a working team and developed documentation and status reporting protocols. The Company has delivered its initial training program and is ensuring that the working team has an in-depth understanding of relevant IFRS as well as new developments in IFRS.

The Company’s working team is completing a detailed assessment of IFRS focused on the identification of differences between the Company’s current policies and those under IFRS. In this regard, a topic specific issues list is being developed, identifying the activities required for resolution and timelines for completion including potential impacts on taxation, information technology and data systems. In conjunction with this analysis, the Company is scoping the associated disclosure requirements.

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 control over financial reporting will be assessed once the impacts of the standards as a whole are identified.

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 the second quarter of 2009, the Company's maximum obligation in respect of such guarantees was \$505 million compared to \$425 million at the end of the first quarter and prior year. At June 20, 2009, an aggregate amount of \$415 million in available lines of credit had been allocated to the Associates by the various banks compared to \$407 million at the end of the first quarter and \$398 million at the end of the prior year. As at June 20, 2009, Associates had drawn an aggregate amount of \$293 million against these available lines of credit compared to \$278 million at the end of the first quarter and \$264 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 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.

	Second Quarter		First Quarter		Fourth Quarter		Third Quarter	
	2009 (12 Weeks)	2008 (12 Weeks)	2009 (12 Weeks)	2008 (12 Weeks)	2008 (13 Weeks)	2007 ⁽¹⁾ (12 Weeks)	2008 (16 Weeks)	2007 ⁽¹⁾ (16 Weeks)
Sales	\$ 2,288,789	\$ 2,109,308	\$ 2,195,260	\$ 2,023,799	\$ 2,496,799	\$ 2,168,822	\$ 2,793,005	\$ 2,542,671
Net earnings	\$ 136,112	\$ 126,593	\$ 106,842	\$ 100,740	\$ 166,537	\$ 151,331	\$ 160,276	\$ 141,672
Per common share								
- Basic net earnings	\$ 0.63	\$ 0.58	\$ 0.49	\$ 0.46	\$ 0.77	\$ 0.70	\$ 0.74	\$ 0.65
- Diluted net earnings	\$ 0.63	\$ 0.58	\$ 0.49	\$ 0.46	\$ 0.77	\$ 0.70	\$ 0.74	\$ 0.65

⁽¹⁾ Does not reflect the impact of the retrospective application of the new accounting standard concerning Goodwill and Other Intangible Assets – CICA Handbook Section 3064. (See discussion on “Accounting Standards Implemented in 2009” under “New Accounting Pronouncements” in this Management's Discussion and Analysis and in note 2 to the accompanying unaudited consolidated financial statements of the Company.)

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 quarterly results, particularly when the 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.

RISKS AND RISK MANAGEMENT

Industry and Regulatory Developments

The Company is reliant on prescription drug sales for a significant and growing portion of its sales and profits. Information regarding industry and regulatory risk factors is included in the section entitled "Risks and Risk Management" in the Company's Management's Discussion and Analysis for the 53 week period ended January 3, 2009.

On July 10, 2009, the Ontario Ministry of Health and Long-Term Care (the "Ministry") announced at a "Drug System Renewal Forum" that it will be introducing reforms to the Ontario drug system intended to implement substantive changes across the supply chain for prescription drug products and pharmacy services. The stated objective of these reforms is to ensure that Ontario receives value for money in all aspects of the provincial drug plan while maintaining or improving patient care. The Ministry indicated that it will be considering a range of options to improve the value for money equation, including reducing professional allowance funding, expanding the scope of pharmacy services and reimbursing pharmacy appropriately for the services provided, promoting alternative drug distribution channels and pricing mechanisms to decrease the costs of prescription drugs, any of which may have an adverse impact on the Company's business, sales and profitability. As part of the reforms, the Ministry stated that it will also be considering applying some of the options for reform to the private sector. The Ministry indicated that it would be unlikely that any of the options for reform will be implemented in isolation but that the integration of multiple options would be part of the solution. The Ministry intends to make decisions on the options after a series of consultations and discussions with industry participants and other parties which are scheduled for late July and early August of 2009. The Ministry stated that, with respect to those options that are ultimately determined to be part of the reforms implemented by the Ministry, the introduction of certain of the reforms could begin as early as the fall or winter of 2009 if such reform could be accommodated under the existing legislative regime. If any reforms require legislative changes to the Ontario Drug Benefit Act and the Drug Interchangeability and Dispensing Fee Act for implementation, the Ministry anticipates that to accommodate the legislative process required for such change, such reforms would not be implemented before the spring of 2010.

