PUBLIC

CT-2010-010

THE COMPETITION TRIBUNAL

IN THE MATTER OF the *Competition Act*, R.S.C. 1985, c. C-34, as amended;

AND IN THE MATTER OF an application by the Commissioner of Competition pursuant to section 76 of the *Competition Act*;

AND IN THE MATTER OF certain agreements or arrangements implemented or enforced by Visa Canada Corporation and MasterCard International Incorporated.

BETWEEN:

COMPETITION TRIBUNAL
TRIBUNAL DE LA CONCURRENCE
RECEIVED / REÇU
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REGISTRAR / REGISTRAIRE
OTTAWA, ONT. by / par Jos LaRose
Document #223

THE COMMISSIONER OF COMPETITION

Applicant

- and -

VISA CANADA CORPORATION and
MASTERCARD INTERNATIONAL INCORPORATED

Respondents

- and -

CANADIAN BANKERS ASSOCIATIONS and
THE TORONTO-DOMINION BANK

Intervenors

WITNESS STATEMENT OF CRAIG DAIGLE

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1. I am the Senior Director, Treasury & Risk Management of Shoppers Drug Mart Inc. ("Shoppers"), a position I have held since 2008. In the period 2002-2008, I held the position of Assistant Treasurer at Shoppers.

2. Before joining Shoppers, I held a variety of positions with other corporations, including Treasurer at Bell Globemedia Inc. and Director, Finance and Administration at NetStar Communications Inc.

3. I received my Chartered Accountant designation in 1989 after obtaining a Graduate Diploma in Public Accounting from McGill University and a Bachelor of Commence – With Distinction from Concordia University

4. In my capacity as Senior Director, Treasury & Risk Management, I oversee Shoppers' treasury and risk management functions, including being the primary contact for managing Shoppers' relationships with Acquirers relating to the acceptance of credit cards and other payment methods.

Overview of Shoppers

5. Founded in 1962, Shoppers is the licensor of full-service retail drug stores operating under the names "Shoppers Drug Mart" and "Pharmaprix". There are currently more than 1,200 Shoppers Drug Mart and Pharmaprix retail drug stores located across Canada, all of which are owned and operated by licensed associate-owners. These stores sell a wide variety of products, including prescription drugs and "front store" merchandise (e.g., over-the-counter medications, health and beauty aids, cosmetics and fragrances, seasonal products and everyday household essentials).

6. In addition to its drug store network, Shoppers licenses or owns 58 medical clinic pharmacies across Canada operating under the names "Shoppers Simply Pharmacy" or "Pharmaprix Simplement Santé", as well as eight luxury beauty destinations in Alberta, British Columbia, Ontario and Quebec operating under the name "Murale". Shoppers also owns and operates 63 Shoppers Home Health Care stores in Alberta, British Columbia and Ontario that supply home health care products and services, including assisted-living devices, medical equipment, home-care products and durable mobility equipment to institutional and retail customers.

7. In addition to its retail operations, Shoppers 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.

8. Shoppers employs over 50,000 employees in its licensed and owned operations. The consolidated revenues generated by these operations amounted to approximately $10.5 billion in 2011.

9. Further information regarding Shoppers is available in its Annual Report for the fiscal year ending January 1, 2011, and in its Annual Financial Statements and Management Discussion and Analysis for the fiscal year ending December 31, 2011, copies of which are attached as Exhibits "A", "B" and "C" to this witness statement.

Canadian Retail Markets

10. The retail markets in which Shoppers participates are highly competitive. Shoppers faces significant competition from many retailers in the merchandise and non-prescription drug categories, including independent operators, banner groups (such as Rexall Pharmaplus and London Drugs), retail chains (such as Sephora), mass merchandisers (such as Walmart) and larger supermarket chains with combination food/drug retail operations (such as Loblaw).

11. Given the competitive market in which Shoppers operates, Shoppers engages in continuing cost reduction efforts in order to lower administrative costs, streamline the corporate and regional management structure and improve operational efficiencies. However, as discussed in greater detail below, Shoppers has not been able to constrain the increasing costs associated with the acceptance of credit card payments.

Payment Methods Accepted by Shoppers

12. Shoppers accepts cash, Interac debit and general purpose credit cards (Visa, MasterCard and American Express) for payment at its retail stores across Canada.

13. Credit card acceptance, particularly acceptance of Visa and MasterCard credit cards, is critical for Shoppers' business, given that Shoppers' customers have become accustomed to paying by credit card and because credit cards represent a significant proportion of Shoppers' sales. This is particularly the case with respect to sales of "front store" merchandise (such as, health and beauty aids and everyday

household essentials), which in 2011 accounted for approximately [redacted] of Shoppers' total sales.

14. Credit card payments accounted for approximately [redacted] of Shoppers' sales during 2011. Of Shoppers' credit card sales, [redacted] were made with Visa, [redacted] were made with MasterCard and [redacted] were made with American Express.

15. The cost of accepting credit cards is significantly higher than the costs of other forms of payment used by Shoppers' customers, such as cash and Interac debit. Specifically, the fees paid by Shoppers on each Visa and MasterCard credit card transaction ("Card Acceptance Fees") range from [redacted] to [redacted] of the transaction value. The weighted average fee paid by Shoppers on Visa and MasterCard credit card transaction in 2011 was [redacted] per transaction. In comparison, Interac debit costs Shoppers less than [redacted] per transaction to process. Specifically, Shoppers pays [redacted] to Interac and [redacted] to its Acquirer for each Interac debit transaction.

16. Card Acceptance Fees for Visa and MasterCard credit cards are a significant expense for Shoppers. In 2011, these fees totalled approximately [redacted]

17. [redacted] Visa and MasterCard credit cards are ubiquitous and customers have come to expect that their credit cards will be accepted in Shoppers' stores. [redacted]

18. [redacted] customers are generally unaware that Card Acceptance Fees impose significant costs on merchants and, in turn, increase prices to all consumers.

Relationship with the Networks and Acquirers

19. Shoppers, through its wholly-owned subsidiary Shoppers Drug Mart Inc., has entered into an agreement (the "Merchant Agreement") with its Acquirer, Moneris Solutions Corporation ("Moneris") for the supply of credit card network services. The Merchant Agreement applies to all of its owned and licensed locations. A copy of the Merchant Agreement and the amendments thereto are attached to this witness statement as Exhibit "D".

20. Specifically, Moneris supplies the services required to allow Shoppers to accept credit cards as a form of payment from customers, including access to the Visa and MasterCard credit card networks, facilitation of authorization requests for credit card transactions and settlement of payment.

21. There is significant competition between Acquirers for the supply of credit card network services to merchants in Canada. As a result of this competition, Shoppers is able to secure competitive pricing from Moneris with respect to its activities as an Acquirer, for which it pays a separate fee per transaction (commonly referred to as an "Acquirer Service Fee"). For Shoppers, the Acquirer Service Fee paid to Moneris is [redacted] per transaction.

[redacted]

23. For example, Shoppers received more than 15 notices from Moneris of fee increases imposed by Visa and/or MasterCard between June 27, 2003 and March 1, 2011, most of which were received since 2008. Copies of certain of these notices are attached to this witness statement as Exhibit "E".

24. The Card Acceptance Fees paid by Shoppers range from [redacted] to [redacted] for Visa and [redacted] to [redacted] for MasterCard, depending upon the type of credit card used by a customer. Shoppers is currently paying an effective Card Acceptance Fee of [redacted] per credit card transaction to accept Visa credit cards and an effective Card Acceptance Fee of [redacted] per credit card transaction to accept MasterCard credit cards. Shoppers has no say with respect to Card Acceptance Fees and not been able to effectively negotiate with Visa and MasterCard to constrain or reduce these fees.

<u>Increasing Cost of Credit Card Acceptance</u>

25. Card Acceptance Fees have increased significantly in recent years due to a number of factors, including the increased utilization of credit cards as a form of payment, which has been driven by the introduction of reward programs, and the increasing penetration of premium credit cards that have higher Card Acceptance Fees than standard credit cards.

26. For example, Shoppers' Card Acceptance Fees for Visa and MasterCard increased from [redacted] million in 2007 to [redacted] million in 2011, an increase of [redacted] Shoppers' average Card Acceptance Fee increased from [redacted] in 2007 to [redacted] in 2011 for Visa credit card transactions and from [redacted] in 2007 to [redacted] in 2011 for MasterCard credit card transactions.

27. Further, Card Acceptance Fees are difficult to forecast or mitigate given the ability of the credit card networks to unilaterally increase such fees or introduce new types of credit cards, such as premium credit cards and now "super premium" credit cards, which carry significantly higher Card Acceptance Fees than standard credit cards. For example, each time a customer uses a premium Visa credit card, such as a Visa Infinite, to make a payment, Shoppers is subject to a Card Acceptance Fee of [redacted] whereas payments made using a standard Visa credit card, such as a Visa Classic, are subject to a Card Acceptance Fee of [redacted] Similarly, where a customer uses a MasterCard "super premium" credit card, such as a MasterCard World Elite, to make a payment, Shoppers is subject to a Card Acceptance Fee of [redacted] whereas payments made using a standard MasterCard credit card are subject to a Card Acceptance Fee of [redacted]

28. The cardholder rewards offered by all credit cards have resulted in increased utilization and an increasing penetration of higher-cost credit cards as customers have been incented to move away from using less expensive payment methods, such as cash and Interac debit. Ultimately, higher costs, such as increased Card Acceptance Fees, are passed on to consumers in the form of higher retail prices.

29. In an effort to attempt to mitigate the cost of credit card acceptance, Shoppers partnered with MBNA, a division of The Toronto-Dominion Bank, in 2008 to offer the MBNA Shoppers Optimum MasterCard. With the MBNA Shoppers Optimum MasterCard, customers earn Shoppers Drug Mart Optimum Points for all their purchases – five points for every dollar spent at other retailers and 15 points for every dollar spent at Shoppers. These points can be redeemed for discounts on "front store" merchandise at Shoppers' locations.

30. [redacted]

The Merchant Rules

31. The Merchant Agreement requires that Shoppers abide by certain rules implemented by Visa and MasterCard, including the following:

(a) the "No Surcharge Rule", which prevents Shoppers from applying an additional charge for customers that elect to use Visa or MasterCard credit cards, even though (as explained above) such credit cards impose higher costs on Shoppers;

(b) the "Honour All Cards Rule", which provides that if Shoppers accepts one type of Visa or MasterCard credit card, it must accept all types of Visa or MasterCard credit cards, respectively, including credit cards that have higher Card Acceptance Fees; and

(c) the "No Discrimination Rule", which prevents Shoppers from engaging in other practices that discourage the use of credit cards in favour of other forms of payment.

[redacted]

33. As a result of the Merchant Rules described above, Shoppers cannot create competition to constrain increases in or encourage reductions of Card Acceptance Fees. The Merchant Rules prevent Shoppers from effectively differentiating between Visa and MasterCard credit cards, and require Shoppers to treat all Visa and MasterCard credit cards alike, even those with higher Card Acceptance Fees.

34. As a result of the Merchant Rules described above, Shoppers is unable to effectively encourage or incent customers to use lower-cost methods of payment, such as cash, Interac debit and lower-cost credit cards, including by surcharging credit cards with higher Card Acceptance Fees, declining to accept credit cards with higher Card Acceptance Fees or steering consumers to lower-cost payment methods.

35. Importantly, as the Merchant Rules prevent Shoppers from surcharging or refusing to accept certain types of credit cards whose costs exceed the basic cost of

credit card acceptance, they reduce or eliminate a significant source of leverage that Shoppers would otherwise have when negotiating with Visa and MasterCard.

36. Having the option to surcharge credit card transactions or refuse certain types of credit cards would provide Shoppers with leverage in negotiations with Visa and MasterCard that would allow it to secure lower Card Acceptance Fees. There is currently a significant imbalance in the bargaining power between merchants and the credit card networks.

[redacted]

38. The Merchant Rules also prevent Shoppers from sending the correct pricing signals to customers that elect to use higher-cost credit cards to make a purchase. Customers are generally unaware that credit cards impose a higher cost on merchants than other forms of payment.

<u>Ability to Use Discounts to Encourage Use of Lower-Cost Payment Methods</u>

39. Although the *Code of Conduct for the Debit and Credit Card Industry* permits merchants to discount for lower-cost payment methods, there are practical and technological limitations to Shoppers doing so.

40. First, Shoppers would be discounting from a "shelf price", whether on a fixed or percentage basis. Shoppers would have to set this shelf price based on an estimate of the mix of payment methods that would be used, which could vary significantly with location and in response to issuer marketing campaigns, prevailing card rewards levels and other factors. The variation in card fees and types means that it would be difficult to establish a standard discount, exacerbated by the fact that a payment card may carry different fees depending on its use, for example, "card present" versus "card not present" transactions.

41. Second, given the competitive nature of retail sectors in which Shoppers competes, it must be able to advertise the lowest possible prices, not a price that will be further discounted depending on the payment method selected by the customer.

42. Third, the discount would have to be offered to all customers, including those that otherwise would have paid with cash, Interac debit or lower-cost credit cards. In this regard, Interac debit accounted for about [redacted] of Shoppers' sales in 2011.

43. The remedies being sought by the Commissioner of Competition would provide Shoppers with practical and much more effective ways to encourage the use of lower-cost payment methods.

Electronic and Visual Identification of Credit Cards

44. Shoppers is unable to identify all premium credit cards at the point of sale, either through visual or electronic means. In general, Shoppers is unable to determine whether a credit card transaction is charged a higher Card Acceptance Fee until after it has received its monthly statement from Moneris.

45. To take advantage of the remedies sought by the Commissioner of Competition, Shoppers must be able to determine at the time of a transaction, and without any additional cost to it, whether a particular credit card attracts a higher Card Acceptance Fee. In particular, Shoppers must be able to identify the Card Acceptance Fee associated with each brand and type of credit card at the point of interaction.

46. I believe that the information required to allow Shoppers to determine the applicable Card Acceptance Fee for Visa and MasterCard transactions already exists and is available to Acquirers, Visa and MasterCard, but is not readily made available to merchants.

47. Visual and electronic identifiers for credit cards would provide clarity and transparency to consumers and enable merchants to effectively communicate changes to their credit card acceptance policy, such as which cards are or are not accepted or are subject to a surcharge prior to the customer entering into the transaction with the customers' preferred form of payment.

Signed: March 6, 2012

CRAIG DAIGLE

Leading through change

Throughout our 49-year history, Shoppers Drug Mart/Pharmaprix has responded to the ever-changing market and regulatory environment, capitalizing on opportunities to drive growth. During challenging times, true leaders emerge. As we look to the future, we are confident that given the strength of our brand and the power of our value proposition, combined with the leadership of our Associate-owners and the capabilities of their teams at store level, we will continue to lead through change and reinforce our position as the country's **leading drug store retailer.**

Contents

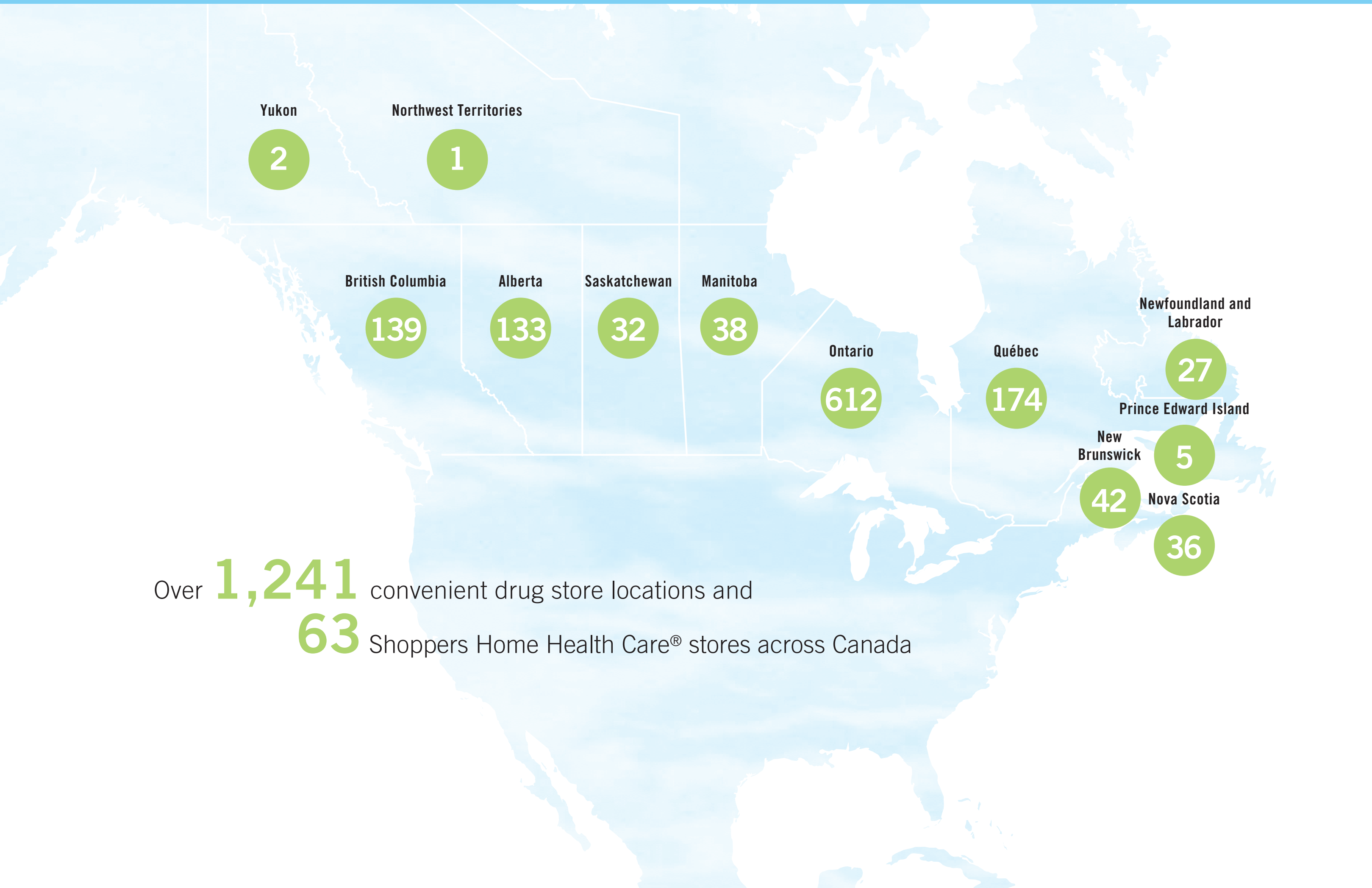
Corporate profile

Shoppers Drug Mart Corporation is the licensor of full-service retail drug stores operating under the name Shoppers Drug Mart® (Pharmaprix® in Québec). Founded in 1962 by Toronto pharmacist Murray Koffler, the Company has grown to a network of more than 1,182 Shoppers Drug Mart/Pharmaprix stores across Canada. These conveniently located stores are owned and operated by the Company's licensed Associate-owners who have helped build a brand that is synonymous with exceptional service, value and trust. The Company also licenses or owns more than 59 medical clinic pharmacies operating under the name Shoppers Simply Pharmacy® (Pharmaprix Simplement Santé® in Québec) and eight luxury beauty destinations operating as Murale™.

With fiscal 2010 sales of approximately of $10.4 billion, the Company is the leader in Canada's retail drug store marketplace and is the number one provider of pharmacy products and services. Shoppers Drug Mart 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, including over-the-counter medications, health and beauty aids, cosmetics and fragrances, seasonal products and everyday household essentials. The Company also offers a broad range of high quality private label products marketed under such trademarks as Life Brand®, Quo®, Etival™, Baléa®, Everyday Market®, Simply Food®, Nativa®, Bio-Life® 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.

As well, the Company owns and operates 63 Shoppers Home Health Care® stores, which 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.

A national retail drug store network



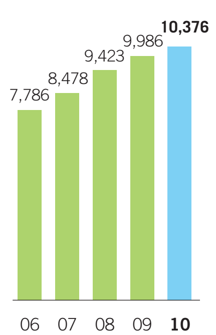
Over **1,241** convenient drug store locations and **63** Shoppers Home Health Care® stores across Canada

Financial highlights[1]

	2010	2009	2008[2]	2007	2006
Summary Earnings Data ($000's)					
Sales	**10,376,067**	9,985,600	9,422,911	8,478,382	7,786,436
Cost of goods sold and other operating expenses	**9,192,181**	8,841,170	8,350,367	7,520,033	6,958,361
Amortization	**286,935**	248,794	205,371	172,075	144,549
Operating income	**896,951**	895,636	867,173	786,274	683,526
Interest expense	**56,036**	58,215	63,952	52,873	49,872
Income taxes	**250,172**	252,513	249,076	242,960	211,163
Net earnings	**590,743**	584,908	554,145	490,441	422,491
Summary Operating Data					
Sales ($000's)	**10,376,067**	9,985,600	9,422,911	8,478,382	7,786,436
Sales growth	**3.9%**	6.0%	11.1%	8.9%	8.9%
Same-store sales growth	**2.1%**	4.8%[3]	4.8%[4]	5.2%	6.5%
Sales mix:					
Pharmacy	**47.8%**	48.3%	47.6%	47.0%	46.9%
Front store	**52.2%**	51.7%	52.4%	53.0%	53.1%
EBITDA ($000's)[5]	**1,183,866**	1,144,430	1,072,544	958,349	828,075
EBITDA growth	**3.4%**	6.7%	11.9%	15.7%	15.0%
EBITDA margin[6]	**11.4%**	11.5%	11.4%	11.3%	10.6%
Capital expenditures ($000's):					
Property and equipment	**414,775**	461,438	476,315	395,526	287,216
Business acquisitions	**12,990**	97,100	243,901	139,833	136,885
Intangible assets	**56,625**	33,989	48,650	—	—
Total	**484,390**	592,527	768,866	535,359	424,101
Summary Balance Sheet Data ($000's)					
Total assets	**7,122,210**	6,852,454	6,364,223	5,621,977	4,929,014
Net debt	**1,215,899**	1,432,425	1,389,315	1,040,401	875,172
Long-term debt	**943,412**	946,098	647,250	—	300,000
Shareholders' equity	**4,223,903**	3,826,110	3,420,529	3,075,710	2,723,954
Key ratios:					
Net debt:shareholders' equity	**0.29:1**	0.37:1	0.41:1	0.34:1	0.32:1
Net debt:total capitalization	**0.22:1**	0.27:1	0.29:1	0.25:1	0.24:1
Share Data ($)[7]					
Price:					
High	**45.96**	50.00	58.23	58.11	51.49
Low	**32.70**	41.40	41.39	47.26	40.22
Close	**39.53**	45.41	48.05	53.26	50.09
Net earnings:					
Basic	**2.72**	2.69	2.55	2.27	1.97
Diluted	**2.72**	2.69	2.55	2.26	1.95
Dividends declared	**0.90**	0.86	0.86	0.64	0.48

(1) Fiscal 2008 consists of 53 weeks. All other fiscal years consist of 52 weeks.
(2) Reflects the impact of the retrospective application of the new accounting standard concerning Goodwill and Other Intangible Assets – CICA Handbook Section 3064. Prior years have not been restated.
(3) Based on a comparable 52 week period.
(4) Based on a comparable 53 week period.
(5) EBITDA (earnings before interest, taxes, depreciation and amortization).
(6) EBITDA as a percentage of sales.
(7) Share price information is presented on a calendar year basis.

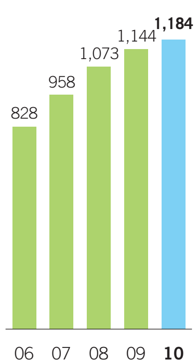
Sales
($ millions)



Growth % 8.9 8.9 11.1 6.0 **3.9**

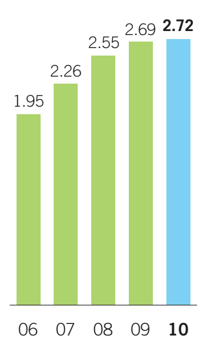
*Fiscal 2008 consists of 53 weeks. All other fiscal years consist of 52 weeks.

EBITDA
($ millions)



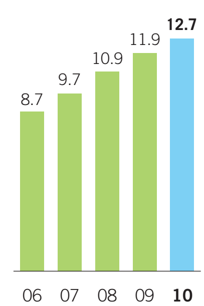
Growth % 15.0 15.7 11.9 6.7 **3.4**

Diluted Earnings Per Share
($)



Growth % 15.4 15.9 12.8 5.5 **1.1**

Retail Selling Space
(millions ft.^{2})



Growth % 10.6 11.5 11.6 9.9 **6.4**

Our business

With more than 1,241 convenient drug store locations from coast to coast and more than 360 million patient and customer transactions in 2010, Shoppers Drug Mart is Canada's leading health, beauty and convenience retailer. Last year, we touched the lives of more than 85% of Canadians, helping them fulfill their everyday health, wellness and convenience needs. Over the course of our 49 years in business, we have earned the trust of Canadians who recognize Shoppers Drug Mart/Pharmaprix for our professional service, knowledge and friendly advice. Together with our Associate-owners and their teams at store level, we are helping our patients and customers enhance their well-being and improve their quality of life.

PHARMACY & HEALTH

With more than 4,800 Associate-owners and pharmacists, 6,100 pharmacy technicians and a commitment to quality patient care, Shoppers Drug Mart/Pharmaprix continues to play a leadership role in providing Canadians with accessible community-based health care products and services.

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BEAUTY

Shoppers Drug Mart/Pharmaprix is one of the country's leading beauty destinations. Trusted beauty advisors, welcoming store formats and an increasing assortment of prestige and exclusive brands have helped us to continue to gain market share in cosmetics, fragrance and dermatological skin care.

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SERVICE & CONVENIENCE

With a national store network that is accessible to 90% of the Canadian population, extended operating hours and a full assortment of innovative products and services, Shoppers Drug Mart/Pharmaprix is Canada's most convenient drug store retailer.

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Shoppers Drug Mart is well-positioned in the marketplace as one of Canada's most trusted brands and the leading provider of pharmacy products and services. Despite the recent changes in the pharmacy industry and challenges of the current market, our financial position is strong and our strategy is sound.

Dear Fellow Shareholders:

As Chair of the Board of Directors and Interim President & Chief Executive Officer, I am pleased to have the opportunity to address you, our shareholders, to provide a review of the Company's operations over the past year. Undoubtedly, 2010 was a challenging year, both from a regulatory perspective and from an economic standpoint. The pharmacy industry, including the services pharmacists provide, was the subject of much review and intense debate as governments and payers across the country sought ways to manage their growing health care expenditures. Although these discussions and resulting reforms have posed some challenges to the way in which pharmacies operate, they have also compelled us to focus our efforts on the fundamentals of our business: to provide exceptional pharmacy care and offer a differentiated shopping experience.

I am proud to report that in 2010, the Company achieved record sales of approximately $10.4 billion, a 3.9% increase over the prior year, with strong sales growth in all regions of the country. The Company's capital investment and store development program, which resulted in a year-over-year increase in selling space of 6.4%, continues to have a positive impact on sales growth, particularly in the front of the store. On a same-store basis, sales increased 2.1% in 2010.

Prescription sales increased 2.8% in 2010 and were up 1.7% on a same-store basis, as a reduction in generic prescription reimbursement rates, the result of drug system reform initiatives implemented in certain provinces in the second half of the year, principally Ontario, combined with greater generic prescription utilization rates, had a negative impact on sales dollar growth in pharmacy. Prescription sales growth was driven by strong growth in the number of prescriptions filled, with total prescription counts increasing by 4.7% during the year. Front store sales increased 4.9% in 2010 and were up 2.5% on a same-store basis, with the Company posting sales gains in all core categories, led by cosmetics and the convenient food and household categories. In addition to square footage growth, investments in marketing, pricing and promotional activities drove sales and market share gains in the front of the store.

In 2010, the benefits of top-line growth, improved purchasing synergies and further gains in productivity and efficiency were essentially offset by the impact of the aforementioned drug system reform initiatives, increased amortization and higher operating expenses associated with our network growth and expansion initiatives, along with continued investments in marketing and promotional activities. As a result, net earnings for the year were $591 million or $2.72 per share compared to $585 million or $2.69 per share in the prior year.

As articulated midway through 2010, we took steps to reduce our capital expenditure program as part of our plan to mitigate the impact of the drug system reform initiatives. Notwithstanding, our drug store development and network expansion efforts resulted in a 6.4% increase in selling square footage, bringing total selling space to more than 12.7 million square feet by year end. In 2010, we opened or acquired 75 drug stores, 43 of which were relocations, and also completed 27 major drug store expansions. In 2011, we plan to allocate $360 million to capital expenditures, of which approximately 75% will be invested in the store network. We expect this to result in an increase in retail selling space of approximately 4.5% through the addition of between 50 and 55 new drug stores, approximately 35 of which will be relocations, and the completion of between 25 and 30 major expansions. We also plan to remodel up to 40 existing drug stores, converting them to smaller prototypical formats, which has proven to be an effective use of capital.

Leading through change

Inherent in our business model and ingrained in our history is the Company's ability to respond to the ever-changing market and regulatory environment, as well as industry and demographic trends, in order to manage risk, capitalize on opportunities and drive growth. So while drug system reform initiatives pose challenges to the pharmacy industry as a whole, they also create opportunities. Given the strength of our brand, the quality of our assets, our solid financial position, the breadth of our offering and the leadership capabilities and skills of our people, we believe Shoppers Drug Mart/Pharmaprix is well-positioned to capitalize on these opportunities and build upon our position as the leading pharmacy retailer in Canada.

There is no doubt that the implementation of drug system reform initiatives in Ontario and in other provinces across the country will continue to have an impact on our industry and our business into 2011 and beyond, resulting in structural changes to both the competitive landscape and the private payer market. In anticipation of these changes, we have adjusted our operating model and continue to promote innovation across all business units to further differentiate ourselves from the competition and drive growth. In addition, we are poised to capitalize on the expected consolidation of the marketplace, which we view as another attractive opportunity to gain market share and increase profitability. In response to the increased pressure on private payers, we have introduced Shoppers Drug Mart Health Solutions in order to help plan sponsors effectively manage the costs of providing benefits, while also improving the overall health and wellness of their employees. We are currently piloting this program with two employers and hope to expand this offering in 2011.

Favourable demographic and industry trends continue to drive growth in our sector and serve to offset some of the challenges inherent to the retail pharmacy marketplace. The Canadian population is aging rapidly, with the fastest growing segment being those in the 60 years or older age bracket. In the coming years, this segment of the population will drive unprecedented growth in the demand for pharmacy products and services, growth that Shoppers Drug Mart/Pharmaprix is well-positioned to capitalize on.

Another industry trend that is favourable to our business is the rapid growth of the specialty drug market. Through Shoppers Drug Mart Specialty Health Network, we are well-equipped to support patients with complex drug therapies manage their disease states, as well as provide assistance with comprehensive reimbursement solutions. I am encouraged by the growth and development of these and other innovative service offerings that are designed to capitalize on opportunities within our sector, and I want to ensure all stakeholders that this Company will remain at the forefront of providing accessible community-based healthcare solutions to patients and customers in the communities we serve.

Driving efficiency

In the context of this environment, it is imperative that we continue to leverage our size and scale to improve productivity and efficiency, enhance operational effectiveness, reduce costs and ensure that we are positioned to capitalize on the growth opportunities that lie ahead. Building on the success of our Project Infinity initiative in the front of the store, 2010 saw us successfully roll-out and implement Phase 1 of Pharmacy Infinity, with the goal of creating a better, more efficient work environment within the dispensary, enabling our Associate-owners and their pharmacy teams to spend more time on what really matters – providing value-added counseling and advice to their patients and customers. In 2011, we will focus on Phase 2 of Pharmacy Infinity, which encompasses the design and implementation of a common pharmacy technology platform across our store network to drive additional efficiencies, enhance the customer experience and prepare us for a future that includes electronic prescribing between physicians and pharmacists. Work has also commenced on a Corporate Infinity project, with the objective of building a more efficient and effective cross-functional support structure within our corporate and regional offices and supply chain.

Leading through differentiation

Success in the marketplace is driven by our ability to differentiate ourselves from the competition by dominating on convenience and offering innovative products and services to our customers and patients.

Innovation within our stores is perhaps best seen on shelf, as evidenced by our extensive range of private label and exclusive brand products. We remain committed to our strategy of providing customers with a multi-tier offering of quality private label and exclusive products from which to choose, depending on budget and preference. As a result, the merchandising and category management teams continue to create and acquire exciting new brands and products across our core categories that enhance customer loyalty, strengthen our value proposition and ultimately, increase profitability. At the end of 2010, sales of private label and exclusive brand products accounted for 19% of front store sales and it remains our objective to have this reach 25% in the next three to five years.

The Shoppers Optimum® loyalty card program continues to be an integral part of our overall value proposition and a key point of differentiation. In 2010, we celebrated the 10th anniversary of the program and increased the total number of active cardholders to more than 10.5 million. This is very encouraging for continued sales growth, as Shoppers Optimum® cardholders frequent our stores more often and have an average basket size or spend which is 63% greater than non-cardholders. In 2010, we also implemented a number of innovative promotional campaigns, including a four-week promotional program in celebration of the card's 10th anniversary. As we look to 2011, we will continue to leverage and build upon the strength of this unique program by enhancing the quality of promotional events and by focusing on the acquisition of new cardholders.

Throughout our 49-year history, we have always evolved our product and service offering to meet the changing needs of our patients and customers. As we look to the future, we will continue to seek new and innovative ways to grow the business, improve efficiencies and elevate the customer experience so as to reinforce our position as Canada's leading health, beauty and convenience retailer.

Leadership and governance

In my role as Chair of the Board of Directors, I am proud to report on behalf of my fellow Directors that, in spite of the many challenges in the marketplace, Shoppers Drug Mart Corporation continues to deliver strong operating and financial results. With a solid balance sheet and a sound strategy in place, the Board is confident that your Company remains well-positioned to capitalize on opportunities, drive growth and enhance long-term shareholder value.

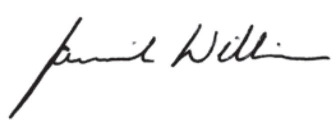
The Board remains focused on total shareholder returns and, in that regard, I am pleased to report that we recently declared a dividend payment of 25 cents per common share, representing an increase in the Company's quarterly dividend payments of 11%, resulting in an annualized dividend of $1.00 per common share. In conjunction with the dividend increase, the Board also announced that it has authorized the purchase of up to 8,700,000 of the Company's common shares, representing approximately 4% of the common shares currently outstanding, by way of normal course purchases effected through the facilities of the Toronto Stock Exchange. The Board's decision with respect to these matters is a testament to the financial strength and solid operating performance of the Company. It also speaks to our confidence in the future with respect to the cash flow generation potential of the business. While we remain committed to utilizing free cash flow to invest in opportunities that will generate attractive rates of return on that capital, the Company also expects that from time to time, it will have cash or debt capacity in excess of its operating, financing and capital investment requirements. Therefore, in addition to maintaining a sector-leading dividend payout ratio, it is the Board's belief that the establishment of a share repurchase program provides the Company with a flexible alternative to enhance total shareholder returns through value-enhancing share repurchases.

As a Board, we are also committed to providing shareholders with timely, accurate and complete information about the Company's successes, opportunities, challenges and risks. As such, we play an active role in overseeing and understanding the strategic direction and key initiatives of the Company and, in addition to our regular Board meetings, meet regularly with members of the Company's senior management team. Throughout the course of this past year, we were well-informed of the risks and the opportunities associated with the drug system reform initiatives, the resultant changes in the regulatory framework and their impact on the retail pharmacy industry in general, and the Company in particular. On an ongoing basis, the Audit Committee is actively engaged in the evaluation and oversight of these and other risks facing the Company.