RISKS ASSOCIATED WITH FINANCIAL INSTRUMENTS

The Company is exposed to a number of risks associated with financial instruments that have the potential to affect its operating and financial performance. The Company's primary financial instrument risk exposures are interest rate risk and liquidity risk. The Company's exposures to foreign currency risk, credit risk and other price risk are not considered to be material. The Company may use derivative financial instruments to manage certain of these risks. The Company 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 (2008 - \$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% (2008 - 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 fulfil 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 June 20, 2009, as the interest rate derivative agreements are in a liability position, unchanged from a year ago.

As at June 20, 2009, the Company had \$434 million (2008 - \$262 million) of unhedged floating rate debt. During the 12 and 24 week periods ended June 20, 2009, the Company's average outstanding unhedged floating rate debt was \$581 million and \$626 million (2008 - \$716 million and \$733 million), respectively. Had interest rates been higher or lower by 50 basis points during the 12 and 24 week periods ended June 20, 2009, net earnings would have decreased or increased, respectively, by approximately \$0.5 million and \$1.0 million (2008 - \$0.6 million and \$1.2 million), respectively, 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 June 20, 2009, the Company recognized a net liability of \$0.7 million, of which \$0.9 million is presented in other assets, \$0.8 million is presented in accounts payable and accrued liabilities and \$0.8 million is presented in other long-term liabilities. Based on market values of the equity forward agreements in place at June 14, 2008, the Company recognized an asset of \$1.6 million, of which \$0.6 million was presented in accounts receivable and \$1.0 million was presented in other assets. During the 12 and 24 week periods ended June 20, 2009 and June 14, 2008, the Company assessed that the percentage of the equity forward agreements in place related to unearned units under the LTIP were 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 and liquidity are to profitably grow its business while maintaining adequate financing flexibility to fund attractive new investment opportunities and other unanticipated requirements or opportunities that may arise. Profitable growth is defined as earnings growth commensurate with the additional capital being invested in the business in order that the Company earns an attractive rate of return on that capital. The primary investments undertaken by the Company to drive profitable growth include additions to the selling square footage of its store network via the construction of new, relocated and expanded stores, including related leasehold improvements and fixtures, the acquisition of sites as part of a land bank program, as well as through the acquisition of independent drug stores or their prescription files. In addition, the Company makes capital investments in information technology and its distribution capabilities to support an expanding store network. The Company also provides working capital to its Associates via loans and/or loan guarantees. The Company largely relies on its cash flow from operations to fund its capital investment program and dividend distributions to its shareholders. This cash flow is supplemented, when necessary, through the borrowing of additional debt. No changes were made to these objectives during the period.

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

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

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

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

INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Chief Executive Officer and the Chief Financial Officer have designed, or caused to be designed under their supervision, internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting, its compliance with Canadian GAAP and the preparation of financial statements for external purposes. Internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be designed effectively can provide only reasonable assurance with respect to financial reporting and financial statement preparation.

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

NON-GAAP FINANCIAL MEASURES

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

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

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

SHOPPERS DRUG MART CORPORATION

Consolidated Statements of Earnings

(unaudited)

(in thousands of dollars except per share amounts)

	12 Weeks Ended		24 Weeks Ended	
	June 20, 2009	June 14, 2008	June 20, 2009	June 14, 2008
Sales	\$ 2,288,789	\$ 2,109,308	\$ 4,484,049	\$ 4,133,107
Operating expenses				
Cost of goods sold and other operating expenses (Notes 2 and 3)	2,023,150	1,864,620	3,994,572	3,683,287
Amortization	56,279	46,324	111,882	91,095
Operating income	209,360	198,364	377,595	358,725
Interest expense (Note 5)	13,881	14,152	28,387	27,912
Earnings before income taxes	195,479	184,212	349,208	330,813
Income taxes (Note 2)				
Current	57,495	56,025	104,219	104,688
Future	1,872	1,594	2,035	(1,208)
	59,367	57,619	106,254	103,480
Net earnings	\$ 136,112	\$ 126,593	\$ 242,954	\$ 227,333