In 2009, the Human Resources and Compensation Committee of the Board was very active in reviewing the Company's total rewards programs to ensure that Shoppers Drug Mart/Pharmaprix is able to attract and retain the best leadership and talent in the industry. This past year, the Committee also turned its attention to adopting a 'say on pay' shareholder advisory vote on executive compensation. The adoption of advisory votes on executive compensation is a recent and evolving governance practice in Canada that provides a company's shareholders with the opportunity to vote on an advisory resolution to ratify executive compensation at each annual meeting of shareholders. The Company is committed to demonstrating leadership in evolving governance issues, including those concerning executive compensation, and accordingly, starting in 2012, will present at our annual meeting of shareholders a non-binding, advisory vote on executive compensation.

I invite you to read more about our corporate governance practices, including information about each Board member's background, in the Management Proxy Circular, which is available at www.sedar.com.

In closing, I want to thank our Associate-owners and their teams at store-level, along with the Company's management team and our corporate and regional office employees, for their efforts, dedication, commitment and contributions to our collective success in 2010. Looking ahead, I remain confident that your Company is well-positioned to meet the challenges and capitalize on the opportunities in this ever-changing marketplace and deliver sustainable, long-term growth and shareholder value.



David Williams
Chair of the Board of Directors and
Interim President & Chief Executive Officer

David Williams was appointed Interim President and Chief Executive Officer of Shoppers Drug Mart in February 2011, upon the resignation of Jürgen Schreiber. On behalf of the shareholders, Associate-owners and employees of Shoppers Drug Mart/Pharmaprix, we pay tribute to Jürgen Schreiber and thank him for his many contributions to the continued success and growth of the Company under his leadership.

Leading through change

At Shoppers Drug Mart/Pharmaprix, we pride ourselves on the leadership role we play in the pharmacy profession and in the practice of community-based health care. We provide our Associates and employees with leading edge training and technology, drive innovation in our front store offering and invest in the communities we serve. As customer demographics, industry dynamics and the regulatory environment continue to evolve, we too will evolve by making the right investments and leveraging our strengths to meet the health, beauty and convenience needs of our patients and customers.

health + beauty + convenience

Our growing network of retail formats, offering specialty services and a portfolio of private label and exclusive brands, is supported by our Associate-owners and their teams, comprised of more than 51,000 employees, who are dedicated to providing Canadians with the best in health, beauty and convenience.

Retail formats	Shoppers Drug Mart; Pharmaprix; Shoppers Simply Pharmacy; Pharmaprix Simplement Santé; Murale
Specialty services	Shoppers Drug Mart Specialty Health Network; Shoppers HomeHealthCare; MediSystem – A Shoppers Drug Mart Company
Corporate brands	Life Brand; Quo; everyday Market; simply food; Nativa Organics; baby life Brand; Baléa; Etival Laboratoires; Bath Retreat; Jolie; stylize; bella; Sox Sense; allude; amigo; bio-life; get; easypix

Our Associate-owners and their pharmacy teams have been providing Canadians with exceptional community-based care for more than 49 years. *We continue to invest in training and development programs to enhance patient care. For example, we have among the highest number of Certified Diabetes Educators in the country and, in 2010, partnered with Motherisk to provide pharmacists with tools and information to provide counsel and support to new and expectant mothers.*

PHARMACY & HEALTH

leaders for better HEALTH

While 2010 was a challenging year from a regulatory and economic standpoint, we continued to leverage the strength of our brand, the knowledge and accessibility of our pharmacy teams and our community-based model to deliver outstanding pharmacy service and patient care. In 2011, we will continue to evolve our business and service model to meet the health care needs of our patients, capitalize on opportunities in the marketplace and drive continued growth.

Rx BLUEPRINT FOR PHARMACY
Designing the Future Together

__In 2010, the Canadian Pharmacists Association developed the Implementation Plan for the Blueprint for Pharmacy.__ Shoppers Drug Mart played a leadership role in shaping the new vision and model for pharmacy services in Canada. Examples of these services include a comprehensive medication management program that we are currently testing in a 12-store pilot program in British Columbia. We look forward to sharing key learnings from these and other programs for possible implementation and roll-out across the country.

Automated prescription refill service Patient feedback is essential in helping to ensure we have the right products, services and knowledge in place to meet our patients' needs. Responding to our customers' need for convenient prescription refills, we implemented an automatic service which enables them to refill online or using our new mobile application. In 2010, we also implemented a promotional campaign to raise awareness of this innovative service, rewarding patients with Optimum points (where permissible) every time they use the automated online e-fill system.

Leaders in productivity and efficiency In 2010, we successfully implemented Phase 1 of Pharmacy Infinity which improved productivity and efficiency, freeing up time for pharmacists to provide patients with even more personalized service and care. This initial phase focused on dispensary workflow, labour scheduling and inventory management and was such a great success that, in 2011, we will work to implement Phase 2 of Pharmacy Infinity, which encompasses the roll-out of a common technology platform across the store network. Looking ahead, we are working towards developing a paperless environment using a platform that will be capable of interacting with the provinces' e-health systems and prepare us for electronic management of prescribing between physicians and pharmacists.

Our pharmacists are trusted members of our patients' health care teams *and remain at the forefront when it comes to providing Canadians with health and wellness information. In addition to providing our patients with expert care and personal advice, we also offer targeted monthly in-store programs through HealthWATCH®. These programs offer patients access to literature, information seminars and interactive tools on a variety of topics, including diabetes, heart health, allergies and asthma.*

PHARMACY & HEALTH

Be Well, Get Well Leveraging the expertise of our pharmacists and the strength of our store network, we held a very successful Be Well, Get Well campaign last year. The program provided patients and customers with helpful information and advice, product coupons and access to more than 640 in-store flu shot clinics across Canada

SANIS

Innovative products Shoppers Drug Mart/Pharmaprix has a history of bringing innovative products and services to its patients and customers. In 2010, we launched Sanis™, a new line of high-quality generic drug products. In addition to increasing dispensing efficiency, Sanis' innovative packaging has been designed to reduce the probability of medication errors, thereby enhancing patient safety. Over the course of the last year, we increased the number of molecules in the line and will continue to do so in 2011.

SHOPPERS DRUG MART HEALTH SOLUTIONS
more ways to benefit

Shoppers Drug Mart Health Solutions We continue to follow trends and lead the industry when it comes to recognizing and capitalizing on future growth opportunities. Responding to the need for Canadian employers to effectively manage their rising health care expenditures, we recently launched Shoppers Drug Mart Health Solutions. This offering leverages our expertise in retail pharmacy, therapeutic formulary management, specialty pharmacy and health & wellness programs. Through Shoppers Drug Mart Health Solutions, we provide expert care and innovative solutions in pharmacy and health care that are cost effective and easy to manage for plan sponsors. We are currently piloting programs with two employers and hope to expand this offering in 2011.

Leaders in specialty pharmacy The specialty drug market is growing at twice the rate of traditional retail pharmacy, making it one of the fastest growing sectors within the industry. By leveraging the powerful combination of our Associate-owned store network and Shoppers Drug Mart Specialty Health Network, we are well-positioned to support those patients with complex drug therapies and assist them with reimbursement solutions in markets all across Canada.

We Care Awards Passionate about meeting the health care needs of Canadians, Shoppers Drug Mart/Pharmaprix pharmacists are trusted and recognized members of their patients' health care teams. In 2010, we introduced We Care Awards to recognize those pharmacists who exemplified exceptional patient care and helped advance the profession. Pharmacists were nominated by their peers and were chosen as best in class in one of the following areas – collaborative team initiative, disease management initiative, overall patient care or pharmacy innovation. The National Pharmacist of the Year was awarded to the pharmacist who stood out and exemplified best in class in all four categories.

Pharmacist of the Year
Debbie Moffatt
Trenton, ON

We Care Awards
Virginia Barbosa
New Glasgow, NS

We Care Awards
Sarah Parker
Granville, BC

We Care Awards
Sarah Duggleby
Kimberley, BC

We Care Awards
Delphine Bercier
Lachine, QC

We Care Awards
Ai Minh Van
Laval, QC

Beauty and cosmetics continues to be an integral part of our business. *Cosmetics customers visit our stores more often and spend more per transaction than non-cosmetics customers. Strengthening the loyalty of our best customers is good for business across the entire store. Accordingly, further enhancing our product and service offering in beauty will continue to be a key priority in 2011.*

BEAUTY

leading change in BEAUTY

Shoppers Drug Mart/Pharmaprix continues to experience strong growth in its beauty business and is a market leader in the sale of cosmetics, fragrance and dermatological skin care products. We are constantly evolving our product and service offering to meet the changing needs of our customers and differentiate ourselves in the marketplace. In 2011, we will be focused on accelerating growth in beauty through a number of initiatives, including a re-line of our mass cosmetics presentation and the introduction of a new and expanded BeautyBOUTIQUE™ format.

Shoppers Drug Mart/Pharmaprix beauty advisors provide friendly and professional service to our customers each and every day. *Committed to ongoing training and development in beauty and cosmetics, we launched a new suite of e-learning programs in 2010 to ensure that our beauty advisors have the tools they need to continue to provide customers with exceptional service and advice.*

Murale™ With the introduction of Murale™, our innovative stand-alone beauty format, we are able to offer our customers access to global beauty brands and an elevated level of service. We've also been able to leverage our relationships with beauty partners to extend the offering of select prestige brands, such as Stila and Rodial, to our Shoppers Drug Mart/Pharmaprix stores.

BeautyBOUTIQUE™ In 2003, we introduced our BeautyBOUTIQUE™ concept to provide our customers with an upscale beauty experience in an easy-to-shop and welcoming environment. Customer response has been overwhelmingly positive, resulting in the rollout of the concept to more than 272 Shoppers Drug Mart/Pharmaprix stores across the network. We continue to enhance the concept, increasing the number of global and exclusive brands and improving the merchandising of the assortment. In 2011, we plan to add 30 to 35 BeautyBOUTIQUES™ to the store network and introduce even more brands to the offering, enabling us to continue to gain market share in prestige cosmetics.

Innovative new products *Customers look to Shoppers Drug Mart/Pharmaprix for the latest trends and innovative new products. Last year alone, we introduced 12 new cosmetic and fragrance lines to our assortment bringing the total number of beauty brands available in our stores to more than 129.*

BEAUTY

Etival™ Private label products have always been a key point of differentiation in our merchandising strategy. Building on the success of Quo®, we introduced a new line of dermatological skin care products, Etival Laboratoire. This line features 29 products, all uniquely tailored to meet the personal skincare needs of different age groups and skin types. Sales in the first year exceeded our expectations. In 2011, we will extend the offering to include a men's line, as well as anti-aging and suncare products.

Quo®

First introduced in 1999, Quo® has grown to become a must-have in the cosmetics bags of many Canadian women. A trusted cosmetics brand that consistently delivers innovative designs and on-trend palettes at affordable prices, the Quo® collection now includes quality brushes, cosmetics bags and specialty gift collections. Customer response to the Quo® line of products has been very positive, with sales increasing 17% in 2010. In 2011, we will build on this momentum and drive brand awareness and penetration through the introduction of new products, supported by innovative marketing campaigns and differentiated merchandising strategies.

***Glow* magazine** Shoppers Drug Mart/Pharmaprix enjoys a unique partnership with Rogers Publishing to produce *Glow* and *Pure*, the country's leading beauty and health magazines. With circulations of more than 370,000 for *Glow* and 75,000 for *Pure*, these magazines are sold at retail stores and distributed free of charge as a special reward to select Shoppers Optimum® cardholders. By partnering with Rogers, we are able to reward loyal customers and showcase innovative beauty and personal care products that are available only at Shoppers Drug Mart/Pharmaprix.

Cosmetic Outstanding Service Awards (COSA) 2010 winners

A point of differentiation at Shoppers Drug Mart/Pharmaprix and Murale™ is the friendly, unbiased and professional service that our beauty advisors provide to customers each and every day. Our beauty advisors continue to be recognized for outstanding service leadership in the industry. Last year, at the 2010 COSA ceremony, a number of them received top honours in recognition of their outstanding customer service. We celebrate their success and congratulate them on this achievement.

Lesley Ordiway SDM Guelph, ON	Tammy Trenholm Murale Toronto, ON	Amaris Crawford Murale Calgary, AB	Cristy Manimtim SDM Winnipeg, MB	Craig MacMillan SDM Dartmouth, NS

Team winners

Murale, Hull Block, Calgary – Amanda Watt (left), Manal Souraya (bottom centre), Lori Bartlett (top centre), Victoria McInerney (right)

Pharmaprix, Place Ville Marie, Montreal – (left to right) Jordhanne Bernard Garcia, Vanessa Lajeunesse, Danielle Rouleau, Manana Barav, Sebastien Manseau, Carmen Romero

***Private label and exclusive brands continue to be a key component of our value proposition and resonate well with our customers.** At the end of 2010, there were more than 7,000 different items and sizes of corporate brand and exclusive products within our assortment. In 2010, the sales penetration rate of corporate and exclusive brand products increased to 19% of front store sales.*

SERVICE & CONVENIENCE

leaders in service and CONVENIENCE

At Shoppers Drug Mart/Pharmaprix, we are focused on ensuring that our customers and patients have the products they need, when they need them. With an extensive network of stores located in communities across the country, expanded hours of operation and an assortment of innovative products and services, we are the largest and most convenient drug store retailer in Canada.

foodEssentials

Food Essentials™ Canadians are increasingly looking for healthy, convenient food options. *Our Food Essentials™ section, available in more than 680 large format stores, offers customers a vast selection of everyday food items, including milk, eggs, juice, bread, frozen foods and other healthy consumables.*

OPEN 24 HRS

The door is always open

In addition to health and beauty, convenience is a cornerstone of our value proposition. Whether it's household items, health and wellness products or innovative services, Shoppers Drug Mart/Pharmaprix is there for our customers, where and when they need us. Our store locations are accessible to 90% of the Canadian population, with more than one-third open to midnight or 24 hours a day.

Exclusive food brands In 2010, we launched Simply Food™, an exclusive line of more than 90 packaged food products, to meet the growing demand for healthy, convenient food options. Simply Food™ includes a range of frozen foods, healthy consumables and snacks, all made with quality ingredients and no hydrogenated oils. Response from customers has been very positive and, as a result, in 2011, we will be expanding this offering with additional healthy options under the Simply Food "Good for Life" brand. Our Nativa® line of organic food products continues to do well with health conscious customers looking for delicious, wholesome foods that they can feel good about purchasing for their families. In 2011, we will be redesigning and refreshing the Nativa® line, adding more than 30 new products to the assortment. Whether it's dinner on the go, party preparation or healthy snacks, Shoppers Drug Mart/Pharmaprix has everything to meet the needs of today's time-starved consumers.

Convenience at Shoppers Drug Mart extends beyond the number of stores and operating hours*; it also includes providing our customers with convenient services and innovative products we know they will value. In 2010, we partnered with a number of leading companies and brands to introduce several new products and services, all designed to respond to our customers' needs for greater service and convenience.*

SERVICE & CONVENIENCE

easypix

Shoppers Drug Mart/Pharmaprix offers affordable and convenient options for customers to print and share photos. Knowing that Canadians are looking for more personalized, creative ways to share their memories, we partnered with Fujifilm to expand our in-store and online photo services to meet the changing demands of our customers. In 2010, we successfully implemented an expanded online offering and began the phased rollout of enhanced in-store kiosks across 700 stores. This means that customers now have access to personalized products, such as photo books, greeting cards and calendars, both in-store and from the comfort of their home or office.

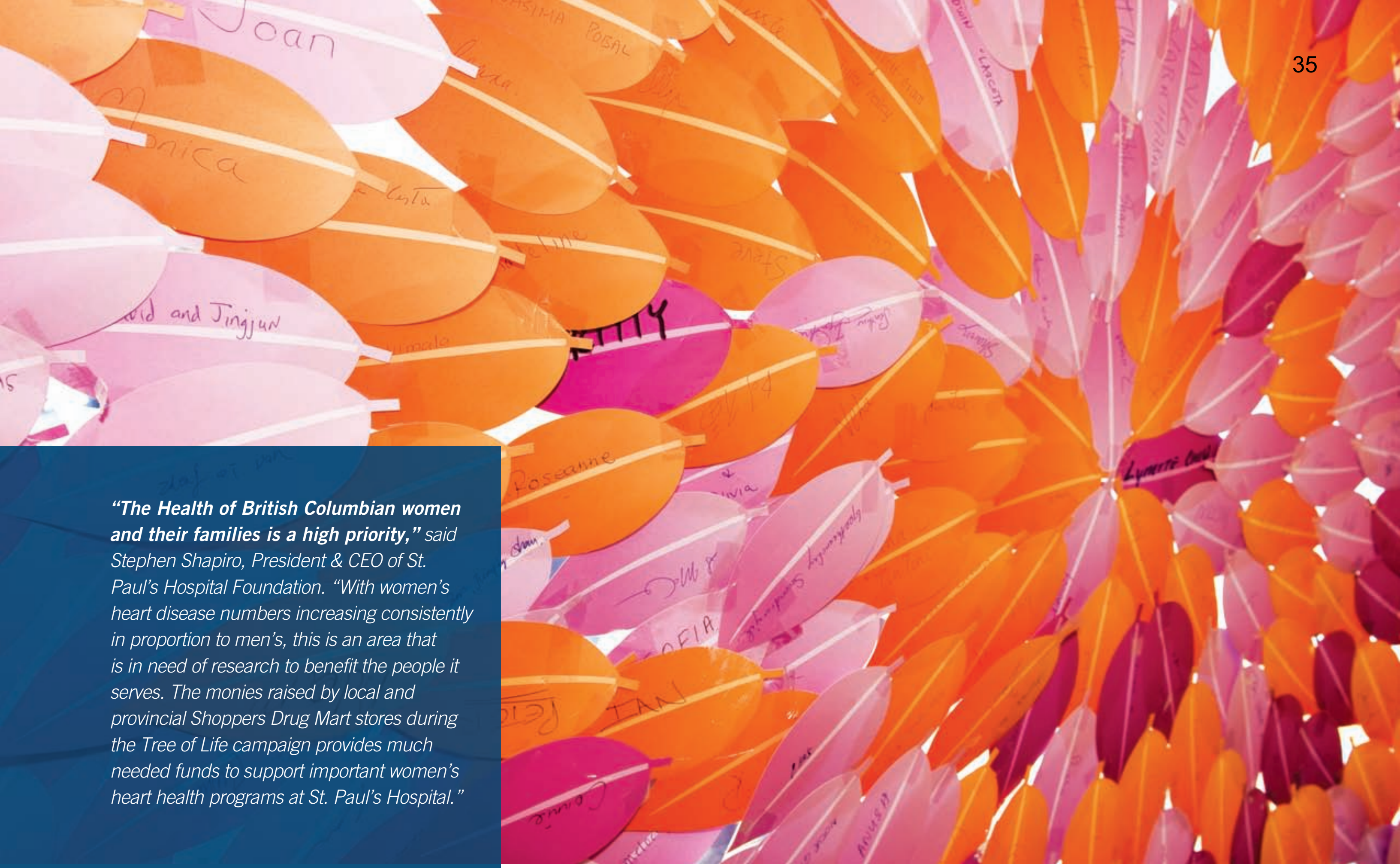
New brands Evolving our private label offering and increasing their penetration of our front store sales mix remain key priorities for us at Shoppers Drug Mart/Pharmaprix. In 2010, we introduced more than 1,000 new products and launched five new brands – Amigo™, Baby Life™, Bath Retreat™, Etival™ and Simply Food™. In addition to further differentiating us from the competition and providing better value to our customers, sales of private label and exclusive brand products benefit margins and enhance profitability.

Canada Post With more than 625 full-service postal outlets in stores across the network, Shoppers Drug Mart/Pharmaprix is the largest franchisee of Canada Post. This convenient and differentiated service provides customers with access to a complete range of postal products and services at locations and times best-suited to fit the demands of their busy schedules.

More for your loyalty With more than 10.5 million active cardholders, Shoppers Optimum® is one of the largest and most successful retail loyalty card programs in Canada. We continue to look for ways to reward and incent our loyal customers, strengthening the program and extending its reach. In 2010, Shoppers Optimum® celebrated its 10th anniversary with a four-week promotional event that offered customers unprecedented savings and rewards. The Very Important Baby program, launched in 2009, continues to grow with more than 215,000 members, as does Shoppers Optimum Plus®, a premium tier program that provides our most valued customers with additional rewards and exclusive offers.

v.i.b. Rewards for a very important baby and you.

At your service As the digital world continues to evolve, we remain committed to enhancing our online capabilities. The recent launch of our mobile application is just one of the many ways we are using technology to create a convenient shopping experience for our patients and customers. The mobile application enables patients and customers to access product information, view our flyer, manage their Shoppers Optimum® account and refill prescriptions, anytime, anywhere. Looking ahead, we will continue to expand our digital presence and enhance our website offering.



"The Health of British Columbian women and their families is a high priority," *said Stephen Shapiro, President & CEO of St. Paul's Hospital Foundation. "With women's heart disease numbers increasing consistently in proportion to men's, this is an area that is in need of research to benefit the people it serves. The monies raised by local and provincial Shoppers Drug Mart stores during the Tree of Life campaign provides much needed funds to support important women's heart health programs at St. Paul's Hospital."*

CSR & SUSTAINABILITY

leaders in our COMMUNITIES

As one of Canada's leading and most-trusted retailers, we have an obligation to conduct our business in a socially responsible manner. Throughout our business operations, we strive to protect the health, safety and well-being of our employees, patients and customers, the communities in which they live and work and ultimately, our collective environment.

Community investment

As a leader in health and community pharmacy, Shoppers Drug Mart/Pharmaprix continues to invest in the well-being of Canadians and our communities. Fundamentally, we believe that when Canadian women are healthy and well, Canada is healthy and well. Our commitment to advancing women's whole health – mind, body, spirit – is an expression of our vision for healthy communities all across the country.

In 2010, we solidified our community investment platform: Shoppers Drug Mart WOMEN supporting women's health. Together with our Associate-owners, we have focused our collective philanthropic and community investment activities on a series of initiatives in support of women's health. In addition to increasing awareness and elevating women's health as a cause worthy of Canadians' attention and support, we helped raise more than $10.8 million in 2010 to benefit over 450 women's health organizations.

In 2011, our Shoppers Drug Mart WOMEN's platform will be brought to life by five impactful partnership programs – Tree of Life®, Shoppers Drug Mart/Pharmaprix Weekend to End Women's Cancers™, Motherisk, facingcancer.ca and womenshealthmatters.ca.

WOMEN body mind spirit
your health. our commitment. SHOPPERS DRUG MART

Tree of Life® The Tree of Life® Campaign is our largest in-store fundraising activity. Since its inception in 2002, this locally driven fundraising effort has raised more than $14.7 million for community-based health initiatives. In 2010, we refreshed the look and feel of the campaign to ensure consistency with our new commitment to WOMEN. Last year, this campaign's fundraising activities raised $2.1 million that was directed to 386 local causes and charitable initiatives advancing women's health – more funds than have ever been raised through Tree of Life® in any previous year.

Shoppers Drug Mart/Pharmaprix Weekend to End Women's Cancers™ As title sponsor of The Shoppers Drug Mart/Pharmaprix Weekend to End Women's Cancers™, we are pleased to support an event that raises funds in support of research and programs for women's cancers at five leading Canadian cancer institutions. In 2010, with more than 1,000 walkers and volunteers participating in walks at six sites across Canada, our team alone raised an impressive $1.2 million. In total, the walks raised $24.7 million in support of essential services specific to women's cancer research and patient care. For 2011, we have increased our goals and are inviting all Canadians to follow our lead and join us in the walk.

More than 1,000 Associate-owners and employees participated in the walks, raising an impressive $1.2 million

> *"The Canadian Mental Health Association – Moncton is delighted that Shoppers Drug Mart has demonstrated the value it places on the health of all Canadians by supporting Women & Wellness across the country. The event literally changes the way people living with mental illness understand their disorder, while helping all guests realize how common and how hidden brain-based disorders are, touching every family."*
>
> ***Helen MacDonnell,*** *Chair, Awareness & Fundraising, Canadian Mental Health Association, Moncton*

Motherisk For the past 25 years, Motherisk, a program of the Hospital for Sick Children, has provided information about the risk or safety of prescription and over-the-counter medications, herbal products, chemicals, x-rays, chronic diseases and infections to new or expectant mothers during pregnancy and while nursing. Through our support, Motherisk now has a national toll-free helpline enabling counselors to receive calls from new and expectant mothers, as well as caregivers and healthcare professionals. We also have Motherisk wallet guides at our dispensary counters to provide our customers and patients with answers to the most commonly asked questions and to ensure they have the toll-free number at their fingertips.

facingcancer.ca Committed to women's health in body, mind and spirit, Shoppers Drug Mart WOMEN supports facingcancer.ca, the first major online community where women living with cancer can share, learn, confide and connect. In partnership with the Canadian Cosmetic Toiletry and Fragrance Association Foundation, facingcancer.ca will connect women living with cancer and all who care for them with experts, video workshops, resources and each other.

womenshealthmatters.ca In partnership with Women's College Hospital, Shoppers Drug Mart WOMEN is lending its support to several initiatives designed to improve and increase the tools and information women need to make good health choices. We are now the premier sponsor of the hospital's popular website, womenshealthmatters.ca, are supporting the creation of a new website focused on women's mental health and are helping to develop a national women's health report to guide the creation of resources women need to achieve optimal health.

TREE OF LIFE
in support of women's health

MOTHERISK
TREATING THE MOTHER –
PROTECTING THE UNBORN

FacingCancer TOGETHER
FacingCancer.ca

SHOPPERS DRUG MART
Weekend to End Women's Cancers
Benefiting
The Campbell Family Institute
AT THE PRINCESS MARGARET

WOMENSHEALTHMATTERS.CA
WOMEN'S COLLEGE HOSPITAL

Employee Relations

At the heart of Shoppers Drug Mart/Pharmaprix are our employees, Associate-owners and their teams. We continue to build a culture based on the core values of ownership and accountability; passion for results; customer-driven innovation; and people and community. We are committed to providing our employees with competitive wages and benefits, safe and equitable working conditions, training and development programs and opportunities to grow.

Employee engagement Attracting and retaining talent is critical to our success. We are committed to being a great place to work and conduct regular employee engagement surveys to better understand employees' perception and satisfaction with their work environment. Participation in our annual employee engagement surveys is exceptional and ranges from 80% to 90% across the organization. This year's results indicate that employees are proud to work for Shoppers Drug Mart/Pharmaprix, have positive perceptions of day-to-day work and believe the Company operates ethically and with integrity. In 2011, we will remain focused on areas identified as opportunities for improvement so that we can help push our employee engagement scores even higher.

Recognizing employees for their contributions above and beyond our annual compensation and benefits is essential in ensuring their continued engagement. Beyond the Call is a peer-nominated rewards and recognition program for corporate and regional office employees, while the Extra Mile program rewards exemplary behaviour and customer service at the store level. Both programs are highly valued by our employees and continue to play a key role in helping us build employee engagement.

Leaders in training and development We have a tremendous pool of talent within Shoppers Drug Mart/Pharmaprix and remain committed to hiring from within whenever possible. Continuous development is essential to our efforts to promote from within. To that end, we recently launched Shoppers Drug Mart University – a centralized resource for learning and development. Comprised of three academies, Pharmacy, Retail and Corporate, Shoppers Drug Mart University integrates employee development with business priorities and strategic objectives.

Our Leadership Excellence and Development (LEAD) program for future Associates, store managers and cosmetic managers continues to be a key component of our learning and education program offerings. In 2010, we redesigned and launched our online version of the program, entitled LEAD Foundations. Advanced LEAD was also introduced to further develop LEAD Foundations graduates, enabling them to apply what they have learned in a store environment via structured learning, supported by a coach. In 2010, the Pharmacy Technician certification training program was enhanced and the Platinum Plus component of this program was rolled out to support Pharmacy Infinity.

The beauty area of our business saw an increased investment in training and development in 2010 with the launch of a suite of e-learning programs directed towards store cosmeticians and cosmetic managers, equipping them to excel in their roles as experts in customer service and product knowledge.

In 2010, we also introduced a new learning management system for store-level employees to provide them with targeted learning experiences that are accessible anytime, anywhere. In 2011, we will introduce this system to our corporate and regional office employees.

The Shoppers Drug Mart Pharmacists of Tomorrow summer employment and training program for pharmacy students is critical to our success in recruiting recent graduates and newly licensed pharmacists from across the country. In 2010, students from every pharmacy school in Canada participated in this program, further developing their skills as future community pharmacists.

Diversity We embrace diversity as an essential part of how we conduct business. Our diverse workforce, along with that of our Associate-owners, includes men and women who vary in age, race, national origin, religious affiliation, sexual orientation and educational background. We value and respect the different ideas, opinions and communication styles of all employees.

In 2010, our diversity representation within our employee base at the director level and above remained consistent with the previous year. We continue to pursue diversity initiatives to support our inclusive environment, including communicating important events relevant to our diverse communities and surveying our corporate and regional office employees and Associate-owners, to ensure that our diversity programs and initiatives achieve the greatest impact.

Environmental responsibility

Shoppers Drug Mart/Pharmaprix is committed to reducing the impact of our operations on the environment and enabling our customers and employees to adopt greener practices. To that end, we have a number of ongoing initiatives focused on waste reduction and diversion, energy conservation and efficiency, and innovation within our product offering.

Waste reduction and diversion With a commitment to eliminating and reducing the volume of waste destined for landfills, we have undertaken a number of cost-effective diversion programs throughout the Company and across the store network. In 2010, we recycled 25,156 tonnes of fibre and 13,404 tonnes of waste, saving the equivalent of 427,668 trees.

In 2010, we undertook a zero waste pilot in 26 stores in British Columbia to better understand achievable goals for zero waste at store level. The goal of zero waste is to turn organics into compost, reuse recyclables and convert non-recyclables into electricity. While the pilot is still underway, we continue to garner key learnings that can be applied to other stores.

Since 2004, we have offered our Sharps Medication and Disposal service in all of our stores to provide customers with a safe disposal option for expired medications and syringes. Expired products and syringes are transferred from our store in a tamper-proof container to be incinerated, preventing risks to patient health and ensuring that these materials do not enter the waste stream.

Energy efficiency Since 2007, Shoppers Drug Mart/Pharmaprix has been focused on improving our energy efficiency by investing in energy management systems for our stores. At the end of 2010, efficient energy management systems had been installed in 526 of our stores and we plan to increase this to more than 700 stores by the end of 2011.

In addition to day-to-day energy management practices, we are also proud to participate in the WWF's Earth Hour activities each March. Building on the prior year's momentum, we were able to more than double store participation in 2010 to in excess of 400 stores.

Reducing PVC's and phthalates We recognize the importance of reducing PVC's and phthalates in our private label products and packaging and, accordingly, have committed resources and undertaken a number of initiatives to achieve that goal. An important first step for our Company was to establish and understand the baseline presence of PVC packaging associated with our private label products. We have completed this initial work and now know which categories and in what format the presence of PVC exists. Most importantly, we are committed to reducing the PVC and phthalates associated with our private label products moving forward. This commitment extends from senior management to our quality assurance team who will lead the project of reducing PVC and phthalates associated with our private label products.

Currently, we have a number of ongoing initiatives to actively reduce and/or eliminate the PVC in our packaging. By way of example, we are transitioning medicinal thermometers from PVC clamshell packaging to cardboard packaging, with some sku's having already been changed and further sku's in the process of being converted. We are also moving a portion of our first aid products from clamshell packaging to cardboard and have identified a high selling item in our cosmetic line that will be switched over to PETE packaging from PVC. Finally, we have identified a number of other packaging conversion projects and are currently assessing their potential.

In terms of phthalates, understanding their existence in our products is a complex and extensive project that we have undertaken and made significant progress on. We are currently investigating and identifying potential sources of phthalates in our assortment of private label products and once those sources have been identified, we will formulate an action plan. At the same time, we are focused on bringing new products to market that are designed to be phthalate and BPA free. A tangible example of our efforts in this area was the 2010 launch of our new line of products under our Baby Life™ brand.

In addition to these initiatives, we are committed to setting objectives, targets and metrics for the reduction of PVC and phthalates associated with our private label packaging and products. It is our intention to have these in place by the end of the first quarter of 2011 and we look forward to sharing information on our progress and achievements in future reports.

Product safety and sourcing

At Shoppers Drug Mart/Pharmaprix the health and safety of our customers and employees is of paramount importance to us. As such, we have stringent product safety protocols in place and work with our vendor partners to ensure that our customers and patients have high-quality merchandise, medications and consumables that are safe, responsibly sourced and competitively priced.

In order to ensure adherence to our own strict guidelines, as well as government regulations, all of our vendors must follow the terms and conditions outlined in our vendor agreement. This agreement clearly states our expectations for product quality, safety and adherence to government regulations. In addition to the agreement, where necessary, we also insist on reviewing social compliance audits before conducting business with our international vendors. If an audit is not available, we will work with independent third-party auditors to ensure a thorough audit of the vendor's operations and production facilities has been completed.

All globally sourced products are tested prior to being shipped to Canada to ensure they comply with all protocols outlined by the appropriate regulatory bodies and by Shoppers Drug Mart/Pharmaprix. If a product does not meet with these protocols and does not pass our tests for quality assurance, it will be refused.

Our private label products also undergo quality assurance testing and our vendors must provide product specifications for all new private label product introductions. All of this information is reviewed and approved by our Product Development and Quality Assurance Team and detailed records are maintained for each product.

NOT TESTED
ON ANIMALS

Shoppers Drug Mart/Pharmaprix does not commission the use of animal testing for any of our private label products.

We follow the direction of Health Canada and the Federal Government when it comes to determining what is safe for sale and use by our patients and customers. We believe that these authorities are best positioned to identify and prevent potential dangers to consumers and therefore, we follow their guidance in this regard. Through direct contact with Health Canada and our membership with associations such as the Canadian Cosmetic, Toiletry and Fragrance Association, the Canadian Association of Chain Drug Stores and the Retail Council of Canada, we are kept apprised of emerging issues within the area of product safety. Our active involvement with these groups provides us with the required time and information necessary to take proactive steps to minimize the impact on our business and protect the safety of our customers and patients.

While we have stringent protocols in place, it is not always possible to identify a specific product concern in advance. To ensure we respond to any concerns, quickly and effectively, Shoppers Drug Mart /Pharmaprix has a clearly identified recall process in place.

We are encouraged by the attention that has been given to customer product safety by governments and government agencies and remain committed to working with them to ensure the safety of our customers and patients.

annual management's discussion and analysis

as at March 11, 2011

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

Forward-looking Information and Statements

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

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

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

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

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

Overview

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

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

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

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

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

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

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

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

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

Strategies and Outlook

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

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

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

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

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

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

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

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

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

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

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

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

Overall Financial Performance

Key Operating, Investing and Financial Metrics

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

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

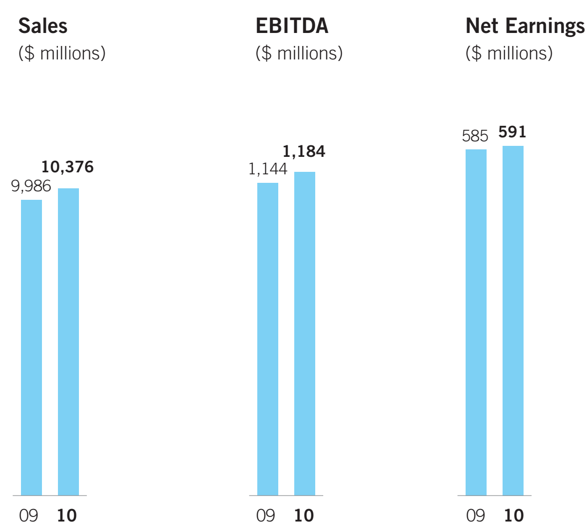
(1) Earnings before interest, taxes, depreciation and amortization, inclusive of a $10 million (pre-tax) charge to settle a long-standing legal dispute related to a commercial arrangement with one of the Company's ancillary businesses. (See reconciliation to the most directly comparable GAAP measure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

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

(3) EBITDA divided by sales.