Net earnings per common share:

Basic	\$ 0.63	\$ 0.58	\$ 1.12	\$ 1.05
Diluted	\$ 0.63	\$ 0.58	\$ 1.12	\$ 1.05
Weighted average common shares outstanding				
- Basic (millions)	217.4	216.9	217.3	216.8
- Diluted (millions)	217.5	217.5	217.5	217.4
Actual common shares outstanding (millions)	217.4	217.1	217.4	217.1

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

	24 Weeks Ended	
	June 20, 2009	June 14, 2008
Retained earnings, beginning of period as reported	\$ 1,938,023	\$ 1,559,551
Impact of the adoption of new accounting standard, Handbook Section 3064, Goodwill and Intangible Assets (Note 2)	(38,884)	(27,817)
Retained earnings, beginning of period as restated	1,899,139	1,531,734
Net earnings	242,954	227,333
Dividends	(93,465)	(93,293)
Retained earnings, end of period	\$ 2,048,628	\$ 1,665,774

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

	12 Weeks Ended		24 Weeks Ended	
	June 20, 2009	June 14, 2008	June 20, 2009	June 14, 2008
Net earnings	\$ 136,112	\$ 126,593	\$ 242,954	\$ 227,333
Other comprehensive income (loss), net of tax				
Change in unrealized gain/loss on interest rate derivatives (net of tax of \$355 and \$476 (2008 - \$585 and \$596))	516	1,186	773	(1,211)
Change in unrealized gain/loss on equity forward derivatives (net of tax of \$190 and \$192 (2008 - \$371 and \$222))	447	755	456	451
Amount of previously unrealized gain/loss recognized in earnings during the period (net of tax of \$48 and \$71 (2008 - \$5 and \$5))	76	(11)	167	(11)
Other comprehensive income (loss)	1,039	1,930	1,396	(771)
Comprehensive income	\$ 137,151	\$ 128,523	\$ 244,350	\$ 226,562
Accumulated other comprehensive (loss) income, beginning of period			\$ (3,442)	\$ 247
Other comprehensive income (loss)			1,396	(771)
Accumulated other comprehensive loss, end of period			\$ (2,046)	\$ (524)

SHOPPERS DRUG MART CORPORATION
Consolidated Balance Sheets
(unaudited)
(in thousands of dollars)

	June 20, 2009	June 14, 2008	January 3, 2009
Assets			
Current			
Cash	\$ 26,059	\$ 80,452	\$ 36,567
Accounts receivable	431,678	353,643	448,476
Inventory (Note 3)	1,712,574	1,537,524	1,743,253
Income taxes recoverable	37,490	-	8,835
Future income taxes (Note 2)	81,129	73,843	84,770
Prepaid expenses and deposits (Note 2)	69,101	100,448	59,327
	2,358,031	2,145,910	2,381,228
Property and equipment (Note 2)	1,396,183	1,109,930	1,331,363
Goodwill (Note 2)	2,458,884	2,316,415	2,427,239
Intangible assets (Note 2)	238,879	158,773	212,279
Other assets (Note 2)	15,160	12,029	12,114
Total assets	\$ 6,467,137	\$ 5,743,057	\$ 6,364,223
Liabilities			
Current			
Bank indebtedness (Note 6)	\$ 277,617	\$ 260,441	\$ 240,844
Commercial paper	240,148	248,696	339,943
Short-term debt (Note 8)	-	-	197,845
Accounts payable and accrued liabilities	907,971	857,148	1,018,505
Income taxes payable	-	1,885	-
Dividends payable	46,738	46,667	46,709
Current portion of long-term debt	-	299,899	-
	1,472,474	1,714,736	1,843,846
Long-term debt (Note 8)	943,809	446,845	647,250
Other long-term liabilities	332,589	269,433	303,117
Future income taxes	34,645	22,832	30,803
	2,783,517	2,453,846	2,825,016
Associate interest	108,588	102,885	118,678
Shareholders' equity			
Share capital	1,517,992	1,510,809	1,514,207
Contributed surplus	10,458	10,267	10,625
Accumulated other comprehensive loss	(2,046)	(524)	(3,442)
Retained earnings (Note 2)	2,048,628	1,665,774	1,899,139
	2,046,582	1,665,250	1,895,697
	3,575,032	3,186,326	3,420,529
Total liabilities and shareholders' equity	\$ 6,467,137	\$ 5,743,057	\$ 6,364,223