(4) Adjusted EBITDA divided by sales.

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



Results of Operations – Fiscal 2010

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

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

[1] Earnings before interest, taxes, depreciation and amortization.

Sales

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

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

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

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

Cost of Goods Sold and Other Operating Expenses

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

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

Amortization

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

Operating Income

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

Interest Expense

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

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

Income Taxes

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

Net Earnings

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

Capitalization and Financial Position

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

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

[1] Cash interest expense excludes the amortization of deferred financing costs but includes capitalized interest.

Financial Ratios and Credit Ratings

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

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

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

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

Outstanding Share Capital

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

Dividend Policy

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

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

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

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

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

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

Normal Course Issuer Bid

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

Financing Activities

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

Liquidity and Capital Resources

Sources of Liquidity

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

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

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

Cash Flows from Operating Activities

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

Cash Flows Used in Investing Activities

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

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

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

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

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

Cash Flows Used in Financing Activities

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

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

Future Liquidity

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

Contractual Obligations

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

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

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

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

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

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

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

Selected Annual Information

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

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

Sales

2010 Compared to 2009

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

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

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

2009 Compared to 2008

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

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

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

Net Earnings

2010 Compared to 2009

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

2009 Compared to 2008

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

Dividends Declared per Common Share

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

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

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

[1] The cash dividends declared per share in 2009 were unchanged from the cash dividends declared per share in 2008.

Total Assets

2010 Compared to 2009

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

2009 Compared to 2008

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

Total Long-term Liabilities

2010 Compared to 2009

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

2009 Compared to 2008

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

Quarterly Information

Reporting Cycle

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

Summary of Quarterly Results

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

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

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

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

Results of Operations – Fourth Quarter of Fiscal 2010

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

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

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

[1] Earnings before interest, taxes, depreciation and amortization.

Sales

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

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

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

Cost of Goods Sold and Other Operating Expenses

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

Amortization

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

Operating Income

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

Interest Expense

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

Income Taxes

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

Net Earnings

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

Cash Flows

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

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

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

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

Critical Accounting Estimates

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

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

Inventory

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

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

Shoppers Optimum®

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

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

Employee Future Benefits

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

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

			2010			2009
	Registered Defined Benefit Pension Plans	**Non-registered Defined Benefit Pension Plan**	**Other Post-employment Benefit Plans**	Registered Defined Benefit Pension Plans	Non-registered Defined Benefit Pension Plan	Other Post-employment Benefit Plans
Accrued benefit obligation, end of period						
Discount rate	**5.25%**	**2.50%**	**5.00%**	6.00%	2.88%	6.00%
Compensation increase	**4.00%**	**4.00%**	**4.00%**	4.00%	4.00%	4.00%
Benefit expense for the period						
Discount rate	**6.00%**	**2.88%**	**5.25%**	6.75%	3.25%	6.75%
Expected return on assets	**7.50%**	**3.75%**	**N/A**	7.50%	3.75%	N/A
Compensation increase	**4.00%**	**4.00%**	**4.00%**	4.00%	4.00%	4.00%

The discount rate is based on current market interest rates at the end of the Company's fiscal year, assuming a portfolio of corporate AA rated bonds with terms to maturity that, on average, match the terms of the accrued benefit plan obligations. A 1% increase in the assumed discount rate would decrease the amount of the Company's accrued benefit obligation and benefit expense in respect of its registered and non-registered defined benefit plans by $17 million and $2 million, respectively. Conversely, a 1% decrease in the assumed discount rate would increase the amount of the Company's accrued benefit obligation and benefit expense in respect of its registered and non-registered defined benefit plans by $20 million and $2 million, respectively.

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

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

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

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

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

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

Income and Other Taxes

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

Goodwill and Intangible Assets

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

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

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

Prescription files	7 to 12 years
Customer relationships	5 to 25 years
Computer software	3 to 10 years
Other	Lease term or 3 years

New Accounting Pronouncements

Transition to International Financial Reporting Standards

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

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

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

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

Opening Balance Sheet – IFRS 1 Elections and Accounting Policy Changes

IFRS 1 Elections

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

Standard/Topic	Options	Expected Financial Impact on the Company's January 3, 2010 Opening Balance Sheet (unaudited)
Business Combinations	• When adopting IFRS, an entity would normally apply IFRS 3, "Business Combinations" ("IFRS 3"), as if it had always been applied and therefore assess all previous business combinations for compliance with IFRS and make any necessary adjustments. • A first-time adopter can elect under IFRS 1 to apply IFRS 3 prospectively to business combinations that occurred before a chosen date that is no later than the date of transition.	The Company elected under IFRS 1 to not apply IFRS 3 retrospectively. The primary impact of this election is with respect to certain transaction costs incurred in historical acquisitions which were capitalized under Canadian Generally Accepted Accounting Principles ("GAAP") that would have been expensed under IFRS. As a result, no adjustment is required to the carrying values on the Company's opening balance sheet.

Standard/Topic	Options	Expected Financial Impact on the Company's January 3, 2010 Opening Balance Sheet (unaudited)
Employee Benefits	• IFRS 1 allows first-time adopters to recognize previously unrecognized actuarial gains and losses on defined benefit pension plans in retained earnings at the date of transition. • If this election is not taken, an entity is required to account for each plan as if IFRS had been applied since plan inception.	The Company has chosen to take this election, resulting in the recognition of previously unrecognized actuarial losses as a charge to opening retained earnings and an increase in the liability for employee future benefits. Upon implementation of IFRS, the Company expects the impact to be an increase in other long-term liabilities of $8.2 million, a decrease in deferred income tax liabilities of $2.3 million and an after-tax charge to opening retained earnings of $5.9 million.
Fair Value or Revaluation as Deemed Cost	• A first-time adopter may elect to measure an item of property, plant and equipment, intangible asset or investment property at the transition date at its fair value and use that fair value as deemed cost at that date.	The Company has chosen to continue to use historical cost for items of property and equipment, intangible assets and investment properties.

Accounting Policy Changes

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

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

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

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

Summary of Opening Retained Earnings Impacts

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

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

Other IFRS Considerations

Balance Sheet

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

2010 Interim Financial Results Impact

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

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

Impact on Other Business Activities

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

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

Future Accounting Standards

Financial Instruments – Disclosures

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

Financial Instruments

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

Risks and Risk Management

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

Industry and Regulatory

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

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

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

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

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

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

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

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

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

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

(i) *The lowering of the cost of most generic prescription drugs by at least 50%, to 25% of the cost of the corresponding original brand name drug* – For Ontario's public drug system, this cost reduction occurred on July 1, 2010. For private payers, as of July 1, 2010, the cost of most generic prescription drug products was limited to a maximum of 50% of the cost of the original brand name drug and the cost will be further limited to a maximum of 35% on April 1, 2011 and to a maximum of 25% on April 1, 2012. After April 1, 2012, there will be parity with the drug benefit price under the public drug system.

(ii) *The elimination of professional allowances from Ontario's public drug system as of July 1, 2010 and the phase-out of professional allowances from the private payer system by April 1, 2013* – On July 1, 2010, professional allowance funding for sales of interchangeable prescription drug products reimbursed under Ontario's public drug program was eliminated and, on private sector sales, a cap on professional allowance funding equal to 50% of sales of interchangeable prescription drug products that are not reimbursed under Ontario's public drug program was imposed. The cap on professional allowance funding in the private sector will be reduced to 35% on April 1, 2011 and will be further reduced to 25% on April 1, 2012. Professional allowance funding will be eliminated in the private sector by April 1, 2013.

(iii) *Increasing the dispensing fees paid to pharmacy operators under Ontario's public drug plan, with larger increases for those operators in rural communities and underserviced areas* – On July 1, 2010, dispensing fees paid under Ontario's public drug plan to most pharmacy operators increased from \$7.00 to \$8.00, while the dispensing fee for certain rural pharmacy operators in underserviced areas increased from \$7.00 to between \$9.00 and \$12.00. The dispensing fees paid under Ontario's public drug plan will increase annually over the next four years, ultimately reaching \$8.83 for most pharmacy operators and up to \$13.25 for certain pharmacy operators in underserviced and rural areas by April 1, 2014.

(iv) *Provision of transitional support fees* – To support the transition to a pharmacy reimbursement model aimed at supporting professional services, a transition fee is being provided to pharmacy operators. Beginning on July 1, 2010, a transition fee, in the form of an additional $1.00 on top of the dispensing fees paid under Ontario's public drug plan, is being provided to pharmacy operators. The transition fee is intended to provide support to pharmacy operators until pharmacy operators can offer additional professional services, which have yet to be defined. This transition fee will decrease to $0.65 on April 1, 2011 and to $0.35 on April 1, 2012 and will be eliminated after March 31, 2013.

(v) *Allowances for ordinary commercial terms* – The Ontario Regulatory Amendments allow manufacturers to provide a benefit to pharmacies in accordance with ordinary commercial terms provided that the benefit meets certain specified conditions including, for interchangeable prescription drug products, that the benefit is a prompt payment discount, a volume discount or a distribution service fee and is provided in the ordinary course of business. In addition, the total value of any benefits provided in accordance with ordinary commercial terms for interchangeable prescription drug products cannot exceed: (i) for the purposes of Ontario's public drug system, 10% of the value of the listed drug products based on the drug benefit price and the number of units dispensed by a pharmacy and reimbursed under the ODBA; and (ii) for the purposes of the private system, 10% of the value of the interchangeable prescription drug products not supplied to an eligible person under the ODBA based on the number of units dispensed by a pharmacy at each product's regulated price. For prescription drug products that are not interchangeable, only a prompt payment discount may be provided.

(vi) *Prohibition on private label products* – The Ontario Regulatory Amendments provide that a prescription drug product that falls under the definition of a "private label product" will not be designated as an interchangeable prescription drug product or as a listed drug product for the Ontario Drug Benefit Program. Designation as an interchangeable prescription drug product is generally necessary for market adoption of generic prescription drug products and designation as a listed drug product for the Ontario Drug Benefit Program is necessary for public reimbursement. The Company pursued a legal challenge to the validity of the prohibition under the current legislation. On February 3, 2011, the Ontario Divisional Court released its decision in respect of the Company's application for judicial review of the prohibition on "private label products" under the Ontario Regulatory Amendments. In its decision, the Ontario Divisional Court found in favour of the Company and Katz Group Canada Inc. (the applicant in a parallel application) and declared the regulatory restrictions in respect of "private label products" to be invalid. The Government of Ontario has since filed its Notice of Motion seeking leave to appeal the decision of the Ontario Divisional Court to the Court of Appeal.

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

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

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

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

(i) *Setting a cap on generic prescription drug prices* – Set a cap on the price of generic prescription drugs based on a percentage of the price of the equivalent brand name drug.

(ii) *Limiting pharmacy rebates* – Require generic prescription drug manufacturers to report the rebates they pay to community pharmacies for stocking their generic prescription drug products, and limit the amount of these rebates.

(iii) *Tendering for one or more prescription drugs* – Establish a competitive process in which the province asks manufacturers for a better price for one or more prescription drugs and list the prescription drug or prescription drugs that come in at that price for coverage under the public drug program.

(iv) *Establishing rules around price increases for generic prescription drug products.*

(v) *Defining the price paid to pharmacies for prescription drugs* – Establish a clearly defined price paid by the government to community pharmacies for brand name drugs.

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

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

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

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

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

Economic and Financial Conditions

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

Competition

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

Ability to Manage Growth and Maintain Profitability

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

Ability to Attract and Retain Pharmacists

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

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

Reliance on Key Personnel

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

Reliance on Information Systems and Technology

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

Employee Future Benefits

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

Third-party Service Providers

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

Real Estate

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

Seasonality

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

Alternative Arrangements for Sourcing Generic Drug Products

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

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

Environmental Compliance

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

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

Ethical Business Conduct

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

Property and Casualty Exposures

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

Workplace Health and Safety

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

Legal, Tax and Accounting

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

Compliance with Privacy Laws

In Canada, the *Personal Information Protection and Electronic Documents Act* ("PIPEDA") was passed into law by the federal government effective as of January 1, 2001. Currently, this law applies to all organizations that collect, use or disclose personal information in the course of commercial activities, except to the extent that provincial privacy legislation has been enacted and declared substantially similar to the federal legislation. To date, the provinces of Québec, British Columbia and Alberta have enacted substantially similar private sector privacy legislation. In addition, Ontario has enacted comprehensive personal health information protection legislation substantially similar to PIPEDA. Other provinces, including Alberta, Saskatchewan and Manitoba, have also passed personal health information protection legislation, but these laws have not yet been declared substantially similar to PIPEDA. As a result, both PIPEDA and these provincial statutes may apply to private sector organizations in relation to personal health information in these three provinces. The federal privacy legislation, PIPEDA, also regulates the inter-provincial collection, use and disclosure of personal information. Applicable Canadian privacy laws create certain obligations on organizations that handle personal information, including obligations relating to obtaining appropriate consent, limitations on use and disclosure of personal information and ensuring appropriate security safeguards are in place. In the course of its business, the Company maintains records containing sensitive information identifying or relating to individual customers and employees. Although the Company has implemented systems to comply with applicable privacy laws in connection with the collection, use and disclosure of such personal information, if a significant failure of such systems were to occur, the Company's business and reputation could be adversely affected.

Associate-owned Store Network

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

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

Supplier and Brand Reputations

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

Business Continuity

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

Litigation

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

Other

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

Risks Associated with Financial Instruments

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

Exposure to Interest Rate Fluctuations

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

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

Furthermore, the Company may be exposed to losses should any counterparty to its derivative agreements fail to fulfill its obligations. The Company has sought to minimize counterparty risk by transacting with counterparties that are large financial institutions. There was no unrecognized exposure as at January 1, 2011, as the Company was not party to any interest rate derivative agreements as at that date.

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

Foreign Currency Exchange Risk

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

Credit Risk

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

Other Price Risk

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

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

Capital Management and Liquidity Risk

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

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

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

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

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

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

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

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

Disclosure Controls and Procedures

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

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

Internal Controls over Financial Reporting

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

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

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

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

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

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

Non-GAAP Financial Measures

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

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

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

Management's Responsibility for Financial Statements

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

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

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

David Williams
Interim President and Chief Executive Officer

Brad Lukow
Executive Vice-President and Chief Financial Officer

TORONTO, ONTARIO
FEBRUARY 10, 2011

To the Shareholders of Shoppers Drug Mart Corporation

We have audited the accompanying consolidated financial statements of Shoppers Drug Mart Corporation, which comprise the consolidated balance sheets as at January 1, 2011 and January 2, 2010, and the consolidated statements of earnings, retained earnings, comprehensive income and accumulated other comprehensive loss and cash flows for each of the 52 week periods ended January 1, 2011 and January 2, 2010, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Shoppers Drug Mart Corporation as at January 1, 2011 and January 2, 2010, and the results of its operations and its cash flows for each of the 52 week periods ended January 1, 2011 and January 2, 2010 in accordance with Canadian generally accepted accounting principles.

Deloitte & Touche LLP

Chartered Accountants,
Licensed Public Accountants

TORONTO, ONTARIO
FEBRUARY 10, 2011

Consolidated Statements of Earnings

52 weeks ended January 1, 2011 and January 2, 2010 (in thousands of dollars, except per share amounts)	2010	2009
Sales	**$ 10,376,067**	$ 9,985,600
Operating expenses		
Cost of goods sold and other operating expenses (Note 3)	**9,192,181**	8,841,170
Amortization	**286,935**	248,794
Operating income	**896,951**	895,636
Interest expense (Note 5)	**56,036**	58,215
Earnings before income taxes	**840,915**	837,421
Income taxes (Note 6)		
Current	**238,779**	249,776
Future	**11,393**	2,737
	250,172	252,513
Net earnings	**$ 590,743**	$ 584,908
Net earnings per common share (Note 14)		
Basic	**$ 2.72**	$ 2.69
Diluted	**$ 2.72**	$ 2.69

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

Consolidated Statements of Retained Earnings

52 weeks ended January 1, 2011 and January 2, 2010 (in thousands of dollars)	2010	2009
Retained earnings, beginning of period	**$ 2,297,091**	$ 1,899,139
Net earnings	**590,743**	584,908
Dividends	**(195,698)**	(186,956)
Retained earnings, end of period	**$ 2,692,136**	$ 2,297,091

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

Consolidated Statements of Comprehensive Income and Accumulated Other Comprehensive Loss

52 weeks ended January 1, 2011 and January 2, 2010 (in thousands of dollars)	2010	2009
Net earnings	**$ 590,743**	$ 584,908
Other comprehensive income, net of tax		
Change in unrealized loss on interest rate derivatives (net of tax of $525 (2009 – $1,035))	**1,120**	1,967
Change in unrealized loss on equity forward derivatives (net of tax of $205 (2009 – $22))	**(521)**	56
Amount of previously unrealized loss recognized in earnings during the period (net of tax of $13 (2009 – $117))	**33**	294
Other comprehensive income	**632**	2,317
Comprehensive income	**$ 591,375**	$ 587,225

Accumulated other comprehensive loss, beginning of period	**$ (1,125)**	$ (3,442)
Other comprehensive income	**632**	2,317
Accumulated other comprehensive loss, end of period (Note 19)	**$ (493)**	$ (1,125)

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

Consolidated Balance Sheets

As at January 1, 2011 and January 2, 2010 (in thousands of dollars)	2010	2009
Assets		
Current		
Cash	**$ 64,354**	$ 44,391
Accounts receivable	**432,089**	471,029
Inventory (Note 3)	**1,957,525**	1,852,441
Income taxes recoverable	**20,384**	–
Future income taxes (Note 6)	**80,476**	86,161
Prepaid expenses and deposits (Note 4)	**68,468**	75,573
	2,623,296	2,529,595
Property and equipment (Notes 7, 12 and 17)	**1,709,656**	1,566,024
Goodwill (Notes 4 and 8)	**2,493,146**	2,481,353
Intangible assets (Notes 4 and 9)	**272,217**	258,766
Other assets	**23,895**	16,716
Total assets	**$ 7,122,210**	$ 6,852,454
Liabilities		
Current		
Bank indebtedness (Note 10)	**$ 209,013**	$ 270,332
Commercial paper (Note 10)	**127,828**	260,386
Accounts payable and accrued liabilities	**981,491**	964,736
Income taxes payable	**–**	17,046
Dividends payable	**48,927**	46,748
	1,367,259	1,559,248
Long-term debt (Note 11)	**943,412**	946,098
Other long-term liabilities (Note 12)	**399,651**	347,951
Future income taxes (Note 6)	**48,992**	42,858
	2,759,314	2,896,155
Associate interest	**138,993**	130,189
Shareholders' equity		
Share capital (Notes 14 and 15)	**1,520,558**	1,519,870
Contributed surplus (Note 15)	**11,702**	10,274
Accumulated other comprehensive loss (Note 19)	**(493)**	(1,125)
Retained earnings	**2,692,136**	2,297,091
	2,691,643	2,295,966
	4,223,903	3,826,110
Total liabilities and shareholders' equity	**$ 7,122,210**	$ 6,852,454

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

On behalf of the Board of Directors:

David Williams
Director

Consolidated Statements of Cash Flows

52 weeks ended January 1, 2011 and January 2, 2010 (in thousands of dollars)	2010	2009
Operating activities		
Net earnings	**$ 590,743**	$ 584,908
Items not affecting cash		
Amortization	**283,401**	250,202
Future income taxes	**11,393**	2,737
Loss (gain) on disposal of property and equipment	**6,358**	(3,456)
Stock-based compensation (Note 15)	**1,592**	694
	893,487	835,085
Net change in non-cash working capital balances (Note 16)	**(81,527)**	(177,724)
Increase in other long-term liabilities	**19,914**	35,757
Cash flows from operating activities	**831,874**	693,118
Investing activities		
Purchase of property and equipment	**(414,775)**	(461,438)
Proceeds from disposition of property and equipment	**60,538**	30,106
Business acquisitions (Note 4)	**(12,990)**	(97,100)
Deposits (Note 4)	**1,534**	3,527
Purchase and development of intangible assets	**(56,625)**	(33,989)
Other assets	**(7,466)**	(4,310)
Cash flows used in investing activities	**(429,784)**	(563,204)
Financing activities		
Bank indebtedness, net (Note 10)	**(61,319)**	29,488
Commercial paper, net (Note 10)	**(133,000)**	(80,000)
Repayment of short-term debt (Note 10)	**–**	(200,000)
Issuance of Series 3 Notes (Note 11)	**–**	250,000
Issuance of Series 4 Notes (Note 11)	**–**	250,000
Revolving term debt, net (Note 11)	**(1,298)**	(198,702)
Financing costs incurred	**(2,792)**	(2,088)
Associate interest	**9,277**	11,511
Proceeds from shares issued for stock options exercised	**491**	4,481
Repayment of share purchase loans	**33**	137
Dividends paid	**(193,519)**	(186,917)
Cash flows used in financing activities	**(382,127)**	(122,090)
Increase in cash	**19,963**	7,824
Cash, beginning of period	**44,391**	36,567
Cash, end of period	**$ 64,354**	$ 44,391
Supplemental cash flow information		
Interest paid	**$ 58,320**	$ 44,818
Income taxes paid	**$ 276,108**	$ 223,296

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

1. SIGNIFICANT ACCOUNTING POLICIES

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

Description of the Business

Shoppers Drug Mart Corporation (the "Company") is a licensor of 1,182 Shoppers Drug Mart®/Pharmaprix® full-service retail drug stores across Canada. The Shoppers Drug Mart/Pharmaprix stores are licensed to Associate-owners ("Associates"). The Company also licenses or owns 59 Shoppers Simply Pharmacy®/Pharmaprix Simplement Santé® medical clinic pharmacies and eight Murale™ retail beauty stores. In addition, the Company owns and operates 63 Shoppers Home Health Care® stores. Collectively, the Company considers these the "store network". In addition to its store network, the Company owns Shoppers Drug Mart Specialty Health Network Inc., a provider of specialty drug distribution, pharmacy and comprehensive patient support services, and MediSystem Technologies Inc., a provider of pharmaceutical products and services to long-term care facilities in Ontario and Alberta.

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

Fiscal Year

The fiscal year of the Company consists of a 52 or 53 week period ending on the Saturday closest to December 31. The Company's 2010 and 2009 fiscal years consisted of 52 week periods.

Basis of Consolidation

Under the Canadian Institute of Chartered Accountants' ("CICA") Accounting Guideline 15, "Consolidation of Variable Interest Entities", the Company consolidates the Associate-owned stores. The individual Associate-owned stores that comprise the Company's store network are variable interest entities ("VIE") and the Company is the primary beneficiary. 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.

The consolidated financial statements include the accounts of Shoppers Drug Mart Corporation, its subsidiaries, and the Associate-owned stores that comprise the majority of the Company's store network. All intercompany balances and transactions are eliminated on consolidation.

Estimates

The preparation of the consolidated financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates are used when accounting for items such as acquisition and purchase price allocations, inventory provisions, Shoppers Optimum® loyalty card program costs, assumptions underlying the actuarial determination of employee future benefits, income and other taxes, the recognition and measurement of contingencies and when testing goodwill, intangible assets and long-lived assets for impairment. Actual results could differ from these estimates.

Revenue Recognition

The Company recognizes revenue at the time goods are sold, net of returns. Product returns are not significant.

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

Vendor Rebates

The Company classifies rebates and other consideration received from vendors as a reduction to the cost of inventory. These amounts are recognized in the cost of goods sold when the associated inventory is sold. Certain exceptions apply where the consideration received from the vendor is a reimbursement of a selling cost or a payment for services delivered to the vendor, in which case the consideration is reflected in other operating expenses.

Bank Indebtedness

Bank indebtedness is comprised of corporate bank overdraft balances, corporate and Associate-owned store bank lines of credit and outstanding cheques.

Inventory

Inventory is comprised of merchandise inventory, which includes prescription inventory, and is valued at the lower of cost and estimated net realizable value. Cost is determined on the first-in, first-out basis and includes all direct expenditures and other appropriate costs incurred in bringing inventory to its present location and condition. The Company classifies rebates and other consideration received from a vendor as a reduction to the cost of inventory unless the rebate clearly relates to the reimbursement of a selling cost or a payment for services.

Property and Equipment

Property and equipment are recorded at cost including capitalized interest. Interest is capitalized on property under development. Interest capitalization ceases when the property under development is ready for its intended use. Amortization is recorded on a straight-line basis over the estimated useful lives of the assets at the rates indicated below.

Buildings	10 to 40 years
Equipment and fixtures	3 to 10 years
Computer equipment	2 to 10 years
Leasehold improvements	Lesser of term of the lease and useful life
Assets under capital leases	Lesser of term of the lease and useful life

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

Goodwill

The Company records as goodwill the excess amount of the purchase price of an acquired business over the fair value of the underlying net assets, including intangible assets, at the date of acquisition. Goodwill is not amortized but is tested for impairment 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. The fair value of the reporting unit is estimated using the expected present value of future cash flows.

Intangible Assets

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

Prescription files	7 to 12 years
Customer relationships	5 to 25 years
Computer software	3 to 10 years
Other	Term of the lease or 3 years

Computer software that is an integral part of computer hardware is presented with computer equipment in property and equipment. All other computer software is treated as an intangible asset. The Company includes computer software under development in intangible assets. The assessment of whether computer software is an integral part of computer hardware is made when the software development project is complete and placed into use. Computer software under development is not amortized. Capitalized software costs include external direct costs and the payroll and payroll-related costs for employees who are directly associated with the software development project.

Intangible assets that are subject to amortization are tested for impairment when an indication of impairment exists. The Company reviews intangible assets subject to amortization for impairment at least annually. Intangible assets that are not subject to amortization are 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 intangible assets would be charged to earnings.

Leases

The Company leases most of its store locations and office space. Terms vary in length and typically permit renewal for additional periods. Leases for which substantially all the benefits and risks of ownership are transferred to the Company based on certain criteria are recorded as capital leases and classified as property and equipment, accounts payable and accrued liabilities and other long-term liabilities. All other leases are classified as operating leases under which minimum rent, including scheduled escalations, is expensed on a straight-line basis over the term of the lease, including any rent-free periods. Landlord inducements are deferred and amortized as reductions to rent expense on a straight-line basis over the same period. The Company capitalizes rent expense during a store's fixturing period to leasehold improvements.

In the normal course of business, the Company sells certain real estate properties and enters into leaseback agreements for the area occupied by the Associate-owned stores. The leases have been assessed as capital or operating in nature and have been accounted for accordingly. The gains realized on the disposal of the real estate properties related to sale-leaseback transactions, which are capital in nature, are deferred and amortized on a straight-line basis over the estimated useful life of the leased asset. The gains realized on the disposal of the real estate properties related to sale-leaseback transactions that are operating in nature are deferred and amortized on a straight-line basis over the lease term. The carrying value of the deferred gains is presented in accounts payable and accrued liabilities and other long-term liabilities in the consolidated balance sheets. In the event the fair value of the asset at the time of the sale-leaseback transaction is less than its carrying value, the difference would be charged to earnings.

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

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

Shoppers Optimum® Loyalty Program

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

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

Employee Future Benefits

The Company maintains registered defined benefit pension plans under which benefits are available to certain employee groups. The Company also makes supplementary retirement benefits available to certain employees under a non-registered defined benefit pension plan.

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

- The cost of pensions and other retirement benefits earned by employees is actuarially determined using the projected benefit method pro-rated on service and management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and expected health care costs.
- For the purpose of calculating the expected return on plan assets, those assets are valued at fair value.
- The excess of the net actuarial gain (loss) over 10% of the greater of the benefit obligation and the fair value of plan assets is amortized over the average remaining service period of active employees. The average remaining service period of the active employees covered by the pension plans and other retirement benefit plan is 11 and 7 years, respectively.

Stock-based Compensation

The Company has stock option compensation plans which are described in Note 15. Compensation expense is recognized for these plans using the fair value method. Any consideration paid by employees and directors on exercise of stock options is credited to share capital.

Income Taxes

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

Classification of Financial Instruments

Financial instruments are classified into one of the following five categories: held for trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities. The classification determines the accounting treatment of the instrument. The classification is determined by the Company when the financial instrument is initially recorded, based on the underlying purpose of the instrument.

The Company's financial assets and financial liabilities are classified and measured as follows:

Financial Asset/Liability	Category	Measurement
Cash	Held for trading	Fair value
Accounts receivable	Loans and receivables	Amortized cost
Deposits(1)	Loans and receivables	Amortized cost
Long-term receivables(2)	Loans and receivables	Amortized cost
Bank indebtedness	Held for trading	Fair value
Commercial paper	Other financial liabilities	Amortized cost
Short-term debt	Other financial liabilities	Amortized cost
Accounts payable	Other financial liabilities	Amortized cost
Dividends payable	Other financial liabilities	Amortized cost
Long-term debt	Other financial liabilities	Amortized cost
Other long-term liabilities	Other financial liabilities	Amortized cost

Derivatives	Classification	Measurement
Interest rate derivative(3)	Effective cash flow hedge	Fair value
Equity forward derivatives(3)	(4)	Fair value

(1) The carrying value of deposits is included in prepaid expenses and deposits in the consolidated balance sheets.

(2) The carrying value of long-term receivables is included in other assets in the consolidated balance sheets.

(3) The carrying values of the Company's derivatives are included in accounts payable and accrued liabilities and other long-term liabilities in the consolidated balance sheets.

(4) The portion of the equity forward derivative agreements relating to the earned long-term incentive plan units is considered a derivative financial instrument. The portion of the equity forward derivative agreements relating to the unearned long-term incentive plan units and unearned restricted share unit plan units is considered an effective cash flow hedge. The unhedged portion of the equity forward derivatives is measured at fair value and recorded in accounts payable and accrued liabilities and other long-term liabilities. See Note 15 for a further discussion of the long-term incentive plan and the restricted share unit plan.

Financial instruments measured at amortized cost are initially recognized at fair value and then subsequently at amortized cost, with gains and losses recognized in earnings in the period in which the gain or loss occurs. Changes in the fair value of financial instruments classified as held for trading are recorded in net earnings in the period of change. Changes in the fair value of the Company's derivative instruments designated as effective cash flow hedges are recognized in other comprehensive loss and changes in derivative instruments not designated as effective hedges are recognized in net earnings in the period of the change.

The Company categorizes its financial assets and financial liabilities that are recognized in the consolidated balance sheets at fair value using the fair value hierarchy. The fair value hierarchy has the following levels:

- Level 1 – quoted market prices in active markets for identical assets or liabilities
- Level 2 – inputs other than quoted market prices included in Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices)
- Level 3 – unobservable inputs such as inputs for the asset or liability that are not based on observable market data.

The level in the fair value hierarchy within which the fair value measurement is categorized in its entirety is determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety.

Transaction Costs

The Company has adopted the policy of adding transaction costs to financial assets and liabilities classified as other than held for trading.

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

Derivative Financial Instruments and Hedge Accounting

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

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") and the Company's restricted share unit plan ("RSU Plan"). The income or expense arising from the use of these instruments is included in cost of goods sold and other operating expenses for the year. See Note 15 for further discussion of the LTIP and RSU Plan.

The Company formally identifies, designates and documents all relationships between hedging instruments and hedged items, as well as its risk assessment objective and strategy for undertaking various hedge transactions. The Company assesses, both at the hedge's inception and on an ongoing basis, including on re-designation, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. When such derivative instruments cease to exist or to be effective as hedges, or when designation of a hedging relationship is terminated, any associated deferred gains or losses are recognized in net earnings in the same period as the corresponding gains or losses associated with the hedged item. When a hedged item ceases to exist, any associated deferred gains or losses are recognized in net earnings in the period the hedged item ceases to exist. Changes in the fair value of the Company's derivatives are non-cash transactions and are therefore not recognized in the consolidated statement of cash flows.

The Company does not have any significant embedded features in contractual arrangements that require separate presentation from the related host contract.

Associate Interest

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

2. CHANGES IN ACCOUNTING POLICIES

Future Accounting Standards

International Financial Reporting Standards

The Accounting Standards Board of the CICA requires all publicly accountable enterprises to report under International Financial Reporting Standards ("IFRS") for years beginning on or after January 1, 2011. As a result, the Company will be adopting IFRS for its 2011 fiscal year commencing January 2, 2011.

3. COST OF GOODS SOLD AND OTHER OPERATING EXPENSES

Inventory

During the current fiscal year, the Company recognized cost of inventory of $6,372,359 (2009 – $6,238,239) as an expense. This expense is included in cost of goods sold and other operating expenses in the consolidated statements of earnings.

During the fiscal years ended January 1, 2011 and January 2, 2010, there were no significant write-downs of inventory as a result of net realizable value being lower than cost and no inventory write-downs recognized in previous years were reversed.

Other Operating Expenses

During the fiscal year ended January 1, 2011, the Company recognized an expense of $10,282 in cost of goods sold and other operating expenses related to the settlement of a long-standing legal dispute related to a commercial arrangement with one of the Company's ancillary businesses.

4. ACQUISITIONS

In the normal course of business, the Company acquires the assets or shares of pharmacies. The total cost of the acquisitions during the fiscal year ended January 1, 2011 of $12,990 (2009 – $97,100), including costs incurred in connection with the acquisitions, is allocated primarily to goodwill and intangible assets based on their fair values. Purchase price allocations are preliminary when initially recognized and may change pending finalization of the valuations of the assets acquired. The operations of the acquired pharmacies have been included in the Company's results of operations from the date of acquisition.

Funds Held in Escrow

The Company had amounts held in escrow of $105 (2009 – $1,639) with respect to a number of offers to acquire certain pharmacies. These amounts are included in prepaid expenses and deposits on the consolidated balance sheets.

5. INTEREST EXPENSE

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

		2010		2009
Interest on bank indebtedness	$	**5,642**	$	5,378
Interest on commercial paper		**4,269**		6,231
Interest on short-term debt		**–**		504
Interest on long-term debt		**51,121**		48,550
		61,032		60,663
Less: interest capitalized		**4,996**		2,448
	$	**56,036**	$	58,215

6. INCOME TAXES

The effective income tax rate is comprised of the following:

	2010	2009
Combined Canadian federal and provincial statutory tax rate	**28.8%**	30.1%
Adjusted for:		
Increase in future income taxes resulting from statutory tax rate changes	**0.8%**	0.1%
Non-deductible charges and other	**0.2%**	–
Effective income tax rate	**29.8%**	30.2%

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

		2010		2009
Current				
Deferred income	$	**57,821**	$	61,676
Accrued liabilities		**9,234**		8,646
Other		**13,421**		15,839
	$	**80,476**	$	86,161
Long-term				
Depreciable assets	$	**(99,919)**	$	(86,575)
Other long-term liabilities		**40,367**		38,606
Net capital loss carry forwards		**5,151**		5,215
Other		**5,409**		(104)
	$	**(48,992)**	$	(42,858)

January 1, 2011 and January 2, 2010 (in thousands of dollars, except per share data)

7. PROPERTY AND EQUIPMENT

	2010			2009		
	Cost	**Accumulated Amortization**	**Net Book Value**	Cost	Accumulated Amortization	Net Book Value
Property held for development	**$ 39,656**	**$ –**	**$ 39,656**	$ 16,849	$ –	$ 16,849
Property under development	**32,378**	**–**	**32,378**	101,463	–	101,463
Land	**78,495**	**–**	**78,495**	58,144	–	58,144
Buildings	**212,468**	**17,411**	**195,057**	145,993	25,301	120,692
Equipment, fixtures, and computer equipment	**1,135,490**	**657,949**	**477,541**	1,048,056	561,691	486,365
Leasehold improvements	**1,253,567**	**379,933**	**873,634**	1,090,225	307,714	782,511
Assets under capital leases (Note 17)	**13,055**	**160**	**12,895**	–	–	–
	$ 2,765,109	**$ 1,055,453**	**$ 1,709,656**	$ 2,460,730	$ 894,706	$ 1,566,024

During the fiscal year ended January 1, 2011, the Company amortized $239,456 (2009 – $212,080) of property and equipment into amortization expense.

8. GOODWILL

The change in the carrying amount of goodwill is as follows:

	2010	2009
Balance, beginning of period	**$ 2,481,353**	$ 2,427,239
Goodwill acquired	**11,793**	54,114
Balance, end of period	**$ 2,493,146**	$ 2,481,353

Goodwill of $8,258 (2009 – $22,257) from asset acquisitions made during the fiscal year ended January 1, 2011 is expected to be deductible for tax purposes.

The Company tested goodwill for impairment using information as at the beginning of the Company's 2010 and 2009 fiscal years. During the fiscal years ended January 1, 2011 and January 2, 2010, there were no write-downs of goodwill due to impairment.

9. INTANGIBLE ASSETS

2010

	Prescription Files	Customer Relationships	Computer Software	Computer Software Under Development	Other	Total
Cost						
Balance, beginning of period	$ 127,701	$ 43,600	$ 170,285	$ 39,639	$ 7,274	$ 388,499
Additions						
– Purchases	–	–	10,963	–	–	10,963
– Development	–	–	–	44,112	1,550	45,662
– Business acquisitions	1,577	–	–	–	–	1,577
Transfers	525	–	29,944	(31,339)	–	(870)
Disposals	–	–	(30)	–	–	(30)
Balance, end of period	129,803	43,600	211,162	52,412	8,824	445,801
Accumulated amortization						
Balance, beginning of period	34,288	6,448	84,639	–	4,358	129,733
Amortization expense for the year	15,387	3,511	23,845	–	1,129	43,872
Disposals	–	–	(21)	–	–	(21)
Balance, end of period	49,675	9,959	108,463	–	5,487	173,584
Net book value, end of period	$ 80,128	$ 33,641	$ 102,699	$ 52,412	$ 3,337	$ 272,217

2009

	Prescription Files	Customer Relationships	Computer Software	Computer Software Under Development	Other	Total
Cost						
Balance, beginning of period	$ 91,599	$ 29,600	$ 137,666	$ 40,499	$ 7,010	$ 306,374
Additions						
– Purchases	–	–	2,337	–	–	2,337
– Development	–	–	–	31,668	264	31,932
– Business acquisitions	36,102	–	–	–	–	36,102
Transfers	–	14,000	30,530	(32,528)	–	12,002
Disposals	–	–	(248)	–	–	(248)
Balance, end of period	127,701	43,600	170,285	39,639	7,274	388,499
Accumulated amortization						
Balance, beginning of period	20,924	3,512	67,392	–	2,267	94,095
Amortization expense for the year	13,364	2,936	17,495	–	2,091	35,886
Disposals	–	–	(248)	–	–	(248)
Balance, end of period	34,288	6,448	84,639	–	4,358	129,733
Net book value, end of period	$ 93,413	$ 37,152	$ 85,646	$ 39,639	$ 2,916	$ 258,766

During the fiscal year ended January 2, 2010, the Company transferred $14,000 from goodwill to customer relationships as a result of finalizing the purchase price allocation of the HealthAccess and Information Healthcare Marketing Corp. acquisition.

During the fiscal year ended January 1, 2011, the Company recognized amortization of $43,068 (2009 – $34,437) in amortization expense and $804 (2009 – $1,449) in cost of goods sold and other operating expenses.

During the fiscal years ended January 1, 2011 and January 2, 2010, there were no write-downs of intangible assets due to impairment.

January 1, 2011 and January 2, 2010 (in thousands of dollars, except per share data)

10. SHORT-TERM DEBT

Bank Indebtedness

The Associate-owned stores borrow under their bank line of credit agreements guaranteed by the Company. The Company has entered into agreements with banks to guarantee a total of $520,000 (2009 – $520,000) of lines of credit. At January 1, 2011, the Associate-owned stores utilized $176,410 (2009 – $254,332) of the available lines of credit.

Commercial Paper

Commercial paper is issued with maturities from overnight to 90 days at floating interest rates based on bankers' acceptance rates. Until December 2010, the Company used interest rate derivative agreements to manage a portion of the interest rate risk on its commercial paper. The Company was party to an agreement converting an aggregate notional principal amount of $50,000 of floating rate commercial paper debt into fixed rate debt at a rate of 4.18%, which expired in December 2010. The Company had an additional agreement in 2009 converting an aggregate notional principal amount of $50,000 of floating rate commercial paper debt into fixed rate debt at a rate of 4.11%, which expired in December 2009. The Company recorded a net loss of $3,766 (2009 – $1,811) over the life of the agreement that expired in 2010 as interest expense on commercial paper. As at January 1, 2011, the Company no longer had any interest rate derivative agreements to convert its floating rate debt into fixed rate debt. See Notes 18 and 19 for further discussion of the derivative agreements.

Under its existing bank credit facility, the Company can issue commercial paper up to the amount of $500,000.

11. LONG-TERM DEBT

	Face Value	Maturity	2010	2009
Medium term notes				
Series 2 Notes – 4.99%	$ 450,000	June 2013	**$ 448,704**	$ 447,977
Series 3 Notes – 4.80%	250,000	January 2012	**249,305**	248,640
Series 4 Notes – 5.19%	250,000	January 2014	**248,632**	248,183
			946,641	944,800
Revolving term facility	$ 750,000 (2009 – $800,000)	December 2014	**–**	1,298
Less: financing costs			**(3,229)**	–
			(3,229)	1,298
Long-term debt			**$ 943,412**	$ 946,098

As at January 1, 2011, $137,053 (2009 – $269,322) of the $750,000 (2009 – $800,000) revolving term facility was utilized as follows: $9,053 (2009 – $8,322) relating to letters of credit and trade finance guarantees and $128,000 (2009 – $261,000) to backstop commercial paper issued by the Company.

2010 Debt Refinancing Transactions

On December 10, 2010, the Company entered into a $750,000 revolving term credit facility. This new credit facility, which matures on December 10, 2014, replaces the Company's previously existing $800,000 revolving term credit facility that was to mature on June 6, 2011. The new credit facility, as was the case with the credit facility it replaces, is available for general corporate purposes, including backstopping the Company's $500,000 commercial paper program. The Company recognized financing costs related to the new credit facility of $3,281, the unamortized portion of which are netted against the long-term debt balance on the consolidated balance sheet.

2009 Debt Refinancing Transactions

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% per annum (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% per annum (the "Series 4 Notes"). The Series 3 Notes and the 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.

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

On June 22, 2009, the Company filed, with the securities regulators in each of the provinces of Canada, an amendment to the Prospectus (as amended, the "Amended Prospectus") to increase the aggregate principal amount of medium-term notes to be issued from time to time pursuant to the Amended Prospectus from $1,000,000 to $1,500,000. On June 22, 2010, the Amended Prospectus expired and was not renewed or extended by the Company.

Minimum Repayments

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

Medium-term notes		
2012 – Series 3 Notes	$	250,000
2013 – Series 2 Notes		450,000
2014 – Series 4 Notes		250,000
	$	950,000

12. OTHER LONG-TERM LIABILITIES

Other long-term liabilities are comprised as follows:

		2010		2009
Deferred rent obligation	**$**	**333,714**	$	304,440
Employee future benefits (Note 13)		**8,997**		15,521
Deferred gain on sale-leaseback transactions		**26,010**		14,090
Capital lease obligations (Note 17)		**12,421**		–
Long-term incentive plan and restricted share unit plan (Note 15)		**8,044**		4,531
Unrealized loss on equity forward derivative instruments (Note 19)		**1,583**		–
Other		**8,882**		9,369
	$	**399,651**	$	347,951

Deferred Rent Obligation

The deferred rent obligation represents the difference between rent expense and cash rent payments and the deferral of landlord inducements.

Deferred Gain on Sale-leaseback Transactions

During the fiscal year ended January 1, 2011, the Company sold certain real estate properties for net proceeds of $57,307 (2009 – $20,783) and entered into leaseback agreements for the area used by the Associate-owned stores. The leases have been assessed as capital or operating in nature and have been accounted for accordingly. During the fiscal year ended January 1, 2011, the Company realized gains on disposal of $14,182 (2009 – $8,012). The gains have been deferred and are being amortized over the lease terms of 10 to 20 years (2009 – 15 to 20 years).

January 1, 2011 and January 2, 2010 (in thousands of dollars, except per share data)

13. EMPLOYEE FUTURE BENEFITS

Employee Future Benefits

The Company maintains registered defined benefit pension plans under which benefits are available to certain employee groups. The Company also makes supplementary retirement benefits available to certain employees under a non-registered defined benefit pension plan.

The pension plans are funded through contributions based on actuarial cost methods as permitted by pension regulatory bodies as applicable. Earnings are charged with the cost of benefits earned by employees as services are rendered. Benefits under these plans are based on the employee's years of service and final average earnings.

The most recent actuarial valuations of the registered plans for funding purposes were performed as at December 31, 2009, which were completed in 2010, and the next valuations will be required as at December 31, 2012. The most recent actuarial valuation of the non-registered plan for funding purposes was as at December 31, 2010, and the next valuation will be required as at December 31, 2011.

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

Information about the Company's pension and other post-retirement benefit plans, measured at November 30, 2010 and 2009, is as follows:

	2010		2009	
	Pension Plans	**Other Benefit Plans**	Pension Plans	Other Benefit Plans
Fair value of plan assets				
Fair value of plan assets, beginning of period	**$ 85,199**	**$ –**	$ 71,805	$ –
Actual return on plan assets	**7,820**	**–**	10,083	–
Company contribution	**16,230**	**510**	6,354	781
Participant contributions	**1,237**	**–**	1,158	–
Benefits paid	**(4,446)**	**(510)**	(4,201)	(781)
Fair value of plan assets, end of period	**$ 106,040**	**$ –**	$ 85,199	$ –
Accrued benefit obligation				
Benefit obligation, beginning of period	**$ 105,105**	**$ 5,172**	$ 87,477	$ 4,864
Service cost	**5,936**	**287**	4,341	761
Interest cost	**5,200**	**295**	4,720	328
Participant contributions	**1,237**	**–**	1,158	–
Actuarial loss	**11,373**	**506**	11,610	–
Benefits paid	**(4,446)**	**(510)**	(4,201)	(781)
Accrued benefit obligation, end of period	**$ 124,405**	**$ 5,750**	$ 105,105	$ 5,172
Funded status – plan deficit	**$ (18,365)**	**$ (5,750)**	$ (19,906)	$ (5,172)
Unrecognized plan amendments	**(904)**	**–**	(1,105)	–
Unrecognized losses	**19,733**	**506**	10,662	–
Accrued benefit liability	**$ 464**	**$ (5,244)**	$ (10,349)	$ (5,172)
Presented as follows:				
Other assets	**$ 4,217**	**$ –**	$ –	$ –
Other long-term liabilities	**(3,753)**	**(5,244)**	(10,349)	(5,172)
Accrued benefit liability	**$ 464**	**$ (5,244)**	$ (10,349)	$ (5,172)

There were no significant changes in the measurement of the Company's pension and other post-retirement benefit plans between November 30, 2010 and January 1, 2011.

The significant actuarial assumptions adopted are as follows:

	2010			2009		
	Registered Pension Plans	**Non-registered Pension Plan**	**Other Benefit Plans**	Registered Pension Plans	Non-registered Pension Plan	Other Benefit Plans
Accrued benefit obligation, end of period						
Discount rate	**5.25%**	**2.50%**	**5.00%**	6.00%	2.88%	6.00%
Compensation increase	**4.00%**	**4.00%**	**4.00%**	4.00%	4.00%	4.00%
Benefit expense for the period						
Discount rate	**6.00%**	**2.88%**	**5.25%**	6.75%	3.25%	6.75%
Expected return on assets	**7.50%**	**3.75%**	**N/A**	7.50%	3.75%	N/A
Compensation increase	**4.00%**	**4.00%**	**4.00%**	4.00%	4.00%	4.00%

The health care cost trend rates used were 5.5% for 2010 and 2009, with 5.5% being the ultimate trend rate for later years. A 1% change in the assumed health care cost trend rate would not have a significant effect on the amounts reported for other benefit plans.

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

	2010		2009	
	Pension Plans	**Other Benefit Plans**	Pension Plans	Other Benefit Plans
Service costs	**$ 5,936**	**$ 287**	$ 4,341	$ 761
Interest cost	**5,200**	**295**	4,720	328
Actual return on plan assets	**(7,820)**	**–**	(10,083)	–
Actuarial losses	**11,373**	**506**	11,610	–
Costs arising from events of the period	**14,689**	**1,088**	10,588	1,089
Difference between:				
Actual and expected return on plan assets	**2,161**	**–**	5,827	–
Actuarial gain or loss recognized for the year and actual actuarial gain or loss on accrued benefit obligation	**(11,232)**	**(506)**	(11,526)	–
Amortization of plan amendment and actual plan amendments	**(201)**	**–**	(201)	–
Net expense	**$ 5,417**	**$ 582**	$ 4,688	$ 1,089

Total cash payments for employee future benefits consist of the Company's contributions to the pension plans and cash payments made directly to beneficiaries of the other benefit plans and totalled $16,740 (2009 – $7,135).

The assets of the registered pension plans consist of cash, contributions receivable and a proportionate share of a Master Trust. The assets held by the Master Trust are invested in a limited number of pooled funds, based on market values as at November 30, 2010 and 2009, respectively, as follows:

	2010	2009
Equity	**60%**	61%
Fixed income	**39%**	39%
Cash and cash equivalents	**1%**	–

There were no significant changes in the assets held by the Master Trust between November 30, 2010 and January 1, 2011.

The assets of the non-registered plan consist of refundable tax on account with Canada Revenue Agency and investments. The investments are in pooled funds with an allocation of 61% equities, 38% bonds and 1% cash and cash equivalents based on market values as at November 30, 2010 and 60% equities, 39% bonds and 1% cash and cash equivalents as at November 30, 2009. There were no significant changes in the allocation of investments between November 30, 2010 and January 1, 2011.

January 1, 2011 and January 2, 2010 (in thousands of dollars, except per share data)

14. SHARE CAPITAL

Authorized

Unlimited number of common shares

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

Outstanding

	2010		2009	
	Number of Common Shares	**Stated Value**	Number of Common Shares	Stated Value
Beginning balance	**217,431,898**	**$ 1,519,870**	217,250,367	$ 1,514,207
Shares issued	**20,170**	**491**	181,531	4,481
Repayment of share purchase loans	**–**	**33**	–	137
Exercised options	**–**	**164**	–	1,045
Ending balance	**217,452,068**	**$ 1,520,558**	217,431,898	$ 1,519,870

Weighted Average Shares Outstanding

	January 1, 2011
Basic	**217,435,868**
Diluted	**217,537,709**

	January 2, 2010
Basic	217,360,238
Diluted	217,501,441

The common shares that may be issued under the Company's stock option plans, including contingently returnable shares issued as part of those plans, have a dilutive impact on the weighted average number of shares of 101,841 (2009 – 141,203). Anti-dilutive options are not included in the diluted net earnings per common share calculation.

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

The Company has issued a loan to a key employee under a stock purchase plan to acquire common shares of the Company. The share purchase loan receivable is non-interest bearing, matures in 2011, is subject to certain terms of repayment pursuant to a shareholders' agreement and is secured by the shares to which the loan relates. The share purchase loan is presented as a reduction in share capital and the related shares are deducted in the determination of the weighted average shares outstanding for purposes of the basic net earnings per common share calculation.

15. STOCK-BASED COMPENSATION

The Company established stock option plans for certain employees and its Board of Directors, as described below, and has reserved 20,000,000 common shares for issuance under the plans. Effective February 2007, non-employee directors are no longer eligible to participate in the stock option plans. The Company established a deferred share unit plan for non-employee directors, which is described below.

The Company uses the fair value method to account for stock options issued under employee and director stock option programs. The fair value of each option is estimated on the date of the grant using the Black-Scholes option-pricing model. During the fiscal year ended January 1, 2011, the Company expensed $1,592 (2009 – $694) associated with stock options issued under the employee and director plans.

Employee Stock Option Plan

Options issued to certain employees have an exercise price per share of no less than the fair market value on the date of the option grant. These options include awards for shares that vest based on the passage of time, performance criteria, or both.

A summary of the status of the employee stock option plan and changes during the fiscal year ended January 1, 2011 is presented below:

	2010			2009		
	Options on Common Shares		**Weighted Average Exercise Price Per Share**	Options on Common Shares		Weighted Average Exercise Price Per Share
Outstanding, beginning of period	**541,542**	**$**	**36.59**	694,341	$	34.22
Granted	**282,120**		**44.09**	–		–
Exercised	**(20,170)**		**24.54**	(146,531)		25.46
Forfeited/cancelled including repurchased	**–**		**–**	(6,268)		33.91
Outstanding, end of period	**803,492**	**$**	**39.53**	541,542	$	36.59
Options exercisable, end of period	**451,372**	**$**	**35.62**	399,440	$	33.18

	2010 Outstanding Options				**2010 Exercisable Options**		
Range of Exercise Price	**Number of Options Outstanding**	**Weighted Average Contractual Life (Years)**		**Weighted Average Exercise Price Per Share**	**Number of Exercisable Options**		**Weighted Average Exercise Price Per Share**
$ 5.00 – $ 5.60	**76,000**	**0.7**	**$**	**5.50**	**76,000**	**$**	**5.50**
$17.13 – $25.86	**45,471**	**1.6**		**23.68**	**45,471**		**23.68**
$29.30 – $36.41	**49,901**	**3.4**		**32.28**	**49,901**		**32.28**
$44.09 – $46.32	**632,120**	**5.9**		**45.32**	**280,000**		**46.32**
	803,492	**5.0**	**$**	**39.53**	**451,372**	**$**	**35.62**

Options Granted Prior to the Company's 2010 Fiscal Year

Time-based options are exercisable 20% per year on the anniversary of the grant date in each of the five subsequent years. Performance-based options are exercisable 20% per year on the anniversary of the grant date in each of the five subsequent years, provided that the Company achieves specified earnings-based performance targets. Performance targets not achieved are considered to be met if the performance is achieved on a cumulative basis in subsequent years. The performance-based options become fully exercisable on the ninth anniversary of the date of grant, provided that they have not otherwise been terminated, whether or not the performance targets are achieved.

January 1, 2011 and January 2, 2010 (in thousands of dollars, except per share data)

15. STOCK-BASED COMPENSATION (continued)

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

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

Options Granted During the Company's 2010 Fiscal Year

In February 2010, the Company granted awards of time-based options under the Company's Share Incentive Plan (the "Share Plan") in respect of the Company's 2009 fiscal year to certain senior management, which vest one-third each year.

The following assumptions were used in the Black-Scholes option-pricing model to calculate the fair value for those options granted during the fiscal year ended January 1, 2011:

Fair value per option	$ 6.94
Valuation assumptions	
Expected life	5 years
Expected dividends	2.10%
Expected volatility	18.70%
Risk-free interest rate	2.54%

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

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

Director Stock Option Plan

Prior to February 2007, under the Company's director stock option plan, participating directors were issued time-based options to purchase 60,000 common shares. The options have an exercise price per share at fair market value on the date of the option grant, which is normally the date the option holder becomes a director. One-third of the options become exercisable in each of the following three years on the anniversary of the date of grant. Unexercisable options expire upon the option holder ceasing to be a director. Exercisable options expire on the earlier of 180 days of the option holder ceasing to be a director or the expiry date of the options, which is on the tenth anniversary of the date of grant.

A summary of the status of the director stock option plan and changes during the current fiscal year is presented below:

	2010		2009	
	Options on Common Shares	**Weighted Average Exercise Price Per Share**	Options on Common Shares	Weighted Average Exercise Price Per Share
Outstanding, beginning of period	**346,000**	**$ 40.38**	381,000	$ 38.82
Exercised	**–**	**–**	(35,000)	23.35
Outstanding, end of period	**346,000**	**$ 40.38**	346,000	$ 40.38
Options exercisable, end of period	**346,000**	**$ 40.38**	346,000	$ 40.38

Range of Exercise Price	2010 Outstanding Options Number of Options Outstanding	Weighted Average Contractual Life (Years)	Weighted Average Exercise Price Per Share	2010 Exercisable Options Number of Exercisable Options	Weighted Average Exercise Price Per Share
$26.95	**60,000**	**2.8**	**$ 26.95**	**60,000**	**$ 26.95**
$41.80	**106,000**	**4.6**	**41.80**	**106,000**	**41.80**
$44.02	**180,000**	**5.1**	**44.02**	**180,000**	**44.02**
	346,000	**4.5**	**$ 40.38**	**346,000**	**$ 40.38**

Deferred Share Unit Plan for Non-employee Directors

The Company maintains a deferred share unit ("DSU") plan to provide non-employee directors with the option to elect to receive DSUs in lieu of cash payment for all or a portion of their director fees. When such an election is made, the Company credits to the account of each non-employee director a number of DSUs (each equivalent in value to a common share) equal to the amount of fees divided by the fair market value of the common shares. The directors' accounts shall be credited with dividend equivalents in the form of additional DSUs if and when the Company pays dividends on the common shares. Upon the director ceasing to be a member of the Board of Directors, the director shall receive a cash amount equal to the number of DSUs in his or her account multiplied by the fair market value of the common shares, as determined in accordance with the DSU plan, on the date the director ceases to be a member of the Board of Directors or on a later date selected by the director, which shall in any event be a date prior to the end of the following calendar year. During the fiscal year ended January 1, 2011, the Company recorded $801 (2009 – $1,107) in director fee compensation.

Non-employee directors who are not holders of unvested stock options to purchase common shares of the Company are also eligible to receive an annual award of DSUs in the amount of up to $60.

The non-executive Chair of the Board of Directors receives an annual fee of $120 in addition to the director fees and annual award of DSUs, one-half of which the Chair may elect, in whole or in part, to be received in DSUs and the other half of which is payable in DSUs.

During the fiscal year ended January 1, 2011, the Company issued an aggregate of 30,569 DSUs (2009 – 26,043) at a weighted average grant date fair value of $41.34 (2009 – $44.64). During the fiscal year ended January 1, 2011, the Company paid out $147 (2009 – $nil) in cash, which was the equivalent of 3,926 DSUs (2009 – nil), for a director who ceased being a member of the Board of Directors during the 2009 fiscal year. As at January 1, 2011, there were 97,956 DSUs outstanding (2009 – 71,313).

Long-term Incentive Plan

The Company maintains a long-term incentive plan ("LTIP") pursuant to which certain employees are eligible to receive an award of share units equivalent in value to common shares of the Company ("share units"). Awards of share units under the LTIP are made in February of the fiscal year immediately following the year in respect of which the award is earned.

During the fiscal year ended January 1, 2011, the Company paid out the fully vested awards granted in 2008 and no awards were made under the LTIP in respect of the 2009 fiscal year.

During the fiscal year ended January 2, 2010, the Company paid out the fully vested awards granted in 2007. During the fiscal year ended January 2, 2010, the Company awarded 167,467 share units under the LTIP in respect of the 2008 fiscal year at a grant-date fair value of $43.74, cumulatively totalling 555,174 share units, which vest one-third each year.

As at January 1, 2011, there were 148,086 units outstanding (2009 – 271,480 units) under the LTIP.

During the fiscal year ended January 1, 2011, the Company recognized compensation expense of $2,221 (2009 – $6,084) associated with the share units under the LTIP.

January 1, 2011 and January 2, 2010 (in thousands of dollars, except per share data)

15. STOCK-BASED COMPENSATION (continued)

As at January 1, 2011, the liability associated with the share units earned by the employees under the LTIP is recorded in accounts payable and accrued liabilities and is carried at the market value of the Company's shares at the end of the fiscal year (2009 – recorded in accounts payable and accrued liabilities and other long-term liabilities).

The Company entered into a cash-settled equity forward agreement to limit its exposure to future price changes in the Company's share price for share unit awards. This agreement matures in December 2011. A percentage of the equity forward derivatives, related to unearned units under the LTIP, has been designated as a hedge.

Restricted Share Unit Plan

In February 2010, the Company made grants of restricted share units ("RSUs"), in respect of the 2009 fiscal year, under the Company's restricted share unit plan ("RSU Plan") and for certain senior management, grants of RSUs, combined with grants of stock options under the Company's Share Incentive Plan (the "Share Plan"), which is described above.

On February 23, 2010, the Company awarded 350,384 RSUs at a grant-date fair value of $44.09, which vest 100% after three years. Full vesting of RSUs will be phased in for employees who received an award under the LTIP in respect of a fiscal year prior to the 2009 fiscal year.

As at January 1, 2011, there were 326,117 units outstanding under the RSU Plan.

During the fiscal year ended January 1, 2011, the Company recognized compensation expense of $8,804 (2009 – $nil) associated with the RSUs.

As at January 1, 2011, the liability associated with the share units earned by the employees under the RSU Plan is recorded in other long-term liabilities and is carried at the market value of the Company's shares at the end of the fiscal year.

The Company entered into a cash-settled equity forward agreement to limit its exposure to future price changes in the Company's share price for share unit awards. This agreement matures in December 2012.

A percentage of the equity forward derivatives, related to unearned units under the RSU Plan, has been designated as a hedge.

16. NET CHANGE IN NON-CASH WORKING CAPITAL BALANCES

	2010	2009
Accounts receivable	$ **38,785**	$ (22,598)
Inventory	**(103,748)**	(109,188)
Prepaid expenses	**5,571**	(19,773)
Accounts payable and accrued liabilities	**15,297**	(52,055)
Income taxes recoverable/income taxes payable	**(37,432)**	25,890
	$ **(81,527)**	$ (177,724)

17. CONTINGENCIES, COMMITMENTS AND GUARANTEES

Obligations Under Operating Leases

The minimum lease payments (exclusive of taxes, insurance and other occupancy charges) on a calendar year basis under long-term leases for store locations and office space are as follows:

	2011	2012	2013	2014	2015	Thereafter
Minimum lease payments	$ 387,119	$ 396,444	$ 395,573	$ 379,445	$ 365,294	$ 2,596,618
Less: sub-lease revenue	3,272	2,733	2,183	1,561	1,256	3,402
Total lease obligations	$ 383,847	$ 393,711	$ 393,390	$ 377,884	$ 364,038	$ 2,593,216

Obligations Under Capital Leases

The minimum lease payments on a calendar year basis for the Company's assets under capital leases are as follows:

	2011	2012	2013	2014	2015	Thereafter
Minimum lease payments	$ 1,181	$ 1,181	$ 1,181	$ 1,181	$ 1,194	$ 19,626
Less: financing expenses included in minimum lease payments	648	621	593	564	533	9,631
Capital lease obligations	$ 533	$ 560	$ 588	$ 617	$ 661	$ 9,995

The Company has capital lease obligations for buildings. The leases have an average interest rate of 5.0% and an average remaining term of approximately 20 years.

Distribution Services

The Company has entered into an agreement with a third party to provide distribution services to the Company's locations to December 31, 2012. Under the terms of this agreement, the third party will charge the Company specified costs incurred to provide the distribution services, plus an annual management fee.

Information Services

The Company has entered into an agreement to outsource certain information services activities to a third party to 2011. The Company has committed to average annual payments of approximately $7,000 over the term of the agreement.

Litigation

The Company has been served with a Statement of Claim in a proposed class proceeding that has been filed in the Ontario Superior Court of Justice by two of its licensed Associate-owners, claiming various declarations and damages of $1,000,000 on behalf of a proposed class comprised of all of its current and former licensed Associate-owners resident in Canada, other than in Québec. The claim alleges, among other things, that Shoppers Drug Mart and two of its affiliates breached contractual and other duties to its Associate-owners by collecting, receiving and/or retaining funds and/or benefits that are in excess of those permitted to be collected, received and/or retained by the applicable agreements. The Company believes that the claim is without merit and will vigorously defend the claim. However, there can be no assurance that the outcome of this claim will be favourable to the Company or that it will not have a material adverse impact on the Company's financial position. The amount payable, if any, is not reasonably determinable at this time.

In addition, the Company is involved in certain legal claims arising in the normal course of business. In the opinion of the Company's management, the eventual settlement of such claims will not have a significant effect on the Company's financial position or results of operations. Management has recorded a provision for these claims based on its best estimate of the final settlements.

17. CONTINGENCIES, COMMITMENTS AND GUARANTEES (continued)

Other

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

The Company could potentially be subject to various claims by third parties arising out of its business including, but not limited to, contract, product liability, labour and employment, regulatory and environmental claims. In addition, the Company is subject to regular audits from federal and provincial tax authorities relating to income, capital and commodity taxes and as a result of these audits, may receive reassessments. While income, capital and commodity tax filings are subject to audits and reassessments, management believes that adequate provisions have been made for all income and other tax obligations. However, changes in the interpretations or judgements may result in an increase or decrease in the Company's income, capital, or commodity tax provisions in the future. The amount of any such increase or decrease cannot be reasonably estimated.

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

Financial Risk Management Objectives and Policies

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

Interest Rate Risk

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

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

The Company monitors market conditions and the impact of interest rate fluctuations on its fixed and floating rate debt instruments on an ongoing basis and may use interest rate derivatives to manage this exposure. Until December 2010, the Company used interest rate derivative agreements to manage a portion of the interest rate risk on its commercial paper. The Company was party to an agreement converting an aggregate notional principal amount of $50,000 of floating rate commercial paper debt into fixed rate debt at a rate of 4.18%, which expired in December 2010. The Company had an additional agreement in 2009 converting an aggregate notional principal amount of $50,000 of floating rate commercial paper debt into fixed rate debt at a rate of 4.11%, which expired in December 2009. As at January 1, 2011, the Company no longer had any interest rate derivative agreements to convert its floating rate debt into fixed rate debt. See Note 19 for further discussion of the derivative agreements.

As at January 1, 2011, the Company had $304,410 (2009 – $466,630) of unhedged floating rate debt. During the fiscal year ended January 1, 2011, the Company's average outstanding unhedged floating rate debt was $538,243 (2009 – $600,562). Had interest rates been higher or lower by 50 basis points during the current fiscal year, net earnings would have decreased or increased, respectively, by approximately $1,885 (2009 – $2,066) as a result of the Company's exposure to interest rate fluctuations on its unhedged floating rate debt.

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 January 1, 2011 are as follows:

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

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

January 1, 2011 and January 2, 2010 (in thousands of dollars, except per share data)

19. FINANCIAL INSTRUMENTS

Interest Rate Derivatives

Until December 2010, the Company used interest rate derivatives to manage a portion of the interest rate risk on its commercial paper. The Company was party to an agreement converting an aggregate notional principal amount of $50,000 of floating rate commercial paper debt into fixed rate debt at a rate of 4.18%, which expired in December 2010. The Company had an additional agreement in 2009 converting an aggregate notional principal amount of $50,000 of floating rate commercial paper debt into fixed rate debt at a rate of 4.11%, which expired in December 2009. The Company recorded a net loss of $3,766 (2009 – $1,811) over the life of the agreement that expired in 2010 as interest expense on commercial paper. As at January 1, 2011, the Company no longer had any interest rate derivative agreements to convert its floating rate debt into fixed rate debt.

Based on the market value of the interest rate derivative agreement at January 2, 2010, the Company recognized a liability of $1,645, all of which was presented in accounts payable and accrued liabilities. During the fiscal years ended January 1, 2011 and January 2, 2010, the Company assessed that the interest rate derivatives were effective hedges for the floating interest rates on the associated commercial paper debt.

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 LTIP and RSU Plan. The income or expense arising from the use of these instruments is included in cost of goods sold and other operating expenses for the year.

Based on the market values of the equity forward agreements in place at January 1, 2011, the Company recognized a liability of $2,257, of which $674 was presented in accounts payable and accrued liabilities and $1,583 was presented in other long-term liabilities. Based on the market values of the equity forward agreements at January 2, 2010, the Company recognized a net liability of $910, of which $286 was presented in other assets and $1,196 was presented in accounts payable and accrued liabilities. During the fiscal years ended January 1, 2011 and January 2, 2010, the Company assessed that the percentages of the equity forward derivatives in place related to unearned units under the LTIP and RSU Plan were effective hedges for its exposure to future changes in the market price of its common shares in respect of the unearned units.

Accumulated Other Comprehensive Loss

The components of the Company's accumulated other comprehensive loss are as follows:

	2010	2009
Accumulated other comprehensive loss		
Unrealized loss on interest rate derivative (net of tax of $nil and $525, respectively)	**$ –**	$ (1,120)
Unrealized loss on equity forward derivatives (net of tax of $195 and $2, respectively)	**(493)**	(5)
Accumulated other comprehensive loss	**$ (493)**	$ (1,125)

During the fiscal year ended January 1, 2011, amounts previously recorded in accumulated other comprehensive loss on the equity forward derivatives of $33 (2009 – $294) were recognized in net earnings.

Fair Value of Financial Instruments

The fair value of financial assets and financial liabilities measured at fair value in the consolidated balance sheets are as follows:

	2010				2009			
	Level 1	**Level 2**	**Level 3**	**Total**	Level 1	Level 2	Level 3	Total
Cash	**$ 64,354**	**$ –**	**$ –**	**$ 64,354**	$ 44,391	$ –	$ –	$ 44,391
Bank indebtedness	**(209,013)**	**–**	**–**	**(209,013)**	(270,332)	–	–	(270,332)
Interest rate derivative	**–**	**–**	**–**	**–**	–	(1,645)	–	(1,645)
Equity forward derivatives	**–**	**(2,257)**	**–**	**(2,257)**	–	(910)	–	(910)
	$ (144,659)	**$ (2,257)**	**$ –**	**$ (146,916)**	$ (225,941)	$ (2,555)	$ –	$ (228,496)

The fair values of the interest rate derivative and equity forward derivatives are determined based on current market rates and on information received from the Company's counterparties to these agreements. The interest rate derivative was valued using one-month Reuters Canadian Dealer Offered Rate index. The primary valuation input for the equity forward derivatives is the Company's common share price.

For financial assets and liabilities that are valued at other than fair value on the consolidated balance sheets: accounts receivable, deposits, commercial paper, accounts payable and accrued liabilities and dividends payable, fair values approximate their carrying values at January 1, 2011 and January 2, 2010 due to their short-term maturities. The fair values of long-term receivables, revolving term facility and other long-term liabilities approximate their carrying values at January 1, 2011 and January 2, 2010 due to the current market rates associated with these instruments and the fair value of the medium-term notes at January 1, 2011 is approximately $997,345 (2009 – $1,007,522) compared to a carrying value of $950,000 (2009 – $950,000) (excluding transaction costs) due to decreases in market interest rates for similar instruments.

20. 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 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 fiscal years ended January 1, 2011 and January 2, 2010.