SHOPPERS DRUG MART CORPORATION
Consolidated Statements of Cash Flows
(unaudited)
(in thousands of dollars)

	12 Weeks Ended		24 Weeks Ended	
	June 20, 2009	June 14, 2008	June 20, 2009	June 14, 2008
Operating activities				
Net earnings (Note 2)	\$ 136,112	\$ 126,593	\$ 242,954	\$ 227,333
Items not affecting cash				
Amortization (Note 2)	56,259	45,508	110,476	89,588
Future income taxes (Note 2)	1,872	1,594	2,035	(1,208)
Loss on disposal of property and equipment	548	1,123	2,413	1,980
Stock-based compensation	200	454	380	796
	194,991	175,272	358,258	318,489
Net change in non-cash working capital				
Balances (Note 2)	4,121	(24,893)	(97,409)	(182,286)
Increase in other long-term liabilities	11,324	9,659	20,947	17,284
Cash flows from operating activities	210,436	160,038	281,796	153,487
Investing activities				
Purchase of property and equipment (Note 2)	(88,886)	(79,952)	(170,093)	(143,359)
Proceeds from disposition of property and equipment	11,833	2,432	17,037	8,172
Business acquisitions (Note 4)	(33,152)	(9,920)	(60,432)	(87,462)
Deposits	(1,786)	(4,908)	(1,231)	39,079
Purchase and development of intangible assets (Note 2)	(7,379)	(6,706)	(9,805)	(13,117)
Other assets (Note 2)	(2,418)	518	(2,176)	(4,198)
Cash flows used in investing activities	(121,788)	(98,536)	(226,700)	(200,885)
Financing activities				
Bank indebtedness, net (Note 6)	12,559	69,359	36,773	35,289
Commercial paper, net	(53,000)	(487,149)	(100,000)	(294,349)
Repayment of short-term debt (Note 8)	-	-	(200,000)	-
Issuance of Series 2 notes	-	450,000	-	450,000
Issuance of Series 3 notes (Note 8)	-	-	250,000	-
Issuance of Series 4 notes (Note 8)	-	-	250,000	-
Revolving term debt, net	-	-	(200,000)	-
Financing costs incurred	-	(3,500)	(2,088)	(3,500)
Associate interest	(2,793)	(2,228)	(10,090)	(10,234)
Proceeds from shares issued for stock options exercised	1,165	3,267	3,110	4,155
Repayment of share purchase loans	18	43	128	213
Dividends paid	(46,728)	(46,626)	(93,437)	(81,312)
Cash flows (used in) from financing activities	(88,779)	(16,834)	(65,604)	100,262
(Decrease) increase in cash	(131)	44,668	(10,508)	52,864
Cash, beginning of period	26,190	35,784	36,567	27,588
Cash, end of period	\$ 26,059	\$ 80,452	\$ 26,059	\$ 80,452
Supplemental cash flow information				
Interest paid	\$ 13,601	\$ 18,894	\$ 18,481	\$ 29,264
Income taxes paid	\$ 85,818	\$ 92,900	\$ 134,094	\$ 167,335

SHOPPERS DRUG MART CORPORATION

Notes to the Consolidated Financial Statements

(unaudited)

(in thousands of dollars except per share amounts)

1. BASIS OF PRESENTATION

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

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

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

2. CHANGES IN ACCOUNTING POLICIES

Adoption of New Accounting Standards

Financial Statement Concepts

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

SHOPPERS DRUG MART CORPORATION

Notes to the Consolidated Financial Statements

(unaudited)

(in thousands of dollars except per share amounts)