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 was in compliance with those covenants as at January 1, 2011 and January 2, 2010.

January 1, 2011 and January 2, 2010 (in thousands of dollars, except per share data)

20. CAPITAL MANAGEMENT (continued)

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 at the end of the periods indicated.

	2010	2009
Cash	**$ (64,354)**	$ (44,391)
Bank indebtedness	**209,013**	270,332
Commercial paper	**127,828**	260,386
Long-term debt	**943,412**	946,098
Net debt	**1,215,899**	1,432,425
Shareholders' equity	**4,223,903**	3,826,110
Total capitalization	**$ 5,439,802**	$ 5,258,535
Net debt:Shareholders' equity	**0.29:1**	0.37:1
Net debt:Total capitalization	**0.22:1**	0.27:1
EBITDA:Cash interest expense[1][2]	**20.16:1**	19:59:1

(1) For purposes of calculating the ratios, EBITDA is comprised of EBITDA for the 52 week periods ended January 1, 2011 and January 2, 2010. 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 52 week periods ended January 1, 2011 and January 2, 2010 and excludes the amortization of deferred financing costs and includes capitalized interest.

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

The following table provides a summary of the Company's credit ratings at January 1, 2011:

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

There were no changes to the Company's credit ratings during the fiscal years ended January 1, 2011 and January 2, 2010.

On April 8, 2010, DBRS Limited placed the short and long-term ratings of the Company under review with negative implications. The rating action was in response to the Ontario Ministry of Health and Long-Term Care's April 7, 2010 announcement with respect to further drug reform in the province. On July 30, 2010, DBRS Limited confirmed the short and long-term ratings of the Company and changed the ratings trend from under review with negative implications to stable.

Earnings Coverage Exhibit to the Consolidated Financial Statements (unaudited)

52 weeks ended January 1, 2011	
Earnings coverage on long-term debt obligations	**18.22 times**

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 fiscal year ended January 1, 2011.

Directors

David M. Williams
Chair of the Board of Directors and Interim President & Chief Executive Officer, Shoppers Drug Mart Corporation

Shân Atkins (3)
Managing Director, Chetrum Capital, LLC

James Hankinson (1)
Corporate Director

Krystyna T. Hoeg (3)
Corporate Director

Holger Kluge (1)
Corporate Director

Gaëtan Lussier (1)
Corporate Director

The Honourable David R. Peterson, P.C., Q.C. (3)
Chairman & Senior Partner, Cassels Brock & Blackwell LLP

Dr. Martha Piper (2)
Corporate Director

Sarah Raiss (2)
Executive Vice-President, TransCanada Corporation

Derek Ridout (2)
Corporate Director

(1) Member of Audit Committee
(2) Member of Human Resources and Compensation Committee
(3) Member of Nominating and Governance Committee

Officers

David M. Williams
Interim President & Chief Executive Officer

Mary Kelly
Executive Vice-President, Merchandising & Category Management

Bradley Lukow
Executive Vice-President & Chief Financial Officer

Michael Motz
Executive Vice-President, Operations

Loreen Paananen
Executive Vice-President, Retail Development

Mark Valesano
Executive Vice-President, Pharmacy

Mary-Alice Vuicic
Chief Administrative Officer & Executive Vice-President, Human Resources

John Caplice
Senior Vice-President, Treasurer, Investor Relations & Corporate Affairs

Frank Pedinelli
Senior Vice-President, Legal Affairs & General Counsel

Adam Grabowski
Vice-President, Legal Affairs & Secretary

Executive Committee

David M. Williams
Interim President & Chief Executive Officer

Mary Kelly
Executive Vice-President, Merchandising & Category Management

Bradley Lukow
Executive Vice-President & Chief Financial Officer

Michael Motz
Executive Vice-President, Operations

Loreen Paananen
Executive Vice-President, Retail Development

Mark Valesano
Executive Vice-President, Pharmacy

Mary-Alice Vuicic
Chief Administrative Officer & Executive Vice-President, Human Resources

Erik Botines
Senior Vice-President, Peers Relations

John Caplice
Senior Vice-President, Treasurer, Investor Relations & Corporate Affairs

Paul Damiani
Senior Vice-President, Healthcare Businesses

Terrence Landry
Senior Vice-President, Corporate Infinity

Geoffrey Martin
Senior Vice-President, Business Development

Jim Noteboom
Senior Vice-President, Business Analytics & Financial Services

Frank Pedinelli
Senior Vice-President, Legal Affairs & General Counsel

Paul Pochon
Senior Vice-President & Chief Information Officer

Sandra Sanderson
Senior Vice-President, Marketing

Kevin Whibbs
Senior Vice-President, Logistics & Supply Chain

DESIGN: BRYAN MILLS IRADESSO WWW.BMIR.COM, TORONTO

Stock Listing

Toronto Stock Exchange

Share Symbol

SC

Dividend Policy

On February 10, 2011, the Company announced that its Board of Directors declared a dividend of 25 cents per common share, payable April 15, 2011 to shareholders of record as of the close of business on March 31, 2011. Subject to financial results, capital requirements, available cash flow and any other factors that the Board of Directors may consider relevant, it is the intention of the Board of Directors to declare a comparable quarterly dividend on an ongoing basis. It is expected that future dividend payments will be made to shareholders of record as of the close of business on the last business day of each calendar quarter and that the related payment date will be the fifteenth day of the month following the record date, or if such day is not a business day, the immediately preceding business day.

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

Corporate Office

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Regional Offices

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Investor Contact Information

Investor Relations may be contacted by a variety of means:

Tel: (416) 493-1220 ext. 5678
Fax: (416) 491-1022
E-mail: investorrelations@shoppersdrugmart.ca

Stock Transfer Agent

Requests for information respecting such matters as share transfers and stock certificates should be directed to the Transfer Agent:

CIBC Mellon Trust Company
PO Box 7010
Adelaide Street Postal Station
Toronto, Ontario
M5C 2W9

Tel: (416) 643-5500 (Toronto area)
1-800-387-0825 (anywhere in North America)
Fax: (416) 643-5501
Web: www.cibcmellon.com
E-mail: inquiries@cibcmellon.com

Outside Legal Counsel

Osler, Hoskin & Harcourt LLP
Toronto, Ontario

Independent Auditor

Deloitte & Touche LLP
Toronto, Ontario

Annual Meeting

The Annual Meeting for shareholders will be held on May 10, 2011 at 11:00 a.m. at the Glenn Gould Studio, Main Floor, Canadian Broadcasting Centre, 250 Front Street West, Toronto, Ontario, Canada.

Une version française de ce rapport est disponible dans la section Investissements du site Web de la société à www.shoppersdrugmart.ca, ou sur le site Web des Autorités canadiennes en valeurs mobilières à www.sedar.com.

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Management's Responsibility for Financial Statements

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

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

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

Domenic Pilla
President and Chief Executive Officer

Brad Lukow
Executive Vice-President and Chief Financial Officer

TORONTO, ONTARIO
FEBRUARY 9, 2012

Independent Auditor's Report

To the Shareholders of Shoppers Drug Mart Corporation

We have audited the accompanying consolidated financial statements of Shoppers Drug Mart Corporation, which comprise the consolidated balance sheets as at December 31, 2011, January 1, 2011, and January 3, 2010 and the consolidated statements of earnings, consolidated statements of comprehensive income, consolidated statements of changes in shareholders' equity and consolidated statements of cash flows for the 52 week periods ended December 31, 2011 and January 1, 2011, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Shoppers Drug Mart Corporation as at December 31, 2011, January 1, 2011 and January 3, 2010 and its financial performance and its cash flows for the 52 week periods ended December 31, 2011 and January 1, 2011 in accordance with International Financial Reporting Standards.

Deloitte & Touche LLP

Chartered Accountants,
Licensed Public Accountants

FEBRUARY 9, 2012
TORONTO, ONTARIO

Consolidated Statements of Earnings

For the 52 weeks ended December 31, 2011 and January 1, 2011 (in thousands of Canadian dollars, except per share amounts)	Note	2011	2010[1]
Sales		**$ 10,458,652**	$ 10,192,714
Cost of goods sold	9	**(6,416,208)**	(6,283,634)
Gross profit		**4,042,444**	3,909,080
Operating and administrative expenses	10, 11, 13	**(3,131,539)**	(3,011,758)
Operating income		**910,905**	897,322
Finance expenses	12	**(64,038)**	(60,633)
Earnings before income taxes		**846,867**	836,689
Income taxes	14		
Current		**(208,696)**	(238,779)
Deferred		**(24,237)**	(6,059)
		(232,933)	(244,838)
Net earnings		**$ 613,934**	$ 591,851
Net earnings per common share			
Basic	25	**$ 2.84**	$ 2.72
Diluted	25	**$ 2.84**	$ 2.72
Weighted average common shares outstanding (millions):			
Basic	25	**216.4**	217.4
Diluted	25	**216.5**	217.5
Actual common shares outstanding (millions)	24	**212.5**	217.5

[1] In preparing its 2010 comparative information, the Company has adjusted amounts reported previously in financial statements prepared in accordance with Canadian Generally Accepted Accounting Principles ("previous Canadian GAAP"). See Note 30 to these consolidated financial statements for an explanation of the transition to International Financial Reporting Standards ("IFRS").

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

Consolidated Statements of Comprehensive Income

For the 52 weeks ended December 31, 2011 and January 1, 2011 (in thousands of Canadian dollars)	Note	2011	2010[1]
Net earnings		**$ 613,934**	$ 591,851
Other comprehensive income (loss), net of tax			
Effective portion of changes in fair value of hedges on interest rate derivatives (net of tax of $nil (2010: $525))	18	**–**	1,120
Effective portion of changes in fair value of hedges on equity forward derivatives (net of tax of $12 (2010: $205))	18	**(39)**	(521)
Net change in fair value of hedges on interest rate and equity forward derivatives transferred to earnings (net of tax of $163 (2010: $13))	18	**411**	33
Retirement benefit obligations actuarial losses (net of tax of $7,433 (2010: $2,905))	21	**(21,943)**	(8,150)
Other comprehensive loss, net of tax	7	**(21,571)**	(7,518)
Total comprehensive income		**$ 592,363**	$ 584,333

[1] In preparing its 2010 comparative information, the Company has adjusted amounts reported previously in financial statements prepared in accordance with previous Canadian GAAP. See Note 30 to these consolidated financial statements for an explanation of the transition to IFRS.

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

Consolidated Balance Sheets

As at December 31, 2011, January 1, 2011 and January 3, 2010
(in thousands of Canadian dollars)

	Note	December 31, 2011	January 1, 2011[1]	January 3, 2010[1]
Current assets				
Cash		**$ 118,566**	$ 64,354	$ 44,391
Accounts receivable		**493,338**	432,089	470,935
Inventory		**2,042,302**	1,957,525	1,852,441
Income taxes recoverable		**–**	20,384	–
Prepaid expenses and deposits		**41,441**	68,468	74,206
Total current assets		**2,695,647**	2,542,820	2,441,973
Non-current assets				
Property and equipment	15	**1,767,543**	1,677,340	1,541,841
Investment property	15	**16,372**	12,770	5,884
Goodwill	16	**2,499,722**	2,493,108	2,483,430
Intangible assets	17	**281,737**	272,217	258,766
Other assets		**18,214**	19,678	16,716
Deferred tax assets	14	**21,075**	26,264	28,456
Total non-current assets		**4,604,663**	4,501,377	4,335,093
Total assets		**$ 7,300,310**	$ 7,044,197	$ 6,777,066
Liabilities				
Bank indebtedness	19	**$ 172,262**	$ 209,013	$ 270,332
Commercial paper	19	**–**	127,828	260,386
Accounts payable and accrued liabilities	18	**1,109,444**	990,244	970,831
Income taxes payable		**26,538**	–	17,046
Dividends payable	24	**53,119**	48,927	46,748
Current portion of long-term debt	20	**249,971**	–	–
Provisions	22	**12,024**	12,562	11,009
Associate interest		**152,880**	138,993	130,189
Total current liabilities		**1,776,238**	1,527,567	1,706,541
Long-term debt	20	**695,675**	943,412	946,098
Other long-term liabilities	23	**520,188**	442,124	386,262
Provisions	22	**1,701**	1,852	1,062
Deferred tax liabilities	14	**38,678**	26,607	25,219
Total long-term liabilities		**1,256,242**	1,413,995	1,358,641
Total liabilities		**3,032,480**	2,941,562	3,065,182
Shareholders' equity				
Share capital	24	**1,486,455**	1,520,558	1,519,870
Treasury shares	24	**(4,735)**	–	–
Contributed surplus	26	**10,246**	11,702	10,274
Accumulated other comprehensive loss	7	**(30,214)**	(8,643)	(1,125)
Retained earnings		**2,806,078**	2,579,018	2,182,865
Total shareholders' equity		**4,267,830**	4,102,635	3,711,884
Total liabilities and shareholders' equity		**$ 7,300,310**	$ 7,044,197	$ 6,777,066

[1] In preparing its 2010 comparative information, the Company has adjusted amounts reported previously in financial statements prepared in accordance with previous Canadian GAAP. See Note 30 to these consolidated financial statements for an explanation of the transition to IFRS.

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

On behalf of the Board of Directors:

Domenic Pilla
Director

Holger Kluge
Director

Consolidated Statements of Changes in Shareholders' Equity

For the 52 weeks ended December 31, 2011 and January 1, 2011
(in thousands of Canadian dollars)

	Note	Share Capital	Treasury Shares	Contributed Surplus	Accumulated Other Comprehensive Loss (Notes 18 and 21)	Retained Earnings	Total
Balance as at January 1, 2011[1]		$ 1,520,558	$ –	$ 11,702	$ (8,643)	$ 2,579,018	$ 4,102,635
Total comprehensive income		–	–	–	(21,571)	613,934	592,363
Dividends	24	–	–	–	–	(215,671)	(215,671)
Share repurchases	24	(35,576)	(4,735)	–	–	(171,203)	(211,514)
Share-based payments	26	–	–	(1,210)	–	–	(1,210)
Share options exercised	26	1,466	–	(246)	–	–	1,220
Repayment of share-purchase loans		7	–	–	–	–	7
Balance as at December 31, 2011		**$ 1,486,455**	**$ (4,735)**	**$ 10,246**	**$ (30,214)**	**$ 2,806,078**	**$ 4,267,830**
Balance as at January 3, 2010[1]		$ 1,519,870	$ –	$ 10,274	$ (1,125)	$ 2,182,865	$ 3,711,884
Total comprehensive income		–	–	–	(7,518)	591,851	584,333
Dividends	24	–	–	–	–	(195,698)	(195,698)
Share-based payments	26	–	–	1,592	–	–	1,592
Share options exercised	26	655	–	(164)	–	–	491
Repayment of share-purchase loans		33	–	–	–	–	33
Balance as at January 1, 2011[1]		$ 1,520,558	$ –	$ 11,702	$ (8,643)	$ 2,579,018	$ 4,102,635

(1) In preparing its 2010 comparative information, the Company has adjusted amounts reported previously in financial statements prepared in accordance with previous Canadian GAAP. See Note 30 to these consolidated financial statements for an explanation of the transition to IFRS.

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

Consolidated Statements of Cash Flows

For the 52 weeks ended December 31, 2011 and January 1, 2011 (in thousands of Canadian dollars)	Note	2011	2010[1]
Cash flows from operating activities			
Net earnings		**$ 613,934**	$ 591,851
Adjustments for:			
Depreciation and amortization	13, 15, 17	**296,464**	278,421
Finance expenses	12	**64,038**	60,633
Loss on sale or disposal of property and equipment, including impairments	15, 17	**2,015**	3,880
Share-based payment transactions	26	**(1,210)**	1,592
Recognition and reversal of provisions, net	22	**9,218**	12,160
Other long-term liabilities	23	**296**	18,491
Income tax expense	14	**232,933**	244,838
		1,217,688	1,211,866
Net change in non-cash working capital balances	27	**32,166**	(34,824)
Provisions used	22	**(9,907)**	(9,817)
Interest paid		**(63,853)**	(62,916)
Income taxes paid		**(202,256)**	(276,108)
Net cash from operating activities		**973,838**	828,201
Cash flows from investing activities			
Proceeds from disposition of property and equipment and investment property		**55,459**	60,538
Business acquisitions	8	**(10,496)**	(11,779)
Deposits		**105**	1,534
Acquisition or development of property and equipment	15	**(341,868)**	(415,094)
Acquisition or development of intangible assets	17	**(53,836)**	(56,625)
Other assets		**1,464**	(3,249)
Net cash used in investing activities		**(349,172)**	(424,675)
Cash flows from financing activities			
Repurchase of own shares	24	**(206,779)**	–
Proceeds from exercise of share options	26	**1,220**	491
Repayment of share-purchase loans	24	**7**	33
Repayment of bank indebtedness, net	19	**(36,714)**	(61,319)
Repayment of commercial paper, net	19	**(128,000)**	(133,000)
Revolving term debt, net	20	**152**	(1,298)
Payment of transaction costs for debt refinancing	20	**(575)**	(2,792)
Repayment of financing lease obligations	23	**(2,173)**	(1,436)
Associate interest		**13,887**	9,277
Dividends paid	24	**(211,479)**	(193,519)
Net cash used in financing activities		**(570,454)**	(383,563)
Net increase in cash		**54,212**	19,963
Cash, beginning of the year		**64,354**	44,391
Cash, end of the year		**$ 118,566**	$ 64,354

[1] In preparing its 2010 comparative information, the Company has adjusted amounts reported previously in financial statements prepared in accordance with previous Canadian GAAP. See Note 30 to these consolidated financial statements for an explanation of the transition to IFRS.

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

1. GENERAL INFORMATION

Shoppers Drug Mart Corporation (the "Company") is a public company incorporated and domiciled in Canada, whose shares are publicly traded on the Toronto Stock Exchange. The Company's registered address is 243 Consumers Road, Toronto, Ontario M2J 4W8, Canada.

The Company is a licensor of 1,199 Shoppers Drug Mart®/Pharmaprix® full-service retail drug stores across Canada. The Shoppers Drug Mart®/Pharmaprix® stores are licensed to corporations owned by pharmacists ("Associates"). The Company also licenses or owns 58 Shoppers Simply Pharmacy®/Pharmaprix Simplement Santé® medical clinic pharmacies and eight Murale™ beauty stores. In addition, the Company owns and operates 63 Shoppers Home Health Care® stores. In addition to its store network, the Company owns Shoppers Drug Mart Specialty Health Network Inc., a provider of specialty drug distribution, pharmacy and comprehensive patient support services, and MediSystem Technologies Inc., a provider of pharmaceutical products and services to long-term care facilities in Ontario and Alberta.

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

These consolidated financial statements of the Company as at and for the financial year ended December 31, 2011 include the accounts of Shoppers Drug Mart Corporation, its subsidiaries, and the Associate-owned stores that comprise the majority of the Company's store network. The financial year of the Company consists of a 52 or 53 week period ending on the Saturday closest to December 31. The current financial year is the 52 weeks ended December 31, 2011. The comparative financial year is the 52 weeks ended January 1, 2011. The Company has also presented the consolidated balance sheet as at January 3, 2010, the Company's date of transition to International Financial Reporting Standards ("IFRS").

2. BASIS OF PREPARATION

(a) Statement of Compliance

These consolidated financial statements have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("Canadian GAAP"). These consolidated financial statements also comply with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

These are the Company's first consolidated financial statements prepared in accordance with IFRS. IFRS 1, "First-time Adoption of International Financial Reporting Standards", has been applied in the preparation of these financial statements. Consolidated financial statements of the Company had been prepared under previous Canadian GAAP, which differs in certain respects from IFRS. When preparing the Company's 2011 consolidated financial statements, management has amended certain accounting methods in order to comply with IFRS. The comparative consolidated financial statements reflect the adoption of IFRS.

An explanation of how the transition from previous Canadian GAAP to IFRS has affected the reported financial position, financial performance and cash flows of the Company is provided in Note 30 to these consolidated financial statements.

These consolidated financial statements were authorized for issuance by the Board of Directors of the Company on February 9, 2012.

(b) Use of Estimates and Judgements

The preparation of these consolidated financial statements in conformity with IFRS requires management to make certain judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of these consolidated financial statements and the reported amounts of revenues and expenses during the reporting period.

2. BASIS OF PREPARATION (continued)

Judgement is commonly used in determining whether a balance or transaction should be recognized in the consolidated financial statements and estimates and assumptions are more commonly used in determining the measurement of recognized transactions and balances. However, judgement and estimates are often interrelated.

The Company has applied judgement in its assessment of the appropriateness of the consolidation of the Associate-owned stores, classification of items such as leases and financial instruments, the recognition of tax losses and provisions, determining the tax rates used for measuring deferred taxes, determining cash-generating units, identifying the indicators of impairment for property and equipment and intangible assets with finite useful lives, and the level of componentization of property and equipment.

Estimates are used when estimating the useful lives of property and equipment and intangible assets for the purpose of depreciation and amortization, when accounting for or measuring items such as inventory provisions, Shoppers Optimum® loyalty card program deferred revenue, assumptions underlying the actuarial determination of retirement benefit obligations, income and other taxes, provisions, certain fair value measures including those related to the valuation of business combinations, share-based payments and financial instruments and when testing goodwill, indefinite useful life intangible assets and other assets for impairment. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

3. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out in these consolidated financial statements have been applied consistently to all periods presented in these consolidated financial statements.

(a) Basis of Consolidation

(i) Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. All of the Company's subsidiaries are wholly-owned. The financial statements of subsidiaries are included in the Company's consolidated financial statements from the date that control commences until the date that control ceases.

(ii) Associate-owned Stores

Associate-owned stores comprise the majority of the Company's store network. The Company does not have any direct or indirect shareholdings in these Associates' corporations. The Associates' corporations remain separate legal entities. The Company consolidates the Associate-owned stores under IAS 27, "Consolidated and Separate Financial Statements" ("IAS 27"). The consolidation of the stores under IAS 27 was determined based on the concept of control under IAS 27 and determined primarily through the agreements with Associates ("Associate Agreements") that govern the relationship between the Company and the Associates.

(iii) Transactions Eliminated on Consolidation

Intra-company balances and transactions and any unrealized earnings and expenses arising from intra-company transactions, including those of the Associate-owned stores, are eliminated in preparing the consolidated financial statements.

(b) Basis of Measurement

These consolidated financial statements have been prepared on the historical cost basis except for certain financial instruments, deferred revenue related to the Shoppers Optimum® loyalty card program and the liabilities for the Company's long-term incentive plan and restricted share unit plan, which are measured at fair value (see Note 26 to these consolidated financial statements for further information on the long-term incentive plan and the restricted share unit plan). Any recognized impairment losses will also impact the historical cost of certain balances.

The methods used to measure fair values are discussed further in Note 4 to these consolidated financial statements.

(c) Revenue

(i) Sale of Goods and Services

Revenue is comprised primarily of retail sales, including prescription sales. Retail sales are recognized as revenue when the goods are sold to the customer. Revenue is net of returns and amounts deferred related to the issuance of points under the Shoppers Optimum® Loyalty Card Program (the "Program"). Where a sales transaction includes points awarded under the Program, revenue allocated to the Program points is deferred based on the fair value of the awards and recognized as revenue when the Program points are redeemed and the Company fulfills its obligations to supply the awards.

Revenue is measured at the fair value of the consideration received or receivable from the customer for products sold or services supplied.

(ii) Shoppers Optimum® Loyalty Card Program

The Shoppers Optimum® Loyalty Card Program allows members to earn points on their purchases in Shoppers Drug Mart®, Pharmaprix®, Shoppers Simply Pharmacy®, Pharmaprix Simplement Santé®, Shoppers Home Health Care® and Murale™ stores at a rate of 10 points for each dollar spent on eligible products and services, plus any applicable bonus points. Members can then redeem points, in accordance with the Program rewards schedule or other offers, for qualifying merchandise at the time of a future purchase transaction.

When points are earned by Program members, the Company defers revenue equal to the fair value of the awards. The Program's deferred revenue is recognized within accounts payable and accrued liabilities in the Company's consolidated balance sheets. When awards are redeemed by Program members, the redemption value of the awards is charged against the deferred revenue balance and recognized as revenue.

The estimated fair value per point is determined based on the expected weighted average redemption levels for future redemptions based on the program reward schedule, including special redemption events. The trends in redemption rates (points redeemed as a percentage of points issued) are reviewed on an ongoing basis and the estimated fair value per point is adjusted based upon expected future activity.

(d) Vendor Rebates

The Company classifies rebates and other consideration received from vendors as a reduction to the cost of inventory. These amounts are recognized in cost of goods sold when the associated inventory is sold. Certain exceptions apply where the consideration received from the vendor is a reimbursement of a selling cost or a payment for services delivered to the vendor, in which case the consideration is reflected in cost of goods sold or operating and administrative expenses dependent on where the related expenses are recorded.

(e) Finance Expenses

Finance expenses are comprised of interest expense on borrowings and the amortization of transaction costs incurred in conjunction with debt transactions. All borrowing costs are recognized in earnings on an accrual basis using the effective interest method, net of amounts capitalized as part of the cost of qualifying property and equipment.

The Company's finance income is not significant.

(f) Borrowing Costs

Borrowing costs that are directly attributable to the acquisition, construction or development of a qualifying asset are recognized as part of the cost of that asset. Qualifying assets are those that require a substantial period of time to prepare for their intended use. All other borrowing costs are recognized as finance expenses in the period in which they are incurred.

The Company capitalizes borrowing costs at the weighted average interest rate on borrowings outstanding for the period. The Company commences capitalization of borrowing costs as part of the cost of a qualifying asset when activities are undertaken to prepare the asset for its intended use and when expenditures, including borrowing costs, are incurred for the asset. Capitalization of borrowing costs ceases when substantially all of the activities necessary to prepare the asset for its intended use are complete.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Income Taxes

Income tax expense is comprised of taxes currently payable on earnings and changes in deferred tax balances, excluding those changes related to business acquisitions. Income tax expense is recognized in net earnings except to the extent that it relates to items recognized either in other comprehensive income (loss) or directly in equity, in which case it is recognized in other comprehensive income (loss) or in equity respectively.

Current tax expense is comprised of the tax payable on the taxable income for the current financial year using tax rates enacted or substantively enacted at the reporting date, and any adjustment to income taxes payable in respect of previous years.

Deferred tax is recognized using the balance sheet method in respect of taxable temporary differences arising from differences between the carrying amount of assets and liabilities for tax purposes and their carrying amounts in the financial statements. Deferred tax is calculated at the tax rates that are expected to apply to temporary differences in the year they are expected to reverse and are based on the tax legislation that has been enacted or substantively enacted by the reporting date. Deferred tax is not recognized for the following temporary differences: the initial recognition of goodwill and the initial recognition of assets or liabilities in a transaction that is not a business acquisition and that affects neither accounting nor taxable earnings; and, differences relating to investments in subsidiaries to the extent that it is probable that they will not reverse in the foreseeable future. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset the recognized amounts and the Company intends to settle on a net basis or to realize the asset and settle the liability simultaneously.

A deferred tax asset is recognized to the extent that it is probable that future taxable earnings will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that all or part of the related tax benefit will be realized.

(h) Earnings per Common Share

The Company presents basic and diluted earnings per share ("EPS") amounts for its common shares. Basic EPS is calculated by dividing the net earnings attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted EPS is determined by dividing the net earnings attributable to common shareholders of the Company by the weighted average number of common shares outstanding after adjusting both amounts for the effects of all potential dilutive common shares, which are comprised of share options granted to employees. Anti-dilutive options are not included in the calculation of diluted EPS.

(i) Financial Instruments

(i) Classification of Financial Instruments

Financial instruments are recognized when the Company becomes a party to the contractual provisions of a financial instrument. Financial instruments are classified into one of the following categories: held for trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets or financial liabilities. The classification determines the accounting treatment of the instrument. The classification is determined by the Company when the financial instrument is initially recorded, based on the underlying purpose of the instrument.

The Company's financial instruments are classified and measured as follows:

Financial Asset/Liability	Category	Measurement
Cash	Loans and receivables	Amortized cost
Accounts receivable	Loans and receivables	Amortized cost
Deposits[(1)]	Loans and receivables	Amortized cost
Long-term receivables[(2)]	Loans and receivables	Amortized cost
Bank indebtedness	Financial liabilities	Amortized cost
Commercial paper	Financial liabilities	Amortized cost
Accounts payable and accrued liabilities	Financial liabilities	Amortized cost
Dividends payable	Financial liabilities	Amortized cost
Long-term debt	Financial liabilities	Amortized cost
Other long-term liabilities	Financial liabilities	Amortized cost

Derivatives	Classification	Measurement
Interest rate derivatives[(3)]	Effective cash flow hedge	Fair value through other comprehensive income (loss)
Equity forward derivatives[(3)(4)]	Derivative financial instrument	Fair value through earnings
Equity forward derivatives[(3)(4)]	Effective cash flow hedge	Fair value through other comprehensive income (loss)

(1) The carrying value of deposits is recognized within prepaid expenses and deposits in the consolidated balance sheets.

(2) The carrying value of long-term receivables is recognized within other assets in the consolidated balance sheets.

(3) The carrying values of the Company's derivatives are recognized within other assets, accounts payable and accrued liabilities and other long-term liabilities in the consolidated balance sheets.

(4) The portion of the equity forward derivative agreements relating to the earned long-term incentive plan units and earned restricted share unit plan units is considered a derivative financial instrument. The portion of the equity forward derivative agreements relating to the unearned long-term incentive plan units and unearned restricted share unit plan units is considered an effective cash flow hedge. See Note 26 to these consolidated financial statements for further discussion of the long-term incentive plan and the restricted share unit plan.

Financial instruments measured at amortized cost are initially recognized at fair value and then subsequently at amortized cost using the effective interest method, less any impairment losses, with gains and losses recognized in earnings in the period in which the gain or loss occurs. Changes in the fair value of the Company's derivative instruments designated as effective cash flow hedges are recognized in other comprehensive income (loss) and changes in derivative instruments not designated as effective hedges are recognized within operating and administrative expenses in the Company's consolidated statements of earnings in the period of the change.

The Company categorizes its financial assets and financial liabilities that are recognized in the consolidated balance sheets at fair value using the fair value hierarchy. The fair value hierarchy has the following levels:

- Level 1 – quoted market prices in active markets for identical assets or liabilities;
- Level 2 – inputs other than quoted market prices included in Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices); and
- Level 3 – unobservable inputs such as inputs for the asset or liability that are not based on observable market data.

The level in the fair value hierarchy within which the fair value measurement is categorized in its entirety is determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(ii) Transaction Costs

Transaction costs are added to the initial fair value of financial assets and liabilities when those financial assets and liabilities are not measured at fair value subsequent to initial measurement. Transaction costs are amortized to net earnings, within finance expenses, using the effective interest method.

(iii) Derivative Financial Instruments and Hedge Accounting

The Company 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 and decreases in interest rates will negatively or positively impact the financial performance of the Company. The Company may use, from time to time, interest rate derivatives to manage this exposure. The earnings or expense arising from the use of these instruments is recognized within finance expenses for the financial year.

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") and restricted share unit plan ("RSU Plan"). The earnings or expense arising from the use of these instruments is included in other comprehensive income (loss) and in operating and administrative expenses, based on the amounts considered to be a hedge or a derivative, respectively, for the financial year. See Note 26 to these consolidated financial statements for further discussion of the LTIP and RSU Plan.

The Company formally identifies, designates and documents all relationships between hedging instruments and hedged items, as well as its risk assessment objective and strategy for undertaking various hedge transactions. The Company assesses, both at the inception of the hedge and on an ongoing basis, including on re-designation, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items. When such derivative instruments cease to exist or to be effective as hedges, or when designation of a hedging relationship is terminated, any associated deferred gains or losses are recognized in earnings in the same period as the corresponding gains or losses associated with the hedged item. When a hedged item ceases to exist, any associated deferred gains or losses are recognized in earnings in the period the hedged item ceases to exist.

(iv) Embedded Derivatives

Embedded derivatives (elements of contracts whose cash flows move independently from the host contract) are required to be separated and measured at their respective fair values unless certain criteria are met. The Company does not have any significant embedded features in contractual arrangements that require separate accounting or presentation from the related host contracts.

(v) Share Capital

Common Shares Common shares issued by the Company are recorded in the amount of the proceeds received, net of direct issue costs.

Repurchase of Share Capital The Company, from time to time, will repurchase its common shares under a Normal Course Issuer Bid. When common shares are repurchased, the amount of the consideration paid which includes directly attributable costs and is net of any tax effects, is recognized as a deduction from share capital. Any repurchased common shares are cancelled. The premium paid over the average book value of the common shares repurchased is charged to retained earnings. At the end of a reporting period, if there are shares that have not yet been cancelled, they are recognized as treasury shares at the purchase price of the transaction.

(j) Business Combinations

The Company applies the acquisition method in accounting for business combinations.

On acquisition, the assets, including intangible assets, and any liabilities assumed are measured at their fair value. Purchase price allocations may be preliminary when initially recognized and may change pending finalization of the valuation of the assets acquired. Purchase price allocations are finalized within one year of the acquisition and prior periods are restated to reflect any adjustments to the purchase price allocation made subsequent to the initial recognition.

The determination of fair values, particularly for intangible assets, is based on management's estimates and includes assumptions on the timing and amount of future cash flows. The Company recognizes as goodwill the excess 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. Transaction costs are expensed as incurred. The date of acquisition is the date on which the Company obtains control over the acquired business.

(k) Inventory

Inventory is comprised of merchandise inventory, which includes prescription inventory, and is valued at the lower of cost and estimated net realizable value. Cost is determined on the first-in, first-out basis. Cost includes all direct expenditures and other appropriate costs incurred in bringing inventory to its present location and condition. The Company classifies rebates and other consideration received from a vendor as a reduction to the cost of inventory unless the rebate relates to the reimbursement of a selling cost or a payment for services.

Net realizable value is the estimated selling price in the ordinary course of business, less the estimated selling expenses.

(l) Property and Equipment and Investment Property

(i) Recognition and Measurement

Items of property and equipment are carried at cost less accumulated depreciation and any recognized impairment losses (see (p) Impairment).

Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the assets to a working condition for their intended use, and, where applicable, the costs of dismantling and removing the items and restoring the site on which they are located. Borrowing costs are recognized as part of the cost of an asset, where appropriate.

Purchased software that is integral to the functionality of the related equipment is capitalized as part of that equipment.

When components of property and equipment have different useful lives, they are accounted for as separate items of property and equipment.

Gains and losses on disposal of an item of property and equipment are determined by comparing the proceeds from disposal with the carrying amount of property and equipment and are recognized net, within operating and administrative expenses, in net earnings.

Fully-depreciated items of property and equipment that are still in use continue to be recognized in cost and accumulated depreciation.

(ii) Subsequent Costs

The cost of replacing part of an item of property and equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Company and its cost can be measured reliably. The carrying amount of the replaced part is de-recognized. The costs of repairs and maintenance of property and equipment are recognized in earnings as incurred.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(iii) Depreciation

Depreciation is recognized in earnings on a straight-line basis over the estimated useful lives of each component of an item of property and equipment. Land is not depreciated. The Company commences recognition of depreciation in earnings when the item of property and equipment is ready for its intended use.

The estimated useful lives for the current and comparative periods are as follows:

Buildings and their components	10 to 40 years
Equipment and fixtures	3 to 10 years
Computer equipment	2 to 10 years
Leasehold improvements	Lesser of term of the lease and useful life
Assets under financing leases	Lesser of term of the lease and useful life

Depreciation methods and useful lives are reviewed at each reporting date.

(iv) Investment Property

Investment property is carried at cost less accumulated depreciation and any recognized impairment losses.

(m) Goodwill

(i) Recognition and Measurement

The Company recognizes goodwill 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 on an annual basis or more frequently if there are indicators that goodwill may be impaired (see (p) Impairment).

(ii) Acquisitions Prior to January 3, 2010

As described in Note 30 to these consolidated financial statements, as part of its transition to IFRS, the Company elected to apply IFRS 3, “Business Combinations” (“IFRS 3”), only to those business combinations that occurred on or after January 3, 2010. In respect of acquisitions prior to January 3, 2010, goodwill represents the amount recognized under previous Canadian GAAP.

(iii) Subsequent Measurement

Goodwill is measured at cost less any accumulated impairment losses.

(n) Intangible Assets

(i) Computer Software

The Company acquires computer software through purchases from vendors and internal development. Computer software that is an integral part of computer equipment is presented in property and equipment. All other computer software is treated as an intangible asset. The Company includes computer software under development in intangible assets. The assessment of whether computer software is an integral part of computer hardware is made when the software development project is complete and placed into use. Costs for internally developed computer software include directly attributable costs including direct labour and overheads associated with the software development project. Expenditures on research activities as part of internally developed computer software are recognized in earnings when incurred.

(ii) Other Intangible Assets

Other intangible assets that are acquired by the Company, other than as a result of a business acquisition, which have finite useful lives, are measured at cost less accumulated amortization and any accumulated impairment losses (see (p) Impairment). Other intangible assets that are acquired by the Company as a result of a business acquisition are measured at their fair values as at the date of acquisition.

(iii) Amortization

Amortization is recognized in earnings on a straight-line basis over the estimated useful lives of intangible assets from the date that they are available for their intended use. The estimated useful lives are as follows:

Prescription files	7 to 12 years
Customer relationships	5 to 25 years
Computer software	3 to 10 years
Other	Term of the lease or 3 years

Computer software under development is not amortized. Amortization methods and useful lives are reviewed at each reporting date.

(o) Leases

The Company leases most of its store locations and office space. Terms vary in length and typically permit renewal for additional periods. Leases for which substantially all the benefits and risks of ownership are transferred to the Company based on certain criteria are recorded as financing leases and classified as property and equipment, accounts payable and accrued liabilities and other long-term liabilities. All other leases are classified as operating leases under which minimum rent, including scheduled escalations, is expensed on a straight-line basis over the term of the lease, including any rent-free periods. Landlord inducements are deferred and amortized as reductions to rent expense on a straight-line basis over the same period.

In the normal course of business, the Company sells certain real estate properties and enters into leaseback arrangements for the area occupied by the Associate-owned stores. The leases are assessed as financing or operating in nature as applicable, and are accounted for accordingly. The gains realized on the disposal of the real estate properties related to sale-leaseback transactions, which are financing in nature, are deferred and amortized on a straight-line basis over the shorter of the lease term and the estimated useful life of the leased asset. The gains realized on the disposal of real estate properties related to sale-leaseback transactions, which are transacted at fair value and are operating in nature, are recognized within operating and administrative expenses in the consolidated statements of earnings. In the event the fair value of the asset at the time of the sale-leaseback transaction is less than its carrying value, the difference would be recognized within operating and administrative expenses in the consolidated statements of earnings.

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

(p) Impairment

(i) Financial Assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events, which have a negative effect on the estimated future cash flows of that asset, have occurred.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows, discounted at the original effective interest rate.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognized in the consolidated statements of earnings.

An impairment loss is reversed if the reversal can be objectively related to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost, the reversal is recognized in earnings.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(ii) Property and Equipment and Intangible Assets with Finite Useful Lives

The carrying amount of property and equipment and intangible assets with finite useful lives is reviewed at each reporting date to determine whether there are any indicators of impairment. If any such indicators exist, then the recoverable amount of the asset is estimated as the higher of the fair value of the asset less costs to sell, or value-in-use. An impairment loss is recognized in net earnings for the amount by which the carrying amount of the asset exceeds its recoverable amount. For the purposes of assessing impairment, when an individual asset does not generate cash flows in and of itself, assets are then grouped and tested at the lowest level for which there are separately identifiable cash flows, called a cash-generating unit. The Company has determined that its cash generating units are primarily its retail stores.

(iii) Goodwill and Intangible Assets with Indefinite Useful Lives

For goodwill and intangible assets that have indefinite useful lives or that are not yet available for use, the carrying value is reviewed for impairment on an annual basis, or more frequently if there are indicators that impairment may exist.

Goodwill is allocated to cash-generating units expected to benefit from the synergies created from a business combination and to the lowest level at which management monitors goodwill. To review for impairment, the recoverable amount of each cash-generating unit to which goodwill is allocated is compared to its carrying value, including goodwill.

(iv) Recoverable Amount

The recoverable amount of an asset or cash-generating unit is the greater of its value-in-use and its fair value less costs to sell. In assessing value-in-use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

(v) Impairment Losses

An impairment loss is recognized if the carrying amount of an asset or its cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognized in operating and administrative expenses in the consolidated statements of earnings. Impairment losses recognized in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating units and, then, to reduce the carrying amounts of the other assets in the cash-generating unit (group of cash-generating units) on a pro rata basis.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognized in prior periods are assessed at each reporting date for any indicators that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the carrying amount of the asset does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

(q) Bank Indebtedness

Bank indebtedness is comprised of corporate bank overdraft balances, corporate and Associate-owned store bank lines of credit and outstanding cheques.

(r) Employee Benefits

(i) Defined Benefit Plans

The Company maintains registered defined benefit pension plans under which benefits are available to certain employee groups. The Company also makes supplementary retirement benefits available to certain employees under a non-registered defined benefit pension plan.

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

- The cost of pensions and other retirement benefits earned by employees is actuarially determined using the projected unit credit method (also known as the projected benefit method pro-rated on service) and management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and their expected future longevity.
- For the purposes of calculating the expected return on plan assets, those assets are valued at fair value.
- The Company recognizes actuarial gains and losses in other comprehensive income (loss) in the period in which those gains and losses occur.

The pension plans are funded through contributions based on actuarial cost methods as permitted by applicable pension regulatory bodies. Benefits under these plans are based on the employees' years of service and final average earnings.

(ii) Defined Contribution Plans

The Company maintains a defined contribution plan for a small number of employees. Required contributions are recognized as an expense when the employees have rendered service.

(iii) Other Long-term Employee Benefits

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

(s) Share-based Payment Transactions

The grant date fair value of stock options granted to employees is recognized as employee compensation expense, with a corresponding increase in equity, over the period that the employees become unconditionally entitled to the options. Fair value is measured using the Black-Scholes option-pricing model. If the Company can reasonably estimate forfeitures of vested options, the amount expensed is adjusted for estimated forfeitures. For amounts that have been recognized related to options not yet vested that are subsequently forfeited, the amounts recognized as expenses and equity are reversed.

The fair value of the amount payable to employees in respect of cash-settled share-based payments is recognized as an expense, with a corresponding increase in liabilities, over the period that the employees become unconditionally entitled to payment. The fair value of the liability is re-measured at each reporting date and at settlement date. Any changes in the fair value of the liability are recognized within operating and administrative expenses in the consolidated statements of earnings.

(t) Provisions

Provisions are recognized when there is a present legal or constructive obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and that obligation can be measured reliably. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects the risks specific to the liability. Provisions are reviewed on a regular basis and adjusted to reflect management's best current estimates. Due to the judgmental nature of these items, future settlements may differ from amounts recognized. Provisions are comprised of estimated insurance claims, litigation settlements and store closing costs.

(i) Insurance Claims

The insurance claim provision is management's best estimate of future payments for current insurance claims that are below the Company's deductible limits and is based on determinations made by an independent insurance adjuster. The timing of utilization of the provision will vary according to the individual claims.

(ii) Litigation Claims

A provision for legal claims is recognized when it is probable that a settlement will be made in respect of a claim.

(iii) Store Closing Costs

The Company records a provision for store closings when it vacates current leased-store locations and relocates.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(u) Associate Interest

Associate interest reflects the investment the Associates have in the net assets of their businesses. Under the terms of the Company's agreements with Associates (the "Associate Agreements"), the Company agrees to purchase the assets that the Associates use in store operations, primarily at the carrying value to the Associate, when Associate Agreements are terminated by either party.

(v) New Standards and Interpretations Not Yet Adopted

A number of new standards, amendments to standards and interpretations have been issued but are not yet effective for the financial year ended December 31, 2011, and accordingly, have not been applied in preparing these consolidated financial statements:

(i) Financial Instruments – Disclosures

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

(ii) Deferred Taxes – Recovery of Underlying Assets

The IASB has issued an amendment to IAS 12, "Income Taxes" ("IAS 12 amendment"), which introduces an exception to the general measurement requirements of IAS 12 in respect of investment properties measured at fair value. The IAS 12 amendment is effective for annual periods beginning on or after January 1, 2012. The Company will apply the amendment at the beginning of its 2012 financial year and does not expect the implementation to have a significant impact on its results of operations, financial position and disclosures.

(iii) Financial Instruments

The IASB has issued a new standard, IFRS 9, "Financial Instruments" ("IFRS 9"), which will ultimately replace IAS 39, "Financial Instruments: Recognition and Measurement" ("IAS 39"). The replacement of IAS 39 is a multi-phase project with the objective of improving and simplifying the reporting for financial instruments and the issuance of IFRS 9 is part of the first phase of this project. IFRS 9 uses a single approach to determine whether a financial asset or liability is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. For financial assets, the approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. IFRS 9 requires a single impairment method to be used, replacing multiple impairment methods in IAS 39. For financial liabilities measured at fair value, fair value changes due to changes in an entity's credit risk are presented in other comprehensive income. IFRS 9 is effective for annual periods beginning on or after January 1, 2015 and must be applied retrospectively. The Company is assessing the impact of the new standard on its results of operations, financial position and disclosures.

(iv) Fair Value Measurement

The IASB has issued a new standard, IFRS 13, "Fair Value Measurement" ("IFRS 13"), which provides a standard definition of fair value, sets out a framework for measuring fair value and provides for specific disclosures about fair value measurements. IFRS 13 applies to all International Financial Reporting Standards that require or permit fair value measurements or disclosures. IFRS 13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. IFRS 13 is effective for annual periods beginning on or after January 1, 2013 and must be applied retrospectively. The Company is assessing the impact of IFRS 13 on its results of operations, financial position and disclosures.

(v) Consolidated Financial Statements

The IASB has issued a new standard, IFRS 10, "Consolidated Financial Statements" ("IFRS 10"), which establishes the principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. IFRS 10 establishes control as the basis for consolidation and defines the principle of control. An investor controls an investee if the investor has power over the investee, exposure or rights to variable returns from its involvement with the investee and the ability to use its power over the investee to affect the amount of the investor's returns. IFRS 10 was issued as part of the IASB's broader project on interests in all types of entities. This project also resulted in the issuance of additional standards as described in (vi) to (ix) below. IFRS 10 is effective for annual periods beginning on or after January 1, 2013 and must be applied retrospectively. The Company is assessing the impact of IFRS 10 on its results of operations, financial position and disclosures.

(vi) Joint Arrangements

The IASB has issued a new standard, IFRS 11, "Joint Arrangements" ("IFRS 11"), which establishes the principles for financial reporting by parties to a joint arrangement. IFRS 11 supersedes IAS 31, "Interests in Joint Ventures" and SIC Interpretation 13, "Jointly Controlled Entities – Non-Monetary Contributions by Venturers". The standard defines a joint arrangement as an arrangement where two or more parties have joint control, with joint control being defined as the contractually agreed sharing of control where decisions about relevant activities require unanimous consent of the parties sharing control. The standard classifies joint arrangements as either joint operations or joint investments and the classification determines the accounting treatment. IFRS 11 is effective for annual periods beginning on or after January 1, 2013 and must be applied retrospectively. The Company is assessing the impact of IFRS 11 on its results of operations, financial position and disclosures.

(vii) Disclosure of Interests in Other Entities

The IASB has issued a new standard, IFRS 12, "Disclosure of Interests in Other Entities" ("IFRS 12"), which integrates and provides consistent disclosure requirements for all interests in other entities such as subsidiaries, joint arrangements, associates and unconsolidated structured entities. IFRS 12 is effective for annual periods beginning on or after January 1, 2013 and must be applied retrospectively. The Company is assessing the impact of IFRS 12 on its disclosures.

(viii) Separate Financial Statements

The IASB has issued a revised standard, IAS 27, "Separate Financial Statements" ("IAS 27"), which contains the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate (non-consolidated) financial statements. IAS 27 is effective for annual periods beginning on or after January 1, 2013 and must be applied retrospectively. IAS 27 will not have an impact on the Company's consolidated results of operations, financial position and disclosures.

(ix) Investments in Associates and Joint Ventures

The IASB has issued a revised standard, IAS 28, "Investments in Associates and Joint Ventures" ("IAS 28"), which prescribes the accounting for investments in associates and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures. IAS 28 is effective for annual periods beginning on or after January 1, 2013 and must be applied retrospectively. The Company is assessing the impact of IAS 28 on its results of operations, financial position and disclosures.

(x) Presentation of Financial Statements – Other Comprehensive Income

The IASB issued an amendment to IAS 1, "Presentation of Financial Statements" (the "IAS 1 amendment") to improve consistency and clarity of the presentation of items of other comprehensive income. A requirement has been added to present items in other comprehensive income grouped on the basis of whether they may be subsequently reclassified to earnings in order to more clearly show the effects the items of other comprehensive income may have on future earnings. The IAS 1 amendment is effective for annual periods beginning on or after July 1, 2012 and must be applied retrospectively. The Company is assessing the impact of the IAS 1 amendment on its presentation of other comprehensive income.

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

(xi) Post-Employment Benefits

The IASB has issued amendments to IAS 19, "Employee Benefits" ("IAS 19"), which eliminates the option to defer the recognition of actuarial gains and losses through the "corridor" approach, revises the presentation of changes in assets and liabilities arising from defined benefit plans and enhances the disclosures for defined benefit plans. IAS 19 is effective for annual periods beginning on or after January 1, 2013 and must be applied retrospectively. The Company is assessing the impact of IAS 19 on its results of operations, financial position and disclosures.

4. DETERMINATION OF FAIR VALUES

A number of the Company's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining the fair values is disclosed in the notes specific to that asset or liability.

(a) Non-derivative Financial Assets

The fair values of cash, accounts receivable and deposits approximate their carrying values due to their short-term maturities. The fair values of long-term receivables approximate their carrying values due to their current market rates. Long-term receivables are recognized within other assets in the consolidated balance sheets.

(b) Property and Equipment Acquired in a Business Combination

The fair values of property and equipment recognized as a result of a business combination are based on the amount for which an item of property and equipment could be exchanged on the date of valuation between knowledgeable, willing parties in an arm's length transaction.

(c) Investment Property

The fair value of investment property is determined by comparison to comparable properties or recent nearby sale transactions as well as a review of recent property tax assessments.

(d) Intangible Assets Acquired in a Business Combination

The fair values of prescription files and customer relationships acquired in a business combination are based on the discounted cash flows that the prescription files and customer relationships, respectively, are expected to generate using an estimated rate of return.

The fair values of other intangible assets acquired in a business combination are based on external valuations, discounted cash flows expected to be derived from the use and eventual sale of these assets, or other methods appropriate to the nature of the assets.

(e) Derivatives

The fair value of the interest rate derivative was valued using the one-month Reuters Canadian Dealer Offered Rate Index as the Company's interest rate derivative agreement had a reset term of one month. The primary valuation input for the determination of the fair values of the equity forward derivatives is the Company's common share price.

(f) Non-derivative Financial Liabilities

The fair values of bank indebtedness, commercial paper, accounts payable and accrued liabilities and dividends payable approximates their carrying values due to their short-term maturities. The fair values of the revolving term facility and other long-term liabilities approximate their carrying values due to the current market rates associated with those instruments. The fair values of medium-term notes are determined by discounting the associated future cash flows using current market rates for items of similar risk.

(g) Share-based Payment Transactions

The grant-date fair values of employee stock options granted to employees are measured using the Black-Scholes option-pricing model (the "model"). Measurement inputs to the model include share price on measurement date, exercise price of the instruments, expected volatility, weighted average expected life of the instruments (based on historical experience and general option holder behaviour), expected dividends and the risk-free interest rate (based on government bonds). The fair value of the amount payable to employees in respect of cash-settled share-based payments is measured based on the Company's common share price.

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

Financial Risk Management Objectives and Policies

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 monitors market conditions and the impact of interest rate fluctuations on its fixed and floating rate debt instruments on an ongoing basis and may use interest rate derivatives to manage this exposure. Until December 2010, the Company used interest rate derivatives to manage a portion of the interest rate risk on its commercial paper. The Company was party to an agreement converting an aggregate notional principal amount of $50,000 of floating rate commercial paper debt into fixed rate debt at a rate of 4.18%, which expired in December 2010. Throughout 2011, the Company no longer had interest rate derivative agreements to convert its floating rate debt into fixed rate debt. See Note 18 to these consolidated financial statements for further discussion of the derivative agreement.

As at December 31, 2011, the Company had $166,592 (2010: $304,410) of unhedged floating rate debt. During the current financial year, the Company's average outstanding unhedged floating rate debt was $386,193 (2010: $538,243). Had interest rates been higher or lower by 50 basis points during the current financial year, net earnings for the financial year would have decreased or increased, respectively, by approximately $1,396 (2010: $1,885) as a result of the Company's exposure to interest rate fluctuations on its unhedged floating rate debt.

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.

December 31, 2011 and January 1, 2011 (in thousands of Canadian dollars, except per share data)

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

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 requirements and fund new investment opportunities or other unanticipated requirements as they arise. The Company manages its liquidity risk as it relates to financial liabilities by monitoring its cash flow from operating activities to meet its short-term financial liability obligations and planning for the repayment of its long-term financial liability obligations through cash flow from operating activities and/or the issuance of new debt or equity.

The contractual maturities of the Company's financial liabilities in the consolidated balance sheet as at December 31, 2011 are as follows:

	Carrying Amount	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 Contractual Cash Flows
Bank indebtedness	$ 172,262	$ 172,262	$ –	$ –	$ –	$ 172,262
Accounts payable and accrued liabilities	1,055,891	1,032,431	23,460	–	–	1,055,891
Derivatives	915	–	793	122	–	915
Dividends payable	53,119	53,119	–	–	–	53,119
Medium-term notes	945,494	262,488	28,943	474,202	256,487	1,022,120
Revolving-term debt	152	–	–	–	152	152
Other long-term liabilities	231,970	–	–	18,478	213,492	231,970
Total	**$ 2,459,803**	**$ 1,520,300**	**$ 53,196**	**$ 492,802**	**$ 470,131**	**$ 2,536,429**

The contractual maturities of the Company's financial liabilities in the consolidated balance sheet as at January 1, 2011, were as follows:

	Carrying Amount	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 Contractual Cash Flows
Bank indebtedness	$ 209,013	$ 209,013	$ –	$ –	$ –	$ 209,013
Commercial paper	127,828	128,000	–	–	–	128,000
Accounts payable and accrued liabilities	930,910	920,384	10,526	–	–	930,910
Derivatives	2,257	–	674	1,583	–	2,257
Dividends payable	48,927	48,927	–	–	–	48,927
Medium-term notes	946,641	12,488	34,943	291,430	730,690	1,069,551
Other long-term liabilities	167,709	–	–	19,207	148,502	167,709
Total	$ 2,433,285	$ 1,318,812	$ 46,143	$ 312,220	$ 879,192	$ 2,556,367

The accounts payable and accrued liabilities and other long-term liabilities amounts exclude certain liabilities that are not considered financial liabilities. The medium-term note amounts, which are recognized within long-term debt in the consolidated balance sheets, include principal and interest liabilities.

6. 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 and the purchase of sites as part of a land bank program, as well as the acquisition of independent drug stores or their prescription files. In addition, the Company makes capital investments in information technology and its distribution capabilities to support an expanding store network. The Company also provides working capital to its Associates via loans and/or loan guarantees. The Company largely relies on its cash flow from operations to fund its capital investment program and dividend distributions to its shareholders. This cash flow is supplemented, when necessary, through the borrowing of additional debt. No changes were made to these objectives during the financial years ended December 31, 2011 and January 1, 2011.

The Company considers its total capitalization to be bank indebtedness, commercial paper, long-term debt (including the current portion thereof), financing lease obligations 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 was in compliance with those covenants as at December 31, 2011, January 1, 2011 and January 3, 2010.

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 financing 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 at the end of the periods indicated.

	December 31, 2011	January 1, 2011	January 3, 2010
Cash	**$ (118,566)**	$ (64,354)	$ (44,391)
Bank indebtedness	**172,262**	209,013	270,332
Commercial paper	**–**	127,828	260,386
Current portion of long-term debt	**249,971**	–	–
Long-term debt	**695,675**	943,412	946,098
Financing lease obligations	**120,810**	79,031	56,670
Net debt	**1,120,152**	1,294,930	1,489,095
Shareholders' equity	**4,267,830**	4,102,635	3,711,884
Total capitalization	**$ 5,387,982**	$ 5,397,565	$ 5,200,979
Net debt:Shareholders' equity	**0.26:1**	0.32:1	0.40:1
Net debt:Total capitalization	**0.21:1**	0.24:1	0.29:1
EBITDA:Cash interest expense(1)(2)	**18.73:1**	18.62:1	19.59:1

(1) For the purposes of calculating the ratios, earnings before interest, taxes, depreciation and amortization ("EBITDA") is comprised of EBITDA for the 52 week periods ended December 31, 2011 and January 1, 2011. The EBITDA for the 52 week period ended January 3, 2010 has not been adjusted for the impact of adopting IFRS. EBITDA is not addressed in IFRS. Such financial measures do not have standardized meanings prescribed by IFRS and therefore may not be comparable to similar measures presented by other reporting issuers.

(2) Cash interest expense is also not addressed in IFRS. Cash interest expense is comprised of finance expense for the 52 week periods ended December 31, 2011 and January 1, 2011. It excludes finance income, finance expenses associated with financing leases and the amortization of deferred financing costs and includes capitalized interest. The cash interest expense for the 52 week period ended January 3, 2010 has not been adjusted for the impact of adopting IFRS.

December 31, 2011 and January 1, 2011 (in thousands of Canadian dollars, except per share data)

6. CAPITAL MANAGEMENT (continued)

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

The following table provides a summary of the Company's credit ratings at December 31, 2011:

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

There were no changes to the Company's credit ratings during the financial years ended December 31, 2011 and January 1, 2011.

On April 8, 2010, DBRS Limited placed the short and long-term ratings of the Company under review with negative implications. The rating action was in response to the Ontario Ministry of Health and Long-Term Care's April 7, 2010 announcement with respect to further drug reform in the province. On July 30, 2010, DBRS Limited confirmed the short and long-term ratings of the Company and changed the ratings trend from under review with negative implications to stable.

7. ACCUMULATED OTHER COMPREHENSIVE LOSS

	December 31, 2011	January 1, 2011	January 3, 2010
Unrealized loss on the interest rate derivative (net of tax of $nil, $nil and $525, respectively)	**$ –**	$ –	$ (1,120)
Unrealized loss on equity forward derivatives (net of tax of $44, $195 and $2, respectively)	**(121)**	(493)	(5)
Actuarial losses on retirement benefit obligations (net of tax of $10,338, $2,905 and $nil, respectively)	**(30,093)**	(8,150)	–
Accumulated other comprehensive loss	**$ (30,214)**	$ (8,643)	$ (1,125)

During the current financial year, amounts previously recorded in accumulated other comprehensive loss related to the equity forward derivatives of $411 (2010: $33) were recognized in net earnings in the consolidated statements of earnings.

8. BUSINESS ACQUISITIONS

In the normal course of business, the Company acquires the assets or shares of pharmacies. The total cost of these acquisitions during the financial year ended December 31, 2011 of $10,496 (2010: $11,779) was allocated primarily to goodwill and other intangible assets based on their fair values. The goodwill acquired represents the benefits the Company expects to receive from the acquisitions. See Note 16 to these consolidated financial statements for further details on goodwill. The Company expects $814 (2010: $8,258) of acquired goodwill will be deductible for tax purposes.

The values of assets acquired and liabilities assumed have been valued at the acquisition date using fair values. See Note 4 to these consolidated financial statements for the methods used in determining fair values, except as shown below. The intangible assets acquired are composed of prescription files. In determining the fair value of prescription files acquired, the Company applied a pre-tax discount rate of 9 percent (2010: 8 percent) to the estimated expected future cash flows.

The Company did not incur any acquisition related costs for acquisitions during the financial year end December 31, 2011 (2010: $38 relating primarily to legal fees). Acquisition-related costs were recognized within operating and administrative expenses in the Company's consolidated statement of earnings for the financial year ended January 1, 2011.

The operations of the acquired pharmacies have been included in the Company's results of operations from the date of acquisition.

Funds Held in Escrow

As at January 1, 2011, the Company had amounts held in escrow of $105 with respect to a number of offers to acquire certain pharmacies. These amounts were recognized within the prepaid expenses and deposits balance in the consolidated balance sheets.

9. COST OF GOODS SOLD

During the current financial year, the Company recorded $39,943 (2010: $37,884) as an expense for the write-down of inventory as a result of net realizable value being lower than cost in cost of goods sold in the consolidated statements of earnings.

During the financial years ended December 31, 2011 and January 1, 2011, the Company did not reverse any significant inventory write-downs recognized in previous years.

10. OPERATING AND ADMINISTRATIVE EXPENSES

During the financial year ended January 1, 2011, the Company recognized an expense of $10,282 in operating and administrative expenses related to the settlement of a long-standing legal dispute related to a commercial arrangement with one of the Company's ancillary businesses.

11. EMPLOYEE BENEFITS EXPENSE

Employee benefits expense, recognized within operating and administrative expenses, is as follows:

	Note	2011	2010
Wages and salaries		**$ 1,391,430**	$ 1,325,489
Statutory deductions		**164,528**	155,721
Expense related to pension and benefits	21	**6,130**	6,059
Share-based payment transactions	26	**2,135**	12,618
		$ 1,564,223	$ 1,499,887

12. FINANCE EXPENSES

The components of the Company's finance expenses are as follows:

	2011	2010
Finance expense on bank indebtedness	**$ 5,907**	$ 5,642
Finance expense on commercial paper	**1,702**	4,269
Finance expense on long-term debt	**52,626**	50,961
Finance expense on financing leases	**6,859**	4,757
	67,094	65,629
Finance expense capitalized	**(3,056)**	(4,996)
	$ 64,038	$ 60,633

The amount of finance expense capitalized is based on the Company's weighted average cost of borrowing and is attributed to those items of property and equipment which meet the definition of a qualifying asset. A qualifying asset is defined as an asset that requires a substantial period of time to get ready for its intended use or sale.

December 31, 2011 and January 1, 2011 (in thousands of Canadian dollars, except per share data)

13. DEPRECIATION AND AMORTIZATION EXPENSE

The components of the Company's depreciation and amortization expense, recognized within operating and administrative expenses, are as follows:

	Note	2011	2010
Property and equipment	15	$ 250,965	$ 238,008
Investment property	15	325	420
Intangible assets	17	46,392	43,077
		$ 297,682	$ 281,505

These amounts include net gains and losses on the disposition of property and equipment and intangible assets and any impairment losses recognized by the Company. During the financial year ended December 31, 2011, the Company recognized a net loss of $1,498 (2010: a net gain of $6,818) on the disposal of property and equipment and a net loss of $24 (2010: $9) on the disposition of intangible assets. During the financial year ended December 31, 2011, the Company did not recognize any impairment losses on property and equipment. During the financial year ended January 1, 2011, the Company recognized an impairment loss on store assets in property and equipment of $10,338. During the financial years ended December 31, 2011 and January 1, 2011, the Company did not recognize any impairment losses on intangible assets.

14. INCOME TAX EXPENSE AND DEFERRED TAX ASSETS AND LIABILITIES

	2011	2010
Current income tax expense		
Current period	$ 201,905	$ 239,379
Adjustment for prior periods	6,791	(600)
	208,696	238,779
Deferred income tax expense		
Origination and reversal of temporary differences	26,843	3,303
Reduction in tax rate	1,834	1,969
Adjustment for prior periods	(4,440)	787
	24,237	6,059
Total income tax expense	$ 232,933	$ 244,838

The effective income tax rate is comprised of the following:

	2011		2010	
Net earnings for the financial year	$ 613,934		$ 591,851	
Total income tax expense	232,933		244,838	
Earnings before income tax expense	$ 846,867		$ 836,689	
Income tax using the Combined Canadian federal and provincial statutory tax rate	$ 229,738	27.13%	$ 240,992	28.80%
Reduction in tax rate	1,834	0.22%	1,969	0.24%
Non-deductible expenses	(990)	(0.12%)	1,690	0.20%
Adjustments for prior periods	2,351	0.28%	187	0.02%
Effective income tax rate	$ 232,933	27.51%	$ 244,838	29.26%

The effective income tax rate for the financial year ended December 31, 2011 declined from the prior financial year due to reductions in statutory income tax rates.

Movement in Deferred Tax Assets (Liabilities) Related to Temporary Differences during the Financial Year

	Balance, January 1, 2011	Recognized in Earnings	Recognized in Equity	Acquired in Business Combinations (Note 8)	Balance, December 31, 2011
Deferred revenue	**$ 6,746**	**$ (26,840)**	**$ –**	**$ –**	**$ (20,094)**
Deferred rent obligations	**33,585**	**1,489**	**–**	**–**	**35,074**
Derivatives	**195**	**–**	**(151)**	**–**	**44**
Property and equipment and investment property	**(59,710)**	**5,241**	**–**	**–**	**(54,469)**
Goodwill and intangible assets	**(19,968)**	**1,122**	**–**	**(305)**	**(19,151)**
Retirement benefit obligations	**3,876**	**(1,566)**	**7,433**	**–**	**9,743**
Provisions	**12,822**	**(572)**	**–**	**–**	**12,250**
Non-capital loss carryforwards	**17,645**	**(5,691)**	**–**	**–**	**11,954**
Capital loss carryforwards	**5,151**	**192**	**–**	**–**	**5,343**
Other items	**(685)**	**2,388**	**–**	**–**	**1,703**
Deferred tax assets (liabilities)	**$ (343)**	**$ (24,237)**	**$ 7,282**	**$ (305)**	**$ (17,603)**

	Balance, January 3, 2010	Recognized in Earnings	Recognized in Equity	Acquired in Business Combinations (Note 8)	Balance, January 1, 2011
Deferred revenue	$ 5,346	$ 1,400	$ –	$ –	$ 6,746
Deferred rent obligations	30,859	2,726	–	–	33,585
Derivatives	527	–	(332)	–	195
Property and equipment and investment property	(50,450)	(9,260)	–	–	(59,710)
Goodwill and intangible assets	(21,562)	1,688	–	(94)	(19,968)
Retirement benefit obligations	3,070	(2,099)	2,905	–	3,876
Provisions	11,156	1,666	–	–	12,822
Non-capital loss carryforwards	19,784	(2,139)	–	–	17,645
Capital loss carryforwards	5,215	(64)	–	–	5,151
Other items	(708)	23	–	–	(685)
Deferred tax assets (liabilities)	$ 3,237	$ (6,059)	$ 2,573	$ (94)	$ (343)

Deferred tax assets are recognized for non-capital loss carryforwards to the extent that the realization of the related tax benefit through future profits is probable and for capital loss carryforwards to the extent that the Company can realize capital gains on the sale of assets.

December 31, 2011 and January 1, 2011 (in thousands of Canadian dollars, except per share data)

15. PROPERTY AND EQUIPMENT AND INVESTMENT PROPERTY

	Properties Under Development	Land	Buildings	Equipment, Fixtures and Computer Equipment	Leasehold Improvements	Assets Under Financing Leases (Note 23)	Total
Cost							
Balance at January 1, 2011	$ 72,035	$ 70,411	$ 206,472	$ 1,135,805	$ 1,179,795	$ 83,082	$ 2,747,600
Additions:							
– Asset acquisitions	9,979	–	–	–	–	43,952	53,931
– Development	9,990	3,688	25,738	168,204	131,667	–	339,287
Transfers	(20,662)	6,147	8,791	752	320	–	(4,652)
Computer software transfers from intangible assets	–	–	–	1,330	–	–	1,330
Disposals	–	(14,768)	(26,958)	(23,563)	(20,337)	–	(85,626)
Retirements	–	–	–	534	–	–	534
Balance at December 31, 2011	**$ 71,342**	**$ 65,478**	**$ 214,043**	**$1,283,062**	**$1,291,445**	**$ 127,034**	**$3,052,404**
Depreciation							
Balance at January 1, 2011	$ –	$ –	$ 16,102	$ 655,467	$ 355,523	$ 11,446	$ 1,038,538
Depreciation for the financial year	–	–	11,542	140,537	92,423	4,965	249,467
Transfers	–	–	(216)	375	(123)	–	36
Computer software transfers from intangible assets	–	–	–	(18)	–	–	(18)
Disposals	–	–	(3,103)	(19,792)	(11,807)	–	(34,702)
Retirements	–	–	–	(182)	–	–	(182)
Balance at December 31, 2011	**$ –**	**$ –**	**$ 24,325**	**$ 776,387**	**$ 436,016**	**$ 16,411**	**$1,253,139**
Impairment losses							
Balance at January 1, 2011	$ –	$ –	$ –	$ 16,257	$ 15,465	$ –	$ 31,722
Impairment loss	–	–	–	–	–	–	–
Balance at December 31, 2011	**$ –**	**$ –**	**$ –**	**$ 16,257**	**$ 15,465**	**$ –**	**$ 31,722**
Net book value							
At December 31, 2011	**$ 71,342**	**$ 65,478**	**$ 189,718**	**$ 490,418**	**$ 839,964**	**$ 110,623**	**$1,767,543**

	Properties Under Development	Land	Buildings	Equipment, Fixtures and Computer Equipment	Leasehold Improvements	Assets Under Financing Leases (Note 23)	Total
Cost							
Balance at January 3, 2010	$ 113,478	$ 57,683	$ 144,515	$ 1,048,056	$ 1,022,868	$ 59,382	$ 2,445,982
Additions:							
– Asset acquisitions	11,139	531	695	–	–	23,700	36,065
– Development	94,745	327	5,206	135,454	166,986	–	402,718
Transfers	(143,302)	27,880	97,365	(1,223)	11,943	–	(7,337)
Computer software transfers from intangible assets	–	–	–	1,395	–	–	1,395
Disposals	(4,025)	(16,010)	(41,309)	(45,515)	(22,002)	–	(128,861)
Retirements	–	–	–	(2,362)	–	–	(2,362)
Balance at January 1, 2011	$ 72,035	$ 70,411	$ 206,472	$ 1,135,805	$ 1,179,795	$ 83,082	$ 2,747,600
Depreciation							
Balance at January 3, 2010	$ –	$ –	$ 24,412	$ 561,691	$ 288,519	$ 8,135	$ 882,757
Depreciation for the financial year	–	–	8,759	136,933	85,487	3,311	234,490
Transfers	–	–	732	(439)	(293)	–	–
Disposals	–	–	(17,801)	(41,255)	(18,190)	–	(77,246)
Retirements	–	–	–	(1,463)	–	–	(1,463)
Balance at January 1, 2011	$ –	$ –	$ 16,102	$ 655,467	$ 355,523	$ 11,446	$ 1,038,538
Impairment losses							
Balance at January 3, 2010	$ –	$ –	$ –	$ 10,502	$ 10,882	$ –	$ 21,384
Impairment loss	–	–	–	5,755	4,583	–	10,338
Balance at January 1, 2011	$ –	$ –	$ –	$ 16,257	$ 15,465	$ –	$ 31,722
Net book value							
At January 1, 2011	$ 72,035	$ 70,411	$ 190,370	$ 464,081	$ 808,807	$ 71,636	$ 1,677,340
At January 3, 2010	$ 113,478	$ 57,683	$ 120,103	$ 475,863	$ 723,467	$ 51,247	$ 1,541,841

During the financial year ended December 31, 2011, the Company recognized depreciation expense of $249,467 (2010: $234,490), an impairment loss on store assets of $nil (2010: $10,338) and a loss on disposal of property and equipment of $1,498 (2010: a net gain of $6,818) within operating and administrative expenses in the consolidated statements of earnings.