2. CHANGES IN ACCOUNTING POLICIES (continued)

Goodwill and Intangible Assets

In February 2008, the CICA issued a new accounting standard concerning Goodwill and Intangible Assets (“Section 3064”), which is based on the International Accounting Standards Board’s (“IASB”) International Accounting Standard 38, “Intangible Assets”. The new section replaced the existing guidance on goodwill and other intangible assets and research and development costs. The objective of 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 applied the new accounting standard retrospectively at the beginning of its current fiscal year, with restatement of prior periods. Intangible assets recognized prior to the Company’s current fiscal year that no longer meet the new recognition or measurement criteria and the definition of an asset were removed from the consolidated balance sheets in accordance with CICA Handbook Section 1506, “Accounting Changes”. The balance of any such deferred costs as at the end of the Company’s 2007 and 2008 fiscal years was reflected as a charge to opening retained earnings.

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

Net Earnings Impact

The following table summarizes the impact of the implementation of the new standard on the Company’s consolidated statements of earnings for the 12 and 24 weeks ended June 14, 2008 and 53 weeks ended January 3, 2009, respectively:

	12 weeks ended June 14, 2008	24 weeks ended June 14, 2008	53 weeks ended January 3, 2009
Adjustment – pre-tax	\$ (2,430)	\$ (3,222)	\$ (15,329)
Income taxes	706	905	4,262
Net earnings impact	\$ (1,724)	\$ (2,317)	\$ (11,067)
Net earnings per common share (diluted) impact	\$ (0.01)	\$ (0.02)	\$ (0.05)
Net earnings, as reported	\$ 128,317	\$ 229,650	\$ 565,212
Net earnings per common share (diluted), as reported	\$ 0.59	\$ 1.06	\$ 2.60
Net earnings, as restated	\$ 126,593	\$ 227,333	\$ 554,145
Net earnings per common share (diluted), as restated	\$ 0.58	\$ 1.05	\$ 2.55

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

SHOPPERS DRUG MART CORPORATION

Notes to the Consolidated Financial Statements

(unaudited)

(in thousands of dollars except per share amounts)

2. CHANGES IN ACCOUNTING POLICIES (continued)

Opening Retained Earnings Adjustment

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

Balance Sheet Adjustments

The following paragraphs summarize the impact of the implementation of the new standard on the Company's consolidated balance sheets as at January 3, 2009 and June 14, 2008, respectively.

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

The impact on balances as at June 14, 2008 was primarily an increase in net future income tax assets of \$14,316, a decrease in prepaid expenses and deposits of \$3,424, a decrease in property and equipment of \$84,836, a decrease in deferred costs of \$36,191, an increase in intangible assets of \$86,852, and a decrease in other assets of \$6,868.

Financial Assets and Financial Liabilities

The Emerging Issues Committee ("EIC") issued a new abstract on January 20, 2009, concerning the measurement of financial assets and financial liabilities ("EIC-173 – Credit Risk and the Fair Value 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 applied the new Abstract at the beginning of its current fiscal year. The implementation did not have a significant impact on the Company's results of operations, financial position or disclosures.

SHOPPERS DRUG MART CORPORATION

Notes to the Consolidated Financial Statements

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2. CHANGES IN ACCOUNTING POLICIES (continued)

Future Accounting Standards

Financial Instruments – Recognition and Measurement

On April 29, 2009, the CICA amended Section 3855, “Financial Instruments – Recognition and Measurement” (“Section 3855”), adding/amending paragraphs regarding the application of the effective interest method to previously impaired financial assets and embedded prepayment options. The amendments are effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011 with early adoption permitted. The amendments are not expected to have a significant impact on the Company’s accounting for its financial instruments.

Financial Instruments – Disclosures

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

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

3. INVENTORY

During the 12 and 24 weeks ended June 20, 2009, the Company recognized cost of inventory of \$1,438,920 and \$2,823,242 (2008 - \$1,333,528 and \$2,619,740), respectively, as an expense. This expense is included in cost of goods sold and other operating expenses in the consolidated statements of earnings for the period.

During the 12 and 24 weeks ended June 20, 2009 and June 14, 2008, there were no significant write-downs of inventory as a result of net realizable values being lower than cost and no inventory write-downs recognized in previous years were reversed.

SHOPPERS DRUG MART CORPORATION

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4. ACQUISITIONS

HealthAccess and Information Healthcare Marketing Corp.