Impairment Loss

During the financial year ended December 31, 2011, the Company reviewed its long-lived assets for indicators of impairment at the cash-generating unit level and determined that an impairment test was not necessary.

During the financial year ended January 1, 2011, the Company reviewed its long-lived assets for indicators of impairment at the cash-generating unit level and determined that a test for impairment was necessary on certain of its store assets. This resulted in the identification of an impairment charge of $7,554, which is net of taxes of $2,784. The impaired assets consist primarily of equipment, fixtures, computer equipment and leasehold improvements at certain of the Company's newer stores. The recoverable amount of the impaired assets was determined through a value-in-use methodology using a pre-tax discount rate of 8 percent.

During the financial years ended December 31, 2011 and January 1, 2011, the Company did not record any reversals of previously recorded impairment charges.

Property under Development

During the financial year ended December 31, 2011, the Company acquired properties with the intention of developing retail stores on the sites. The cost of acquisition was $9,979 (2010: $11,139).

December 31, 2011 and January 1, 2011 (in thousands of Canadian dollars, except per share data)

15. PROPERTY AND EQUIPMENT AND INVESTMENT PROPERTY (continued)

Investment Property

			2011			2010
	Land	Building	Total	Land	Building	Total
Cost						
Balance, beginning of financial year	$ 8,084	$ 5,995	$ 14,079	$ 3,729	$ 3,044	$ 6,773
Transfers	4,325	327	4,652	4,386	2,951	7,337
Disposals	(723)	(2)	(725)	(31)	–	(31)
Balance, end of financial year	$ 11,686	$ 6,320	$ 18,006	$ 8,084	$ 5,995	$ 14,079
Amortization						
Balance, beginning of financial year	$ –	$ 1,309	$ 1,309	$ –	$ 889	$ 889
Amortization for the financial year	–	325	325	–	420	420
Transfers	–	–	–	–	–	–
Balance, end of financial year	$ –	$ 1,634	$ 1,634	$ –	$ 1,309	$ 1,309
Net book value			$ 16,372			$ 12,770
Net book value at January 3, 2010						$ 5,884

The fair value of investment property approximates its carrying value.

16. GOODWILL

	Note	2011	2010
Cost			
Balance, beginning of the financial year		$ 2,493,108	$ 2,483,430
Additions			
– business acquisitions	8	10,496	11,779
Transfers		(3,882)	(2,101)
Balance, end of the financial year		$ 2,499,722	$ 2,493,108

During the financial year ended December 31, 2011, the Company transferred $3,882 (2010: $2,101) from goodwill related to business acquisitions transacted during the financial year to prescription files, which are recognized within intangible assets, net of deferred taxes.

Impairment Testing of Goodwill

For the purpose of impairment testing, goodwill is allocated to the group of cash-generating units which represent the lowest level within the group at which the goodwill is monitored for internal management purposes.

The aggregate carrying amounts of goodwill allocated to each unit are as follows:

	December 31, 2011	January 1, 2011	January 3, 2010
Goodwill allocated to the store network	$ 2,474,540	$ 2,467,926	$ 2,458,248
Goodwill allocated to Shoppers Home Health Care®	25,182	25,182	25,182
	$ 2,499,722	$ 2,493,108	$ 2,483,430

During the financial years ended December 31, 2011 and January 1, 2011, the Company performed impairment testing of goodwill in accordance with the Company's accounting policy. No impairment was identified.

The Company uses the value-in-use method for determining the recoverable amount of the group of cash-generating units to which goodwill is allocated. The values assigned to the key assumptions represent management's assessment of future trends in the retail and drug industry and are based on both external sources and internal sources (historical data). Key assumptions include comparable store sales growth, gross margin rates, changes in employee wages and benefits, occupancy cost changes and other operating expense changes. The Company has projected cash flows based on the most recent three-year budgets and forecasts. For the purposes of the impairment test, the Company has adjusted budgets and forecasts to reflect a zero growth assumption at the time the test was performed. Years four and five of the projection continue to reflect a zero growth rate and terminal value growth of two percent after the fifth year is used for the present value calculation.

The Company has used a pre-tax discount rate of 9 percent (2010 – 8 percent), which is based on the Company's weighted average cost of capital with appropriate adjustments for the risks associated with the group of cash-generating units to which goodwill is allocated and market data from a comparable industry grouping. Cash flow projections are discounted over a five-year period.

The above estimates are particularly sensitive in the following areas:

- An increase in one percentage point in the discount rate used would have decreased the excess of fair value over the carrying value of goodwill by approximately $1,600 (2010: $1,300).
- A 10 percent decrease in future planned revenues would have decreased the excess of fair value over the carrying value of goodwill by approximately $1,200 (2010: $900).

17. INTANGIBLE ASSETS

	Note	Prescription Files	Customer Relationships	Computer Software	Computer Software Under Development	Other	Total
Cost							
Balance at January 1, 2011		$ 129,803	$ 43,600	$ 211,162	$ 52,412	$ 8,824	$ 445,801
Additions							
– purchases		–	7,136	1,381	–	696	9,213
– development		–	–	–	44,624	–	44,624
– business acquisitions	8, 15	4,184	–	–	–	–	4,184
Transfers	16	–	–	74,260	(75,337)	(253)	(1,330)
Disposals		–	–	–	(24)	–	(24)
Balance at December 31, 2011		**$ 133,987**	**$ 50,736**	**$ 286,803**	**$ 21,675**	**$ 9,267**	**$ 502,468**
Amortization							
Balance at January 1, 2011		$ 49,675	$ 9,959	$ 108,463	$ –	$ 5,487	$ 173,584
Amortization for the financial year		14,697	3,732	27,932	–	804	47,165
Transfers		–	–	11	–	(29)	(18)
Balance at December 31, 2011		**$ 64,372**	**$ 13,691**	**$ 136,406**	**$ –**	**$ 6,262**	**$ 220,731**
Net book value							
At December 31, 2011		**$ 69,615**	**$ 37,045**	**$ 150,397**	**$ 21,675**	**$ 3,005**	**$ 281,737**

December 31, 2011 and January 1, 2011 (in thousands of Canadian dollars, except per share data)

17. INTANGIBLE ASSETS (continued)

	Note	Prescription Files	Customer Relationships	Computer Software	Computer Software Under Development	Other	Total
Cost							
Balance at January 3, 2010		$ 127,701	$ 43,600	$ 170,285	$ 39,639	$ 7,274	$ 388,499
Additions							
– purchases		–	–	10,963	–	–	10,963
– development		–	–	–	44,112	1,550	45,662
– business acquisitions	8, 15	1,577	–	–	–	–	1,577
Transfers	15, 16	525	–	29,944	(31,339)	–	(870)
Disposals		–	–	(30)	–	–	(30)
Balance at January 1, 2011		$ 129,803	$ 43,600	$ 211,162	$ 52,412	$ 8,824	$ 445,801
Amortization							
Balance at January 3, 2010		$ 34,288	$ 6,448	$ 84,639	$ –	$ 4,358	$ 129,733
Amortization for the financial year		15,387	3,511	23,845	–	1,129	43,872
Disposals		–	–	(21)	–	–	(21)
Balance at January 1, 2011		$ 49,675	$ 9,959	$ 108,463	$ –	$ 5,487	$ 173,584
Net book value							
At January 1, 2011		$ 80,128	$ 33,641	$ 102,699	$ 52,412	$ 3,337	$ 272,217
At January 3, 2010		$ 93,413	$ 37,152	$ 85,646	$ 39,639	$ 2,916	$ 258,766

During the financial year ended December 31, 2011, the Company recognized amortization expense of $46,368 (2010: $43,068), operating expense of $797 (2010: $804) and a pre-tax loss on disposal of intangible assets of $24 (2010: $9) within operating and administrative expenses in the consolidated statements of earnings.

Impairment Loss

During the financial years ended December 31, 2011 and January 1, 2011, the Company reviewed its definite life intangible assets for indicators of impairment at the cash-generating unit level and determined that an impairment test was not necessary. An impairment loss and any subsequent reversals, if any, are recognized within operating and administrative expenses in the consolidated statements of earnings.

18. FINANCIAL INSTRUMENTS

See Note 5 to these consolidated financial statements for a discussion of the Company's exposure to risks from its use of financial instruments.

Interest Rate Derivatives

Until December 2010, the Company used interest rate derivatives to manage a portion of the interest rate risk on its commercial paper. The Company was party to an agreement converting an aggregate notional principal amount of $50,000 of floating rate commercial paper debt into fixed rate debt at a rate of 4.18%, which expired in December 2010. The Company recorded a net loss of $3,766 over the life of the agreement that expired in 2010 as finance expense on commercial paper. As at January 1, 2011, the Company no longer had any interest rate derivative agreements to convert its floating rate debt into fixed rate debt and the Company did not enter into any new interest rate derivative agreements during the financial year ended December 31, 2011.

Based on the market value of the interest rate derivative agreement at January 3, 2010, the Company recognized a liability of $1,645, all of which was presented in accounts payable and accrued liabilities. During the financial year ended January 1, 2011, the Company assessed that the interest rate derivative was an effective hedge for the floating interest rates on the associated commercial paper debt.

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 LTIP and RSU Plan. The earnings or expense arising from the use of these instruments is recognized within operating and administrative expenses on the consolidated statements of earnings for the financial year.

Based on the market values of the equity forward agreements at December 31, 2011, the Company recognized a liability of $916 (2010: $2,257), of which $794 (2010: $674) is presented in accounts payable and accrued liabilities and $122 (2010: $1,583) is presented in other long-term liabilities. Based on the market values of the equity forward agreements at January 3, 2010, the Company recognized a net liability of $910, of which $286 was presented in other assets and $1,196 was presented in accounts payable and accrued liabilities. During the financial years ended December 31, 2011 and January 1, 2011, the Company assessed that the percentages of the equity forward derivatives in place related to unearned units under the LTIP and RSU Plan were effective hedges for its exposure to future changes in the market price of its common shares in respect of the unearned units.

Fair Value of Financial Instruments

The fair value of financial assets and financial liabilities measured at fair value in the consolidated balance sheet as at December 31, 2011 is as follows:

	Level 1	Level 2	Level 3	Total
Equity forward derivatives	$ –	$ (916)	$ –	$ (916)
Total	**$ –**	**$ (916)**	**$ –**	**$ (916)**

The fair value of financial assets and financial liabilities measured at fair value in the consolidated balance sheet as at January 1, 2011 is as follows:

	Level 1	Level 2	Level 3	Total
Equity forward derivatives	$ –	$ (2,257)	$ –	$ (2,257)
Total	**$ –**	**$ (2,257)**	**$ –**	**$ (2,257)**

The fair value of financial assets and financial liabilities measured at fair value in the consolidated balance sheet as at January 3, 2010 is as follows:

	Level 1	Level 2	Level 3	Total
Interest rate derivative	$ –	$ (1,645)	$ –	$ (1,645)
Equity forward derivatives	$ –	$ (910)	$ –	$ (910)
Total	**$ –**	**$ (2,555)**	**$ –**	**$ (2,555)**

The fair values of the interest rate derivative and equity forward derivatives are determined based on current market rates and on information received from the Company's counterparties to the agreements. The interest rate derivative was valued using the one-month Reuters Canadian Dealer Offered Rate Index. The primary valuation input for the equity forward derivatives is the Company's common share price.

For financial assets and liabilities that are valued at other than fair value on the consolidated balance sheets: cash, accounts receivable, deposits, bank indebtedness, commercial paper, accounts payable and accrued liabilities and dividends payable, fair values approximate their carrying values at December 31, 2011, January 1, 2011 and January 3, 2010 due to their short-term maturities. The fair values of long-term receivables, revolving term facility and other long-term liabilities approximate their carrying values at December 31, 2011, January 1, 2011, and January 3, 2010 due to the current market rates associated with these instruments. The fair value of the medium-term notes at December 31, 2011 was approximately $984,442 (2010: $997,345, 2009: $1,007,522) compared to a carrying value of $950,000 (2010 and 2009: $950,000) (excluding transaction costs) due to decreases in market interest rates for similar instruments.

December 31, 2011 and January 1, 2011 (in thousands of Canadian dollars, except per share data)

19. BANK INDEBTEDNESS AND COMMERCIAL PAPER

Bank Indebtedness

The Associate-owned stores borrow under their bank line of credit agreements guaranteed by the Company. The Company has entered into agreements with banks to guarantee a total of $520,000 (2010 and 2009: $520,000) of lines of credit. At December 31, 2011, the Associate-owned stores utilized $166,592 (2010: $176,410, 2009: $254,332) of the available lines of credit.

Commercial Paper

Commercial paper is issued with maturities from overnight to 90 days at floating interest rates based on bankers' acceptance rates. Until December 2010, the Company used interest rate derivative agreements to manage a portion of the interest rate risk on its commercial paper. The Company was party to an agreement converting an aggregate notional principal amount of $50,000 of floating rate commercial paper debt into fixed rate debt at a rate of 4.18%, which expired in December 2010. The Company recorded a net loss of $3,766 over the life of the agreement that expired in 2010 as finance expense on commercial paper in the consolidated statement of earnings. As at January 1, 2011, the Company no longer had any interest rate derivative agreements to convert its floating rate debt into fixed rate debt. During the financial year ended December 31, 2011, the Company did not enter into any interest rate derivative agreements to convert its floating rate debt into fixed rate debt. See Notes 5 and 18 to these consolidated financial statements for further discussion of the derivative agreement.

20. LONG-TERM DEBT

	Face Value as at December 31, 2011	Maturity	December 31, 2011	January 1, 2011	January 3, 2010
Medium-term notes					
Series 2 Notes – 4.99%	$ 450,000	June 2013	**$ 449,298**	$ 448,704	$ 447,977
Series 3 Notes – 4.80%	250,000	January 2012	**249,971**	249,305	248,640
Series 4 Notes – 5.19%	250,000	January 2014	**249,081**	248,632	248,183
			948,350	946,641	944,800
Less: current portion of long-term debt			**(249,971)**	–	–
			698,379	946,641	944,800
Revolving term facility	$ 725,000	December 2015	**152**	–	1,298
Less: financing costs			**(2,856)**	(3,229)	–
			(2,704)	(3,229)	1,298
Total long-term debt			**$ 695,675**	$ 943,412	$ 946,098

As at December 31, 2011, $9,598 (2010: $137,053) of the $725,000 (2010: $750,000) revolving term facility was utilized as follows: drawings on the revolving term facility $152 (2010: $nil), $9,446 (2010: $9,053) relating to letters of credit and trade finance guarantees and $nil (2010: $128,000) relating to commercial paper issued by the Company. As at January 3, 2010, the revolving term facility was $800,000 and was utilized as follows: $8,322 related to letters of credit and trade finance guarantees and $261,000 relating to commercial paper issued by the Company.

2011 Debt Refinancing Transactions

On October 27, 2011, the Company amended its previously existing $750,000 revolving term credit facility that was to mature on December 10, 2014. The credit facility was amended to reduce the size of the credit facility to $725,000, to extend the maturity date by one year to December 10, 2015, reduce the applicable stamping fee on bankers' acceptance borrowings from 150 basis points per annum to 100 basis points per annum and reduce the applicable commitment fee rate on undrawn amounts to 20 basis points per annum from 37.5 basis points per annum. The consolidated net debt position of the Company remained substantially unchanged as a result of this refinancing. The new credit facility is available for general corporate purposes, including backstopping the Company's $500,000 commercial paper program. The Company recognized financing costs related to the credit facility of $575, the unamortized portion of which was netted against the long-term debt balance on the consolidated balance sheets.

2010 Debt Refinancing Transactions

On December 10, 2010, the Company entered into a $750,000 revolving term credit facility. This credit facility, which was to mature on December 10, 2014, replaced the Company's previously existing $800,000 revolving term credit facility that was to mature on June 6, 2011. The credit facility, as was the case with the credit facility it replaced, was available for general corporate purposes, including backstopping the Company's $500,000 commercial paper program. The Company recognized financing costs related to the credit facility of $3,281, the unamortized portion of which was netted against the long-term debt balance on the consolidated balance sheets.

Minimum Repayments

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

Medium-term notes	
2012 – Series 3	$ 250,000
2013 – Series 2	450,000
2014 – Series 4	250,000
	$ 950,000

See Note 31 Subsequent Events for additional discussion of long-term debt transactions.

21. RETIREMENT BENEFIT OBLIGATIONS

	Note	December 31, 2011	January 1, 2011	January 3, 2010
Present value of defined benefit obligation for unfunded plans		**$ (6,380)**	$ (5,750)	$ (5,172)
Present value of defined benefit obligation for partially funded plans		**(140,340)**	(110,774)	(90,138)
Total present value of defined benefit obligations		**(146,720)**	(116,524)	(95,310)
Fair value of plan assets		**108,616**	106,040	85,199
Defined benefit liability included in other long-term liabilities	23	**$ (38,104)**	$ (10,484)	$ (10,111)

Information about the Company's pension and other post-retirement benefit plans is as follows:

	2011		2010	
	Pension Plans	**Other Benefit Plans**	Pension Plans	Other Benefit Plans
Fair value of plan assets				
Fair value of plan assets, beginning of the financial year	**$ 106,040**	**$ –**	$ 85,199	$ –
Expected return on plan assets	**6,718**	**–**	5,659	–
Actuarial gains/(losses)	**(7,588)**	**–**	2,161	–
Company contributions	**7,262**	**625**	16,230	510
Plan participants' contributions	**1,292**	**–**	1,237	–
Benefits paid	**(5,108)**	**(625)**	(4,446)	(510)
Fair value of plan assets, end of the financial year	**$ 108,616**	**$ –**	$ 106,040	$ –
Present value of the defined benefit obligation				
Defined benefit obligation, beginning of the financial year	**$ 110,774**	**$ 5,750**	$ 90,138	$ 5,172
Current service cost	**6,200**	**306**	5,936	287
Interest cost	**6,044**	**298**	5,200	295
Plan participants' contributions	**1,292**	**–**	1,237	–
Actuarial losses	**21,138**	**651**	12,709	506
Benefits paid	**(5,108)**	**(625)**	(4,446)	(510)
Present value of the defined benefit obligations, end of the financial year	**$ 140,340**	**$ 6,380**	$ 110,774	$ 5,750
Net defined benefit liability	**$ 31,724**	**$ 6,380**	$ 4,734	$ 5,750

December 31, 2011 and January 1, 2011 (in thousands of Canadian dollars, except per share data)

21. RETIREMENT BENEFIT OBLIGATIONS (continued)

The significant actuarial assumptions adopted are as follows:

	2011			2010		
	Registered Pension Plans	**Non-registered Pension Plans**	**Other Benefit Plans**	Registered Pension Plans	Non-registered Pension Plans	Other Benefit Plans
Defined benefit obligations, end of the financial year						
Discount rate	**4.25%**	**4.25%**	**4.25%**	5.25%	5.00%	5.00%
Rate of compensation increase	**4.00%**	**4.00%**	**4.00%**	4.00%	4.00%	4.00%
Net benefit expense for the financial year						
Discount rate	**5.25%**	**5.00%**	**5.00%**	6.00%	5.75%	5.25%
Expected rate of return on plan assets	**7.50%**	**3.75%**	**N/A**	7.50%	3.75%	N/A
Rate of compensation increase	**4.00%**	**4.00%**	**4.00%**	4.00%	4.00%	4.00%

The discount rate is based on current market interest rates at the end of the Company's fiscal year, assuming a portfolio of corporate AA rated bonds with terms to maturity that, on average, match the terms of the accrued retirement benefit obligations. A 1.0% increase in the assumed discount rate would decrease the amount of the Company's accrued retirement benefit obligations and retirement benefit expense in respect of its registered and non-registered defined benefit plans by $23,049 and $1,843, respectively. Conversely, a 1.0% decrease in the assumed discount rate would increase the amount of the Company's accrued retirement benefit obligations and retirement benefit expense in respect of its registered and non-registered defined benefit plans by $27,318 and $1,933, respectively.

The expected long-term rate of return on plan assets is based on the asset mix of invested assets and historical returns. A 1.0% increase in the assumed long-term rate of return on plan assets would decrease the amount of the Company's retirement benefit expense in respect of its registered and non-registered defined benefit plans by $928. Conversely, a 1.0% decrease in the assumed long-term rate of return on plan assets would increase the amount of the Company's retirement benefit expense in respect of its registered and non-registered defined benefit plans by $928.

A 1.0% increase in the assumed rate of compensation increase would increase the amount of the Company's accrued retirement benefit obligations and retirement benefit expense in respect of its registered and non-registered defined benefit plans by $4,414 and $708, respectively. Conversely, a 1.0% decrease in the assumed rate of compensation increase would decrease the amount of the Company's accrued retirement benefit obligations and retirement benefit expense in respect of its registered and non-registered defined benefit plans by $4,214 and $732, respectively.

The expected health care cost trend rate is based on historical trends and external data. The health care cost trend rate used was 8.0% for 2011 (2010: 8.0%), with 8.0% being the trend rate for 2012. The trend rate is then reduced by 0.5% in each of the following years until reaching the ultimate trend rate of 5.0% for 2018 and later years. A 1.0% change in the assumed health care cost trend rate would result in an impact of $639 (2010: $570) on the retirement benefit obligation and a pre-tax impact of $38 (2010: $30) on the benefits expense recognized in earnings.

Assumptions regarding future mortality are based on published statistics and mortality tables. The current longevities underlying the values of the liabilities in the defined benefit plans as at December 31, 2011 and January 1, 2011 are as follows:

	Males	Females
Longevity at age 65 for current pensioners	19.7	22.1
Longevity at age 65 for current member aged 45	21.2	22.9

The calculation of the defined benefit obligation is sensitive to the mortality assumptions set out above. As the actuarial estimates of mortality continue to be refined, an increase of one year in the lives shown above is considered reasonably possible in the next financial year.

The experience adjustments are as follows:

	2011 Pension Plans	2011 Other Benefit Plans	2010 Pension Plans	2010 Other Benefit Plans
Asset experience adjustments				
Asset (gain)/loss during the financial year	**$ 7,588**	**$ –**	$ (2,161)	$ –
Liability experience adjustments				
Liability loss during the financial year	**$ –**	**$ –**	$ –	$ 506
Liability assumptions				
Liability loss during the financial year	**$ 21,138**	**$ 651**	$ 12,709	$ N/A

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

	2011 Pension Plans	2011 Other Benefit Plans	2010 Pension Plans	2010 Other Benefit Plans
Current service costs	**$ 6,200**	**$ 306**	$ 5,936	$ 287
Interest on obligation	**6,044**	**298**	5,200	295
Expected return on plan assets	**(6,718)**	**–**	(5,659)	–
Expense recognized in operating and administrative expenses	**$ 5,526**	**$ 604**	$ 5,477	$ 582

The actual loss on plan assets for the financial year was $870 (2010: gain of $7,820).

The Company recognized the following actuarial losses for the financial year in other comprehensive income (loss):

	2011 Pension Plans	2011 Other Benefit Plans	2010 Pension Plans	2010 Other Benefit Plans
Cumulative amount, beginning of the financial year	**$ (10,548)**	**$ (506)**	$ –	$ –
Recognized during the financial year	**(28,726)**	**(651)**	(10,548)	(506)
Cumulative amount, end of the financial year	**$ (39,274)**	**$ (1,157)**	$ (10,548)	$ (506)

Cash payments for employee future benefits, which consist of the Company's contributions to the pension plans and cash payments made directly to beneficiaries of the other benefit plans, totalled $7,887 (2010: $16,740). The Company expects to make contributions to the pension plans and cash payments to beneficiaries of the other benefit plans of $6,302 in 2012.

The assets of the registered pension plans consist of cash, contributions receivable and investments held in a Master Trust for the benefit of the Company's pension plans. The assets held by the Master Trust are invested in a limited number of pooled funds, based on market values as at November 30, 2011, 2010 and 2009, respectively, as follows:

	December 31, 2011	January 1, 2011	January 3, 2010
Equity	**57%**	**60%**	61%
Fixed income	**42%**	**39%**	39%
Cash and cash equivalents	**1%**	**1%**	–
	100%	**100%**	100%

There were no significant changes in the assets held by the Master Trust between November 30, 2011 and December 31, 2011, between November 30, 2010 and January 1, 2011 and between November 30, 2009 and January 3, 2010.

December 31, 2011 and January 1, 2011 (in thousands of Canadian dollars, except per share data)

21. RETIREMENT BENEFIT OBLIGATIONS (continued)

The assets of the non-registered plan consist of investments and refundable tax on account with Canada Revenue Agency. The investments are in pooled funds with an allocation of 59% equities, 40% bonds and 1% cash and cash equivalents based on market values as at November 30, 2011. The investments were in pooled funds with an allocation of 61% equities, 38% bonds and 1% cash and cash equivalents as at November 30, 2010 and 60% equities, 39% bonds and 1% cash and cash equivalents based on market values as at November 30, 2009. There were no significant changes in the allocation of investments between November 30, 2011 and December 31, 2011, between November 30, 2010 and January 1, 2011 and between November 30, 2009 and January 3, 2010.

22. PROVISIONS

	2011	2010
Balance, beginning of the financial year	**$ 14,414**	$ 12,071
Provisions made	**8,980**	12,341
Provisions used	**(9,907)**	(9,817)
Provisions reversed	**(192)**	(306)
Unwind of discount	**430**	125
Balance, end of the financial year	**$ 13,725**	$ 14,414
Balance, end of the financial year, presented as follows:		
Current liabilities	**$ 12,024**	$ 12,562
Long-term liabilities	**1,701**	1,852
	$ 13,725	$ 14,414

The Company has been served with a Statement of Claim in a proposed class proceeding that has been filed in the Ontario Superior Court of Justice by two of its licensed Associate-owners, claiming various declarations and damages of $1,000,000 on behalf of a proposed class comprised of all of its current and former licensed Associate-owners resident in Canada, other than in Québec. The claim alleges, among other things, that Shoppers Drug Mart and two of its affiliates breached contractual and other duties to its Associate-owners by collecting, receiving and/or retaining funds and/or benefits that are in excess of those permitted to be collected, received and/or retained by the applicable agreements. The Company believes that the claim is without merit and will vigorously defend the claim. However, there can be no assurance that the outcome of this claim will be favourable to the Company or that it will not have a material adverse impact on the Company's financial position. The amount payable, if any, is not reasonably determinable at this time.

In addition, the Company is involved in certain legal claims arising in the normal course of business. In the opinion of the Company's management, the eventual settlement of such claims will not have a significant effect on the Company's financial position or results of operations. Management has recorded a provision for these claims based on its best estimate of the final settlements.

23. OTHER LONG-TERM LIABILITIES

The components of the Company's other long-term liabilities are as follows:

	Note	December 31, 2011	January 1, 2011	January 3, 2010
Deferred rent obligations		**$ 338,721**	$ 330,295	$ 300,826
Retirement benefit obligations	21	**38,104**	10,484	10,111
Deferred gains on sale-leaseback transactions on financing leases		**12,525**	7,769	6,754
Financing lease obligations	15, 28	**117,911**	76,918	55,500
Long-term incentive plan and restricted share unit plan	26	**8,134**	11,900	4,531
Unrealized loss on derivatives	18	**122**	1,583	–
Other		**4,671**	3,175	8,540
		$ 520,188	$ 442,124	$ 386,262

Deferred Rent Obligations

The deferred rent obligations represent the difference between rent expense and cash rent payments and the deferral of landlord inducements.

Sale-leaseback Transactions

During the financial year ended December 31, 2011, the Company sold certain real estate properties for net proceeds of $54,210 (2010: $57,307) and entered into lease agreements for the area used by the Associate-owned stores. The leases have been accounted for as operating or financing leases as appropriate. During the financial year ended December 31, 2011, the Company recognized gains on disposal of $9,935 (2010: $14,182), of which $5,250 (2010: $1,597) were deferred under financing lease treatment. The deferred gains are presented in other long-term liabilities on the consolidated balance sheets and are being amortized over lease terms of 15–20 years.

24. SHARE CAPITAL

Share Capital and Contributed Surplus

Authorized

Unlimited number of common shares

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

Outstanding

	2011		2010	
	Number of Common Shares	**Stated Value**	Number of Common Shares	Stated Value
Beginning balance	**217,452,068**	**$ 1,520,558**	217,431,898	$ 1,519,870
Shares issued for cash	**109,729**	**1,220**	20,170	491
Shares repurchased in cash	**(5,086,200)**	**(35,576)**	–	–
Repayment of share purchase loans	**–**	**7**	–	33
Exercise of share options	**–**	**246**	–	164
Ending balance	**212,475,597**	**$ 1,486,455**	217,452,068	$ 1,520,558

The Company also has issued share options. See Note 26 to these consolidated financial statements for further details on the Company's issued share options.

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

The holders of common shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company.

Normal Course Issuer Bid

On February 10, 2011, the Company implemented a normal course issuer bid to repurchase, for cancellation, up to 8,700,000 of its common shares, representing approximately 4.0% of the Company's then outstanding common shares. Repurchases will be effected through the facilities of the Toronto Stock Exchange (the "TSX") and may take place over a 12-month period ending no later than February 14, 2012. Repurchases will be made at market prices in accordance with the requirements of the TSX.

From February 10, 2011 to December 31, 2011, the Company purchased and cancelled 5,086,200 common shares under the normal course issuer bid at a cost of $206,779. The premium paid over the average book value of the common shares repurchased of $171,203 has been charged to retained earnings. The Company purchased an additional 115,900 shares at the end of the financial year at a cost of $4,735. These shares were cancelled subsequent to the end of the financial year. The cost of this latter purchase is recorded as treasury shares in Shareholders' Equity as at December 31, 2011.

December 31, 2011 and January 1, 2011 (in thousands of Canadian dollars, except per share data)

24. SHARE CAPITAL (continued)

Dividends

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

Declaration Date	Record Date	Payment Date	Dividend per Common Share
February 10, 2011	March 31, 2011	April 15, 2011	$ 0.250
April 27, 2011	June 30, 2011	July 15, 2011	$ 0.250
July 21, 2011	September 30, 2011	October 14, 2011	$ 0.250
November 9, 2011	December 30, 2011	January 13, 2012	$ 0.250
February 11, 2010	March 31, 2010	April 15, 2010	$ 0.225
April 28, 2010	June 30, 2010	July 15, 2010	$ 0.225
July 22, 2010	September 30, 2010	October 15, 2010	$ 0.225
November 9, 2010	December 31, 2010	January 14, 2011	$ 0.225

On February 9, 2012, the Board of Directors declared a dividend of 26.5 cents per common share payable April 13, 2012 to shareholders of record as of the close of business on March 30, 2012.

25. EARNINGS PER COMMON SHARE

Basic Net Earnings per Common Share

The calculation of basic net earnings per common share at December 31, 2011 was based on net earnings for the financial year of $613,934 (2010: $591,851) and a weighted average number of shares outstanding (basic) of 216,420,096 (2010: 217,435,868). The weighted average number of shares outstanding (basic) is calculated as follows:

Weighted Average Shares Outstanding (Basic)

	Note	2011	2010
Issued shares, beginning of the financial year	24	**217,452,068**	217,431,898
Effect of share options exercised		**52,350**	8,094
Effect of shares repurchased		**(1,082,326)**	–
Effect of share purchase loans		**(1,996)**	(4,124)
Weighted average number of shares outstanding (basic), end of the financial year		**216,420,096**	217,435,868

Diluted Net Earnings per Common Share

The calculation of diluted net earnings per common share at December 31, 2011 was based on net earnings for the financial year of $613,934 (2010: $591,851) and a weighted average number of shares outstanding, after adjustment for the effects of all potentially dilutive shares, of 216,504,784 (2010: 217,537,709). The weighted average number of shares outstanding (diluted) is calculated as follows:

Weighted Average Shares Outstanding (Diluted)

	2011	2010
Weighted average number of shares outstanding (basic), end of the financial year	**216,420,096**	217,435,868
Potentially dilutive share options	**84,688**	101,841
Weighted average number of shares outstanding (diluted), end of the financial year	**216,504,784**	217,537,709

The average market value of the Company's shares for purposes of calculating the effect of dilutive share options was based on quoted market prices for the period that the stock options were outstanding. Anti-dilutive stock options have been excluded.

26. SHARE-BASED PAYMENTS

The Company established stock option plans for certain employees and its Board of Directors, as described below, and has reserved 20,000,000 common shares for issuance under the plans. Effective February 2007, non-employee directors are no longer eligible to participate in the stock option plans. The Company established deferred share unit plans for its Chief Executive Officer and non-employee directors, which are described below. The Company uses the fair value method to account for stock options issued under employee and director stock option programs. The fair value of each option is established on the date of the grant using the Black-Scholes options-pricing model.

The Company recognized the following compensation expense or reversal of compensation expense associated with stock options issued under the employee plan ("share plan") and the director stock option plan in the financial years ended December 31, 2011 and January 1, 2011:

	Note	2011	2010
Options granted in 2006		**$ (921)**	$ 395
Options granted in 2010		**(637)**	1,197
Options granted in 2011		**348**	–
Total net (reversal of) expenses recognized in operating and administrative expenses	11	**$ (1,210)**	$ 1,592

During the financial year ended December 31, 2011, the Company recognized compensation expense of $505 (2010: $1,592) associated with the stock options outstanding and reversed compensation expense of $1,715 (2010: $nil), the latter as a result of the departure of certain management personnel.

Employee Stock Option Plan

Options issued to certain employees have an exercise price per share of no less than the fair market value on the date of the option grant. These options include awards for shares that vest based on the passage of time, performance criteria, or both.

The following is a summary of the status of the share plan and changes during the current and prior financial years:

	2011		2010	
	Options on Common Shares	**Weighted Average Exercise Price Per Share**	Options on Common Shares	Weighted Average Exercise Price Per Share
Outstanding, beginning of the financial year	**803,492**	**$ 39.53**	541,542	$ 36.59
Granted	**253,186**	**41.80**	282,120	44.09
Exercised	**(109,729)**	**12.15**	(20,170)	24.54
Forfeited/cancelled including repurchased	**(566,072)**	**45.38**	–	–
Outstanding, end of the financial year	**380,877**	**$ 40.23**	803,492	$ 39.53
Options exercisable, end of the financial year	**88,917**	**$ 33.47**	451,372	$ 35.62

	2011 Outstanding Options			2011 Exercisable Options	
Range of Exercise Price	**Number of Options Outstanding**	**Weighted Average Contractual Life (Years)**	**Weighted Average Exercise Price Per Share**	**Number of Exercisable Options**	**Weighted Average Exercise Price Per Share**
$23.48 – $26.57	**32,390**	**0.61**	**$ 23.68**	**32,388**	**$ 23.68**
$29.30 – $36.41	**29,253**	**2.68**	**34.39**	**29,253**	**34.39**
$40.81 – $44.09	**319,234**	**6.29**	**42.43**	**27,276**	**44.09**
	380,877	**5.53**	**$ 40.23**	**88,917**	**$ 33.47**

December 31, 2011 and January 1, 2011 (in thousands of Canadian dollars, except per share data)

26. SHARE-BASED PAYMENTS (continued)

Options Granted Prior to the Company's 2010 Financial Year

Time-based options are exercisable 20% per year on the anniversary of the grant date in each of the five subsequent years. Performance-based options are exercisable 20% per year on the anniversary of the grant date in each of the five subsequent years, provided that the Company achieves specified earnings-based performance targets. As at December 31, 2011, all performance targets have been achieved.