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

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

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

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

Other Business Acquisitions

During the 12 and 24 weeks ended June 20, 2009, the Company acquired the assets or shares of a number of pharmacies, each of which is individually immaterial to the Company's total acquisitions. The total cost of acquisitions of \$33,152 and \$60,432 (2008 - \$9,920 and \$87,462), respectively, including costs incurred in connection with the acquisitions, is allocated primarily to goodwill and other intangible assets based on their fair values. Certain purchase price allocations are preliminary and may change. The operations of the acquired pharmacies have been included in the Company's results of operations from the date of acquisition.

5. INTEREST EXPENSE

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

	12 Weeks Ended		24 Weeks Ended	
	June 20, 2009	June 14, 2008	June 20, 2009	June 14, 2008
Interest on bank indebtedness	\$ 1,256	\$ 2,125	\$ 2,790	\$ 4,851
Interest on commercial paper	1,372	7,292	3,372	15,034
Interest on short-term debt	-	-	504	-
Interest on long-term debt	11,253	4,735	21,721	8,027
	\$ 13,881	\$ 14,152	\$ 28,387	\$ 27,912

SHOPPERS DRUG MART CORPORATION

Notes to the Consolidated Financial Statements

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6. BANK INDEBTEDNESS

Bank indebtedness is comprised of lines of credit borrowings by both the Company and the Associate-owned stores. The Associate-owned stores borrow under agreements guaranteed by the Company. The Company has entered into agreements with banks to guarantee a total of \$505,000 (2008 - \$425,000) of lines of credit. As at June 20, 2009, the Associate-owned stores have utilized \$293,335 (2008 - \$261,943) of the available lines of credit.

7. EMPLOYEE FUTURE BENEFITS

The net benefit expense included in the results for the 12 and 24 weeks ended June 20, 2009, for benefits provided under pension plans was \$1,082 and \$2,164 (2008 – \$1,356 and \$2,712), respectively, and for benefits provided under other benefit plans was \$23 and \$46 (2008 – \$23 and \$46), respectively.

8. DEBT REFINANCING

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

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

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

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

Interest Rate Risk

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

The Company, including its Associate-owned store network, is exposed to fluctuations in interest rates by virtue of its borrowings under its bank credit facilities, commercial paper program and financing programs available to its Associates. Increases or decreases in interest rates will 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 \$100,000 of floating rate commercial paper debt into fixed rate debt.

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

As at June 20, 2009, the Company had \$434,335 (2008 - \$261,943) of unhedged floating rate debt. During the 12 and 24 weeks ended June 20, 2009, the Company's average outstanding unhedged floating rate debt was \$581,492 and \$626,231 (2008 - \$716,330 and \$733,384), respectively. Had interest rates been higher or lower by 50 basis points during the 12 and 24 weeks ended June 20, 2009, net earnings would have decreased or increased, respectively, by approximately \$462 and \$994 (2008 - \$569 and \$1,165), respectively, as a result of the Company's exposure to interest rate fluctuations on its unhedged floating rate debt.

Furthermore, the Company may be exposed to losses should any counterparty to its derivative agreements fail to fulfill its obligations. The Company has sought to minimize counterparty risk by transacting with counterparties that are large financial institutions. As at June 20, 2009 and June 14, 2008, there are no net exposures, as the interest rate derivative agreements are in a liability position.

Credit Risk

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

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

Liquidity Risk

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

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

The contractual maturities of the Company's financial liabilities as at June 20, 2009, are as follows:

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

\$000's	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	\$ 277,617	\$ -	\$ -	\$ -	\$ 277,617
Commercial paper	241,000	-	-	-	241,000
Accounts payable	852,284	37,834	-	-	890,118
Dividends payable	46,738	-	-	-	46,738
Medium-term notes	-	-	-	950,000	950,000
Other long-term liabilities	-	-	14,482	14,663	29,145
Total	\$ 1,417,639	\$ 37,834	\$ 14,482	\$ 964,663	\$ 2,434,618

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

10. FINANCIAL INSTRUMENTS

Interest Rate Derivatives

The Company has interest rate derivative agreements converting an aggregate notional principal amount of \$100,000 of floating rate commercial paper debt into fixed rate debt. The fixed rates payable by the Company under the derivative agreements range from 4.11% to 4.18%. The agreements mature as follows: \$50,000 with a fixed rate payable of 4.11% in December 2009 and \$50,000 with a fixed rate payable of 4.18% in December 2010, with reset terms of one month.

Based on market values of the interest rate derivative agreements at June 20, 2009, the Company recognized a liability of \$3,399 (2008 - \$1,379), of which \$915 (2008 - \$555) is presented in accounts payable and accrued liabilities and \$2,484 (2008 - \$824) is presented in other long-term liabilities. During the 12 and 24 weeks ended June 20, 2009 and June 14, 2008, the Company assessed that the interest rate derivatives were an effective hedge for the floating interest rates on the associated commercial paper debt. Market values were determined based on information received from the Company's counterparties to these agreements.

Equity Forward Derivatives

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

SHOPPERS DRUG MART CORPORATION

Notes to the Consolidated Financial Statements

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10. FINANCIAL INSTRUMENTS (continued)

Based on market values of the equity forward agreements at June 20, 2009, the Company recognized a net liability of \$692, of which \$870 is presented in other assets, \$750 is presented in accounts payable and accrued liabilities and \$812 is presented in other long-term liabilities. Based on market values of equity forward agreements at June 14, 2008, the Company recognized an asset of \$1,638, of which \$666 was presented in accounts receivable and \$972 was presented in other assets. During the 12 and 24 weeks ended June 20, 2009 and June 14, 2008, the Company assessed that the percentage of the equity forward derivatives related to unearned units under the LTIP were an effective hedge for the common share price of the unearned units. Market values were determined based on information received from the Company's counterparties to these agreements.

During the 12 and 24 weeks ended June 20, 2009, amounts previously recorded in accumulated other comprehensive loss of \$76 and \$167 (2008 – \$11 and \$11), respectively, were recognized in earnings.

Fair Value of Financial Instruments

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

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

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

11. CAPITAL MANAGEMENT

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

SHOPPERS DRUG MART CORPORATION

Notes to the Consolidated Financial Statements

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11. CAPITAL MANAGEMENT (continued)

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

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

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

	June 20, 2009	June 14, 2008	January 3, 2009
Cash	\$ (26,059)	\$ (80,452)	\$ (36,567)
Bank indebtedness	277,617	260,441	240,844
Commercial paper	240,148	248,696	339,943
Short-term debt	-	-	197,845
Current portion of long-term debt	-	299,899	-
Long-term debt	943,809	446,845	647,250
Net debt	1,435,515	1,175,429	1,389,315
Shareholders' equity	3,575,032	3,186,326	3,420,529
Total capitalization	\$ 5,010,547	\$ 4,361,755	\$ 4,809,844
Net debt:Shareholders' equity	0.40:1	0.37:1	0.41:1
Net debt:Total capitalization	0.29:1	0.27:1	0.29:1
EBITDA:Cash interest expense ⁽¹⁾⁽²⁾	17.86:1	17.72:1	17.21:1

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

⁽²⁾ Cash interest expense is also a non-GAAP measure and is comprised of interest expense for the 53 week and 52 week periods then ended, as appropriate, and exclude the amortization of deferred financing costs.

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

SHOPPERS DRUG MART CORPORATION

Notes to the Consolidated Financial Statements

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11. CAPITAL MANAGEMENT (continued)

The following table provides a summary of the Company's credit ratings at June 20, 2009:

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

There were no changes to the Company's credit ratings during the 12 and 24 weeks ended June 20, 2009.

12. SUBSEQUENT EVENTS

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

To date, no incremental debt has been incurred by the Company as a result of the filing of the Amended Prospectus.

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

Earnings Coverage Exhibit to the Consolidated Financial Statements

53 Weeks Ended June 20, 2009

Earnings coverage on long-term debt obligations	21.34 times
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The earnings coverage ratio on long-term debt (including any current portion) is equal to earnings (before interest and income taxes) divided by interest expense on long-term debt (including any current portion). Interest expense excludes any amounts in respect of amortization and includes amounts capitalized to property and equipment that were included in and excluded from, respectively, interest expense as shown in the consolidated statement of earnings of the Company for the period.