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

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

Options Granted During the Company's 2010 and 2011 Financial Years

In February 2011 and 2010, the Company granted awards of time-based options under the share plan in respect of the Company's 2010 and 2009 financial years, respectively, to certain senior management, with one-third of such options vesting each year.

In November 2011, the Company granted an award of time-based options under the share plan to the Company's Chief Executive Officer, with one-fourth of such options vesting each year.

The following assumptions were used in the Black-Scholes option-pricing model to calculate the fair value for those options granted during the financial years ended December 31, 2011 and January 1, 2011:

	November 2011	February 2011	2010
Fair value per unit at grant date	**$ 5.89**	**$ 6.32**	$ 6.94
Share price	**$ 42.28**	**$ 40.81**	$ 44.09
Exercise price	**$ 42.28**	**$ 40.81**	$ 44.09
Valuation assumptions:			
Expected life	**5 years**	**5 years**	5 years
Expected dividends	**2.37%**	**2.45%**	2.10%
Expected volatility (based on historical share price volatility)	**19.86%**	**19.32%**	18.70%
Risk-free interest rate (based on government bonds)	**1.39%**	**2.63%**	2.54%

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

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

Director Stock Option Plan

Prior to February 2007, under the Company's director stock option plan, participating directors were issued time-based options to purchase 60,000 common shares. The options have an exercise price per share at fair market value on the date of the option grant, which is normally the date the option holder becomes a director. One-third of the options become exercisable in each of the following three years on the anniversary of the date of grant. Unexercisable options expire upon the option holder ceasing to be a director. Exercisable options expire on the earlier of (i) depending on the circumstances of the option holder ceasing to be a director and the determination of the Human Resources and Compensation Committee, 180 or 365 days of the option holder ceasing to be a director or (ii) the expiry date of the options, which is on the tenth anniversary of the date of grant.

A summary of the status of the director stock option plan and changes during the financial years ending December 31, 2011 and January 1, 2011 is presented below:

	2011			2010		
	Options on Common Shares		**Weighted Average Exercise Price Per Share**	Options on Common Shares		Weighted Average Exercise Price Per Share
Outstanding, beginning of the financial year	**346,000**	**$**	**40.38**	346,000	$	40.38
Exercised	**–**		**–**	–		–
Forfeited/cancelled including repurchased	**–**		**–**	–		–
Outstanding, end of the financial year	**346,000**	**$**	**40.38**	346,000	$	40.38
Options exercisable, end of the financial year	**346,000**	**$**	**40.38**	346,000	$	40.38

	2011 Outstanding and Exercisable Options			
Exercise Price	**Number of Options Outstanding**	**Weighted Average Contractual Life (Years)**		**Weighted Average Exercise Price Per Share**
$26.95	**60,000**	**1.8**	**$**	**26.95**
$41.80	**106,000**	**3.6**		**41.80**
$44.02	**180,000**	**4.1**		**44.02**
	346,000	**3.5**	**$**	**40.38**

Deferred Share Unit Plan for Non-employee Directors

The Company maintains a deferred share unit ("DSU") plan to provide non-employee directors with the option to elect to receive DSUs in lieu of cash payment for all or a portion of their director fees. When such an election is made, the Company credits to the account of each non-employee director a number of DSUs (each equivalent in value to a common share) equal to the amount of fees divided by the fair market value of the common shares. The directors' accounts are credited with dividend equivalents in the form of additional DSUs if and when the Company pays dividends on the common shares. Upon the director ceasing to be a member of the Board of Directors, the director shall receive a cash amount equal to the number of DSUs in his or her account multiplied by the fair market value of the common shares on the date the director ceases to be a member of the Board of Directors or on a later date selected by the director, which shall in any event be a date prior to the end of the following calendar year. During the current financial year, the Company recorded $1,487 (2010: $801) in director fee compensation, which is included in operating and administrative expenses in the consolidated statements of earnings.

Non-employee directors who are not holders of unvested stock options to purchase common shares of the Company are eligible to receive an annual award of DSUs in the amount of up to $60.

The non-executive Chair of the Board of Directors receives an annual fee of $120 in addition to the director fees and annual award of DSUs, one-half of which the Chair may elect, in whole or in part, to be received in DSUs and the other half of which is payable in DSUs.

During the current financial year, the Company issued an aggregate of 31,039 DSUs (2010: 30,569 DSUs) at a weighted average grant date fair value of $40.70 (2010: $41.34). During the financial year ended December 31, 2011, no director (2010: one director) ceased being a member of the Board of Directors and thus, the Company did not make any cash payments (2010: $147 cash payment which was the equivalent of 3,926 DSUs). As at December 31, 2011, there were 128,995 DSUs (2010: 97,956 DSUs) outstanding.

26. SHARE-BASED PAYMENTS (continued)

Chief Executive Officer Deferred Share Unit Plan

In November 2011, the Company established a deferred share unit plan for its Chief Executive Officer ("CEO DSU Plan") and granted time-based deferred share units ("DSUs") under the CEO DSU Plan, which vest 100% after three years. At the award date, the Company converted compensation awarded to the Chief Executive Officer into a number of DSUs based on the weighted average fair value at the award date. The Company records the compensation expense related to the granted DSUs evenly over the vesting period.

In addition, the Human Resource and Compensation Committee of the Board of Directors can mandate that all or a specified percentage of the Chief Executive Officer's short-term incentive compensation in respect of a calendar year be paid in the form of DSUs. Subject to any such determination, the Human Resource and Compensation Committee may permit the Chief Executive Officer to elect to receive an additional percentage of the Chief Executive Officer's short-term incentive compensation in respect of any calendar year in the form of DSUs. If such a mandate or election is made, the Company will credit to the account of the Chief Executive Officer a number of DSUs (each equivalent in value to a common share) equal to the amount of short-term incentive compensation divided by the fair value of the common shares. The date the short-term incentive compensation is payable is the award date of the DSUs, which will be fully vested at that time. The Chief Executive Officer's account is credited with dividend equivalents in the form of additional DSUs if and when the Company pays dividends on its common shares.

Upon the termination of employment, the Company will arrange to purchase shares, equal to the number of Chief Executive Officer DSUs on account of the Chief Executive Officer, on the secondary market. These shares will be held on behalf of the Chief Executive Officer for a one-year period.

Long-term Incentive Plan

Prior to 2010, the Company maintained a long-term incentive plan ("LTIP") pursuant to which certain employees were eligible to receive an award of share units equivalent in value to common shares of the Company ("share units"). Awards of share units under the LTIP were made in February of the financial year immediately following the year in respect of which the award was earned.

During the financial years ended December 31, 2011 and January 1, 2011, the Company did not award any share units under the Company's LTIP. During the financial years ended December 31, 2011 and January 1, 2011, the Company paid out the fully-vested awards granted in 2009 and 2008, respectively.

During the current financial year, the Company cancelled 18,289 share units (2010: nil) under the LTIP as a result of the departure of certain management personnel.

During the current financial year, the Company recognized compensation expense of $337 (2010: $2,221) associated with the LTIP share units outstanding and reversed compensation expense of $537 (2010: $nil), the latter as a result of the cancellation of previously granted share units under the LTIP.

As at December 31, 2011, there were no share units (2010: 148,086 share units) outstanding under the LTIP and the Company did not have any liability associated with the share units earned by the employees under the LTIP (2010: the liability associated with the share units earned by the employees under the LTIP was recognized within accounts payable and accrued liabilities in the consolidated balance sheet and was carried at the market value of the Company's shares at the end of the financial year).

In December 2011, the Company's cash-settled equity forward agreement, which related to the share units granted in 2009 under the LTIP, matured. Until December 2011, a percentage of the equity forward derivatives, which related to unearned share units under the LTIP, was designated as a hedge. As at December 31, 2011, the Company no longer has any cash-settled equity forward agreements related to the share units granted under the LTIP.

Restricted Share Unit Plan

In February 2011 and 2010, the Company made grants of restricted share units ("RSUs"), in respect of the 2010 and 2009 financial years under the Company's restricted share unit plan ("RSU Plan") and, for certain senior management, grants of RSUs, combined with grants of stock options under the Company's share plan.

During the current financial year, the Company awarded 193,474 RSUs (2010: 350,384 RSUs) at a grant-date fair value of $40.81 (2010: $44.09), which vest 100% after three years. Full vesting of RSUs will be phased in for employees who received an award under the Company's LTIP in respect of a financial year prior to the Company's 2009 financial year.

During the current financial year, the Company cancelled 80,537 RSUs (2010: nil) as a result of the departure of certain management personnel.

As at December 31, 2011, there were 381,380 RSUs (2010: 326,117 RSUs) outstanding.

During the financial year ended December 31, 2011, the Company recognized compensation expense of $4,973 (2010: $8,804) associated with the RSUs granted during the financial year and reversed compensation expense of $1,428 (2010: $nil), the latter as a result of the cancellation of previously granted RSUs.

As at December 31, 2011 and January 1, 2011, the liability associated with the RSUs is recognized within accounts payable and accrued liabilities and other long-term liabilities in the Company's consolidated balance sheets and is carried at the market value of the Company's shares at the end of the respective financial year.

The Company entered into cash-settled equity forward agreements to limit its exposure to future price changes in the Company's share price for the Company's RSUs. These agreements mature in December 2012 and December 2013.

A percentage of the equity forward derivatives, related to unearned RSUs, has been designated as a hedge.

27. NET CHANGE IN NON-CASH WORKING CAPITAL BALANCES

	2011	2010
Accounts receivable	**$ (36,242)**	$ 38,846
Inventory	**(84,242)**	(103,749)
Prepaid expenses	**32,759**	4,218
Accounts payable and accrued liabilities	**119,891**	25,861
	$ 32,166	$ (34,824)

December 31, 2011 and January 1, 2011 (in thousands of Canadian dollars, except per share data)

28. CONTINGENCIES, COMMITMENTS AND GUARANTEES

Obligations under Operating Leases

As at December 31, 2011, the minimum lease payments (exclusive of taxes, insurance and other occupancy charges) on a calendar year basis under long-term leases for store locations and office space are as follows:

	2012	2013	2014	2015	2016	Thereafter	Total
Minimum lease payments	$ 406,831	$ 408,198	$ 397,259	$ 382,422	$ 369,568	$ 2,335,088	$ 4,299,366
Less: sub-lease revenue	3,409	2,756	2,046	1,707	1,317	3,316	14,551
Total operating lease obligations	$ 403,422	$ 405,442	$ 395,213	$ 380,715	$ 368,251	$ 2,331,772	$ 4,284,815

Obligations under Financing Leases

As at December 31, 2011, the minimum lease payments on a calendar year basis for the Company's assets under financing leases are as follows:

	2012	2013	2014	2015	2016	Thereafter	Total
Minimum lease payments	$ 11,583	$ 11,634	$ 11,811	$ 11,943	$ 12,268	$ 161,549	$ 220,788
Less: financing expenses included in minimum lease payments	8,684	8,479	8,254	8,000	7,717	58,844	99,978
Total financing lease obligations	$ 2,899	$ 3,155	$ 3,557	$ 3,943	$ 4,551	$ 102,705	$ 120,810

The Company has financing lease obligations for buildings. The leases have an average interest rate of 7% (2010: 8 percent) and an average remaining term of approximately 17 years (2010: 17 years).

Distribution Services

The Company has entered into an agreement with a third party to provide inventory distribution services to the Company's locations to December 31, 2012. Under the terms of this agreement, the third party will charge the Company specified costs incurred to provide the distribution services, plus an annual management fee.

Information Services

The Company has entered into agreements with several third parties to provide information services to the Company. These agreements have terms of 5 years. The Company has committed to annual payments over the next five years as follows:

Minimum commitment	
2012	$ 8,952
2013	7,050
2014	6,665
2015	4,066
2016	1,744
Total	$ 28,477

Litigation

See Note 22 to these consolidated financial statements for a discussion of the Company's exposure to litigation claims.

Other

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

The Company is involved in and could potentially be subject to various claims by third parties arising out of its business including, but not limited to, contract, product liability, labour and employment, regulatory and environmental claims. In addition, the Company is subject to regular audits from federal and provincial tax authorities relating to income, capital and commodity taxes, and as a result of these audits, may receive reassessments. While income, capital and commodity tax filings are subject to audits and reassessments, management believes that adequate provisions have been made for all income and other tax obligations. However, changes in the interpretations or judgements may result in an increase or decrease in the Company's income, capital, or commodity tax provisions in the future. The amount of any such increase or decrease cannot be reasonably estimated.

29. RELATED PARTY TRANSACTIONS

Key Management Personnel Compensation

Key management personnel are those individuals having authority and responsibility for planning, directing and controlling the activities of the Company including the Company's Board of Directors. The Company considers key management to be the members of the Board of Directors and the Chief Executive Officer.

Key management personnel may also participate in the Company's stock-based compensation plans and the Company's LTIP and RSU Plan. See Note 26 to these consolidated financial statements for further details on the Company's share-based payment plans.

Key management personnel compensation is comprised of:

	2011	2010
Salaries and directors' fees	**$ 5,134**	$ 1,638
Statutory deductions	**104**	105
Expense related to pension and benefits	**293**	1,745
Share-based payment transactions	**(734)**	5,120
	$ 4,797	$ 8,608

Key management personnel may purchase goods for personal and family use from the Company on the same terms as those available to all other employees of the Company.

Principal Subsidiaries

All of the Company's subsidiaries are wholly-owned. Intra-company balances and transactions and any unrealized earnings and expenses arising from intra-company transactions are eliminated in preparing the consolidated financial statements. Principal subsidiary companies as at December 31, 2011 were as follows:

Shoppers Home Health Care (Canada) Inc.

Shoppers Drug Mart Specialty Health Network Inc.

MediSystem Technologies Inc.

Shoppers Drug Mart Inc.

Shoppers Drug Mart (London) Limited

Pharmaprix Inc.

911979 Alberta Ltd.

Shoppers Realty Inc.

Sanis Health Inc.

The list excludes non-trading companies that have no material effect on the accounts of the Company.

The Associate-owned stores are each operated through a corporation owned by the Associates. See Note 3(a)(ii) to these consolidated financial statements for a further discussion.

December 31, 2011 and January 1, 2011 (in thousands of Canadian dollars, except per share data)

30. EXPLANATION OF TRANSITION TO IFRS

As stated in Note 2(a) to these consolidated financial statements, these are the Company's first consolidated financial statements prepared in accordance with IFRS. Prior to the adoption of IFRS, the Company prepared its financial statements in accordance with Canadian Generally Accepted Accounting Principles ("previous GAAP").

The accounting policies set out in Note 3 to these consolidated financial statements have been applied in preparing the financial statements for the financial year ended December 31, 2011, the comparative information presented in these financial statements for the financial year ended January 1, 2011 and in the preparation of an opening IFRS balance sheet at January 3, 2010 (the Company's date of transition).

In preparing its opening IFRS balance sheet, the Company has adjusted amounts reported previously in financial statements prepared in accordance with previous GAAP based on IFRS 1, "First-time Adoption of International Financial Reporting Standards" ("IFRS 1"), elections and exceptions and IFRS policy choices. An explanation of how the transition from previous GAAP to IFRS has affected the Company's financial performance, financial position and cash flows is set out in the following tables and the notes that accompany the tables.

Reconciliation of Consolidated Statement of Earnings for 52 Weeks Ended January 1, 2011

	Note	Previous GAAP	Presentation Adjustment from Previous GAAP to IFRS	Effect of Transition to IFRS: Shoppers Optimum® Loyalty Card Program	Rent Expense During the Fixturing Period	Impairment of Store Assets	Sale-Leaseback Transactions	Financing Leases Classification	Employee Benefits – Ongoing Recognition of Pension Expense	Business Combinations	Income Taxes	IFRS
Sales	b)i)	$ 10,376,067	$ –	$ (183,353)	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ 10,192,714
Cost of goods sold and other operating expenses		(9,192,181)	9,192,181	–	–	–	–	–	–	–	–	–
Cost of goods sold	b)i)	–	(6,462,705)	179,071	–	–	–	–	–	–	–	(6,283,634)
Gross profit		1,183,886	2,729,476	(4,282)	–	–	–	–	–	–	–	3,909,080
Amortization		(286,935)	286,935	–	–	–	–	–	–	–	–	–
Operating and administrative expenses	b)ii); b)iii); b)iv); b)v); b)vi); b)vii)	–	(3,016,411)	–	(2,946)	(7,177)	10,906	3,967	(59)	(38)	–	(3,011,758)
Operating income		896,951	–	(4,282)	(2,946)	(7,177)	10,906	3,967	(59)	(38)	–	897,322
Interest expense		(56,036)	56,036	–	–	–	–	–	–	–	–	–
Finance expenses	b)iv)	–	(56,036)	–	–	–	–	(4,597)	–	–	–	(60,633)
Finance expenses		(56,036)	–	–	–	–	–	(4,597)	–	–	–	(60,633)
Earnings before income taxes		840,915	–	(4,282)	(2,946)	(7,177)	10,906	(630)	(59)	(38)	–	836,689
Income taxes	b)											
Current		(238,779)	–	–	–	–	–	–	–	–	–	(238,779)
Deferred		(11,393)	–	1,204	521	1,933	(2,029)	(241)	(114)	11	4,049	(6,059)
		(250,172)	–	1,204	521	1,933	(2,029)	(241)	(114)	11	4,049	(244,838)
Net earnings		$ 590,743	$ –	$ (3,078)	$ (2,425)	$ (5,244)	$ 8,877	$ (871)	$ (173)	$ (27)	$ 4,049	$ 591,851
Net earnings per common share												
Basic		$ 2.72										$ 2.72
Diluted		$ 2.72										$ 2.72

Reconciliation of Comprehensive Income for the 52 Weeks Ended January 1, 2011

	Note	Previous GAAP	Effect of Transition to IFRS	IFRS
Net earnings		$ 590,743	$ 1,108	$ 591,851
Other comprehensive income (loss), net of tax:				
Effective portion of changes in fair value hedges on interest rate derivatives (net of tax of $525)		1,120	–	1,120
Effective portion of changes in fair value hedges on equity forward derivatives (net of tax of $205)		(521)	–	(521)
Net change in fair value of hedges on interest rate and equity forward derivatives transferred to earnings (net of tax of $13)		33	–	33
Retirement benefit obligations actuarial losses (net of tax of $2,905)	b)vi)	–	(8,150)	(8,150)
Other comprehensive income (loss), net of tax		632	(8,150)	(7,518)
Total comprehensive income for the financial year		$ 591,375	$ (7,042)	$ 584,333

Reconciliation of Shareholders' Equity as at January 1, 2011

	Note	Previous GAAP	Effect of Transition to IFRS								IFRS
			Shoppers Optimum® Loyalty Card Program	Rent Expense During the Fixturing Period	Impairment of Store Assets	Sale-Leaseback Transactions	Financing Leases Classification	Employee Benefits – Ongoing Recognition of Pension Expense	Business Combinations	Income Taxes	
Share capital		$ 1,520,558	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ 1,520,558
Contributed surplus		11,702	–	–	–	–	–	–	–	–	11,702
Accumulated other comprehensive loss	b)vi)	(493)	–	–	–	–	–	(8,150)	–	–	(8,643)
Retained earnings	b)	2,692,136	(14,184)	(36,951)	(21,432)	14,796	(2,675)	3,983	(27)	(56,628)	2,579,018
Total shareholders' equity		$ 4,223,903	$ (14,184)	$ (36,951)	$ (21,432)	$ 14,796	$ (2,675)	$ (4,167)	$ (27)	$ (56,628)	$ 4,102,635

Reconciliation of Shareholders' Equity as at January 3, 2010

	Note	Previous GAAP	Effect of Transition to IFRS							IFRS
			Shoppers Optimum® Loyalty Card Program	Rent Expense During the Fixturing Period	Impairment of Store Assets	Sale-Leaseback Transactions	Financing Leases Classification	Employee Benefits – Ongoing Recognition of Pension Expense	Income Taxes	
Share capital		$ 1,519,870	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ 1,519,870
Contributed surplus		10,274	–	–	–	–	–	–	–	10,274
Accumulated other comprehensive loss		(1,125)	–	–	–	–	–	–	–	(1,125)
Retained earnings	b)	2,297,091	(11,106)	(34,526)	(16,188)	5,919	(1,804)	4,156	(60,677)	2,182,865
Total shareholders' equity		$ 3,826,110	$ (11,106)	$ (34,526)	$ (16,188)	$ 5,919	$ (1,804)	$ 4,156	$ (60,677)	$ 3,711,884

December 31, 2011 and January 1, 2011 (in thousands of Canadian dollars, except per share data)

30. EXPLANATION OF TRANSITION TO IFRS (continued)

Reconciliation of Consolidated Balance Sheet as at January 1, 2011

	Note	Previous GAAP	Presentation Adjustment from Previous GAAP to IFRS	Effect of Transition to IFRS								IFRS
				Shoppers Optimum® Loyalty Card Program	Rent Expense During the Fixturing Period	Impairment of Store Assets	Sale-Leaseback Transactions	Financing Leases Classification	Employee Benefits – Ongoing Recognition of Pension Expense	Business Combinations	Income Taxes	
Current assets												
Cash		$ 64,354	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ 64,354
Accounts receivable		432,089	–	–	–	–	–	–	–	–	–	432,089
Inventory		1,957,525	–	–	–	–	–	–	–	–	–	1,957,525
Income taxes recoverable	b)i); b)ii); b)iii); b)iv); b)v); b)vi)	20,384	–	–	–	–	–	–	–	–	–	20,384
Future income taxes	b)ix)	80,476	–	–	–	–	–	–	–	–	(80,476)	–
Prepaid expenses and deposits		68,468	–	–	–	–	–	–	–	–	–	68,468
Total current assets		2,623,296	–	–	–	–	–	–	–	–	(80,476)	2,542,820
Non-current assets												
Property and equipment	b)iii); b)iv); b)v); c)i)	1,709,656	(12,770)	–	(49,726)	(28,561)	–	58,741	–	–	–	1,677,340
Investment property	c)i)	–	12,770	–	–	–	–	–	–	–	–	12,770
Goodwill	b)vii)	2,493,146	–	–	–	–	–	–	–	(38)	–	2,493,108
Intangible assets		272,217	–	–	–	–	–	–	–	–	–	272,217
Other assets	b)vi)	23,895	–	–	–	–	–	–	(4,217)	–	–	19,678
Deferred tax assets	b)ix)	–	–	–	–	–	–	–	–	–	26,264	26,264
Total non-current assets		4,498,914	–	–	(49,726)	(28,561)	–	58,741	(4,217)	(38)	26,264	4,501,377
Total assets		$ 7,122,210	$ –	$ –	$ (49,726)	$ (28,561)	$ –	$ 58,741	$ (4,217)	$ (38)	$ (54,212)	$ 7,044,197
Liabilities												
Bank indebtedness		$ 209,013	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ 209,013
Commercial paper		127,828	–	–	–	–	–	–	–	–	–	127,828
Accounts payable and accrued liabilities	b)i); b)iv); c)ii)	981,491	(12,562)	19,735	–	–	–	1,580	–	–	–	990,244
Dividends payable		48,927	–	–	–	–	–	–	–	–	–	48,927
Provisions	c)ii)	–	12,562	–	–	–	–	–	–	–	–	12,562
Associate interest	c)iii)	–	138,993	–	–	–	–	–	–	–	–	138,993
Total current liabilities		1,367,259	138,993	19,735	–	–	–	1,580	–	–	–	1,527,567
Long-term debt		943,412	–	–	–	–	–	–	–	–	–	943,412
Other long-term liabilities	b)ii); b)iv); b)vi); c)ii)	399,651	(1,852)	–	–	–	(18,242)	61,079	1,488	–	–	442,124
Provisions	c)ii)	–	1,852	–	–	–	–	–	–	–	–	1,852
Deferred tax liabilities	b)	48,992	–	(5,551)	(12,775)	(7,129)	3,446	(1,243)	(1,538)	(11)	2,416	26,607
Total long-term liabilities		1,392,055	–	(5,551)	(12,775)	(7,129)	(14,796)	59,836	(50)	(11)	2,416	1,413,995
Total liabilities		2,759,314	138,993	14,184	(12,775)	(7,129)	(14,796)	61,416	(50)	(11)	2,416	2,941,562
Associate interest	c)iii)	138,993	(138,993)	–	–	–	–	–	–	–	–	–
Shareholders' equity												
Share capital		1,520,558	–	–	–	–	–	–	–	–	–	1,520,558
Contributed surplus		11,702	–	–	–	–	–	–	–	–	–	11,702
Accumulated other comprehensive loss	b)vi)	(493)	–	–	–	–	–	–	(8,150)	–	–	(8,643)
Retained earnings	b)	2,692,136	–	(14,184)	(36,951)	(21,432)	14,796	(2,675)	3,983	(27)	(56,628)	2,579,018
Total shareholders' equity		4,223,903	–	(14,184)	(36,951)	(21,432)	14,796	(2,675)	(4,167)	(27)	(56,628)	4,102,635
Total liabilities and shareholders' equity		$ 7,122,210	$ –	$ –	$ (49,726)	$ (28,561)	$ –	$ 58,741	$ (4,217)	$ (38)	$ (54,212)	$ 7,044,197

Reconciliation of Consolidated Balance Sheet as at January 3, 2010

	Note	Previous GAAP	Presentation Adjustment from Previous GAAP to IFRS	Effect of Transition to IFRS: Shoppers Optimum® Loyalty Card Program	Rent Expense During the Fixturing Period	Impairment of Store Assets	Sale-Leaseback Transactions	Financing Leases Classification	Employee Benefits – Ongoing Recognition of Pension Expense	Business Combinations	Income Taxes	IFRS
Current assets												
Cash		$ 44,391	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ 44,391
Accounts receivable	b)vii)	471,029	–	–	–	–	–	–	–	(94)	–	470,935
Inventory		1,852,441	–	–	–	–	–	–	–	–	–	1,852,441
Future income taxes	b)ix)	86,161	–	–	–	–	–	–	–	–	(86,161)	–
Prepaid expenses and deposits	b)vii)	75,573	–	–	–	–	–	–	–	(1,367)	–	74,206
Total current assets		2,529,595	–	–	–	–	–	–	–	(1,461)	(86,161)	2,441,973
Non-current assets												
Property and equipment	b)iii); b)iv); b)v); c)i)	1,566,024	(5,884)	–	(48,162)	(21,384)	–	51,247	–	–	–	1,541,841
Investment property	c)i)	–	5,884	–	–	–	–	–	–	–	–	5,884
Goodwill	b)vii)	2,481,353	–	–	–	–	–	–	–	2,077	–	2,483,430
Intangible assets		258,766	–	–	–	–	–	–	–	–	–	258,766
Other assets		16,716	–	–	–	–	–	–	–	–	–	16,716
Deferred tax assets	b)ix)	–	–	–	–	–	–	–	–	–	28,456	28,456
Total non-current assets		4,322,859	–	–	(48,162)	(21,384)	–	51,247	–	2,077	28,456	4,335,093
Total assets		$ 6,852,454	$ –	$ –	$ (48,162)	$ (21,384)	$ –	$ 51,247	$ –	$ 616	$ (57,705)	$ 6,777,066
Liabilities												
Bank indebtedness		$ 270,332	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ –	$ 270,332
Commercial paper		260,386	–	–	–	–	–	–	–	–	–	260,386
Accounts payable and accrued liabilities	b)i); b)iv); b)vii); c)ii)	964,736	(11,009)	15,453	–	–	–	1,267	–	384	–	970,831
Income taxes payable		17,046	–	–	–	–	–	–	–	–	–	17,046
Dividends payable		46,748	–	–	–	–	–	–	–	–	–	46,748
Provisions	c)ii)	–	11,009	–	–	–	–	–	–	–	–	11,009
Associate interest	c)iii)	–	130,189	–	–	–	–	–	–	–	–	130,189
Total current liabilities		1,559,248	130,189	15,453	–	–	–	1,267	–	384	–	1,706,541
Long-term debt		946,098	–	–	–	–	–	–	–	–	–	946,098
Other long-term liabilities	b)ii); b)iii); b)iv); b)vi); b)vii); c)ii)	347,951	(1,062)	–	(1,382)	–	(7,336)	53,268	(5,409)	232	–	386,262
Provisions	c)ii)	–	1,062	–	–	–	–	–	–	–	–	1,062
Deferred tax liabilities	b)	42,858	–	(4,347)	(12,254)	(5,196)	1,417	(1,484)	1,253	–	2,972	25,219
Total long-term liabilities		1,336,907	–	(4,347)	(13,636)	(5,196)	(5,919)	51,784	(4,156)	232	2,972	1,358,641
Total liabilities		2,896,155	130,189	11,106	(13,636)	(5,196)	(5,919)	53,051	(4,156)	616	2,972	3,065,182
Associate interest	c)iii)	130,189	(130,189)	–	–	–	–	–	–	–	–	–
Shareholders' equity												
Share capital		1,519,870	–	–	–	–	–	–	–	–	–	1,519,870
Contributed surplus		10,274	–	–	–	–	–	–	–	–	–	10,274
Accumulated other comprehensive loss		(1,125)	–	–	–	–	–	–	–	–	–	(1,125)
Retained earnings	b)i); b)ii); b)iii); b)iv); b)v); b)vi); b)ix)	2,297,091	–	(11,106)	(34,526)	(16,188)	5,919	(1,804)	4,156	–	(60,677)	2,182,865
Total shareholders' equity		3,826,110	–	(11,106)	(34,526)	(16,188)	5,919	(1,804)	4,156	–	(60,677)	3,711,884
Total liabilities and shareholders' equity		$ 6,852,454	$ –	$ –	$ (48,162)	$ (21,384)	$ –	$ 51,247	$ –	$ 616	$ (57,705)	$ 6,777,066

30. EXPLANATION OF TRANSITION TO IFRS (continued)

Notes to the Reconciliations

(a) Elections under IFRS 1, "First-time Adoption of International Financial Reporting Standards" ("IFRS 1")

(i) Business Combinations

IFRS 1 permits a first-time adopter to elect not to apply IFRS 3, "Business Combinations" ("IFRS 3"), to business combinations that occurred prior to the date of transition to IFRS. A first-time adopter can also elect to choose a date prior to the date of transition and apply IFRS 3 to all subsequent business combinations. The Company has elected to apply IFRS 3 prospectively to business combinations that occurred on or after January 3, 2010 (or "the date of transition to IFRS"). No change has been made to the recognition and measurement of business combinations that occurred prior to this date.

(ii) Share-based Payment Transactions

IFRS 1 does not require first-time adopters to apply the requirements of IFRS 2, "Share-based Payment" ("IFRS 2"), to equity instruments that were granted on or prior to November 7, 2002 or to equity instruments that were granted after November 7, 2002 and vested before the date of transition to IFRS. The Company has not applied IFRS 2 to stock options issued on or prior to November 7, 2002. The Company has not applied IFRS 2 to liabilities arising from share-based payment transactions that were settled prior to the date of transition to IFRS.

(iii) Deemed Cost

IFRS 1 allows a first-time adopter to elect to measure an item of property, plant and equipment or intangible asset at the date of transition to IFRS at fair value and use that fair value as deemed cost at that date. The Company has not elected to use fair value as deemed cost for any item of property and equipment or intangible assets.

(iv) Leases

IFRS 1 permits a first-time adopter to determine whether an arrangement contains a lease in accordance with IFRIC 4, "Determining whether an Arrangement contains a Lease" ("IFRIC 4"), based on the facts and circumstances existing at the date of transition rather than at the date the arrangement was entered into. The Company has applied IFRIC 4 on a retrospective basis. There was no impact on the Company's financial position or results of operations as a result of applying IFRIC 4 retrospectively, as there were no such arrangements.

(v) Employee Benefits

IFRS 1 permits a first-time adopter to account for its employee benefits under the "corridor" approach as measured retrospectively under IFRS or to recognize all cumulative actuarial gains and losses in retained earnings at the date of transition to IFRS. The Company has elected to recognize all unrecognized actuarial gains and losses as determined under the Company's previous GAAP as at January 3, 2010 in retained earnings. The Company has applied this election to all of its pension and other benefit plans.

(vi) Investments in Subsidiaries, Jointly Controlled Entities and Associates

IFRS 1 addresses the determination of "cost" for investments in subsidiaries, jointly controlled entities and associates in separate (non-consolidated) financial statements. The Company is not presenting separate financial statements under IAS 27, "Consolidated and Separate Financial Statements" ("IAS 27"). As a result, no election was made under IFRS 1.

(vii) Designation of Previously Recognized Financial Instruments

Financial instrument designations are made on initial recognition. IFRS 1 permits an "available for sale" designation or a "fair value through profit or loss" designation to be made at the date of transition to IFRS. No election was made under IFRS 1.

(viii) Fair Value Measurement of Financial Assets or Financial Liabilities at Initial Recognition

IFRS 1 permits a first-time adopter to use a valuation technique prospectively from the date of transition to IFRS in place of the transaction price where an active market does not exist. The Company has used the transaction price to establish the fair value of financial instruments upon initial recognition of the financial instruments. As a result, no election was made under IFRS 1.

(ix) Borrowing Costs

IFRS 1 permits a first-time adopter to apply the transitional guidance in IAS 23, "Borrowing Costs" ("IAS 23"), rather than adopt IAS 23 retrospectively. The Company has chosen to apply the requirements of IAS 23 to borrowing costs incurred on or after December 30, 2007 associated with all qualifying assets.

(x) Hedge Accounting

The Company formally identified, designated and documented all relationships between its hedging instruments and hedged items, as well as its risk assessment objectives and strategies for undertaking various hedge transactions as at January 3, 2010. The Company's hedge transactions continue to be effective hedges under IFRS. Accordingly, there was no change to the Company's financial position or results of operations associated with its hedging activity as a result of the transition to IFRS.

(xi) Non-controlling Interests

IFRS 1 requires a first-time adopter to apply certain requirements of IAS 27 on a prospective basis. These exceptions to the retrospective application of IAS 27 did not have an impact on the Company's transition to IFRS.

(xii) Estimates

The estimates used under IFRS are consistent with those made, for the same dates, in accordance with previous GAAP, except where they were impacted by a difference in accounting policy.

(b) Financial Impacts of Adopting IFRS

(i) Revenue Recognition – Optimum® Loyalty Card Program

Under previous GAAP, the Company recorded an expense and established a liability for future redemptions when points were earned by a program member by multiplying the number of points issued by the estimated cost per point. When points were redeemed, the actual costs of the redemptions were charged against the liability account. Points were valued at cost. Under IFRS, the Company defers a portion of the revenue associated with the sales transaction equivalent to the fair value of the points issued to the customer (retail value of the points) when points are earned by a program member. When points are redeemed, the redemption value of the award is charged against the deferred revenue balance and the revenue is recognized. Points are valued at fair value.

December 31, 2011 and January 1, 2011 (in thousands of Canadian dollars, except per share data)

30. EXPLANATION OF TRANSITION TO IFRS (continued)

The following is the impact of adopting IFRIC 13, "Customer Loyalty Programmes" ("IFRIC 13"), on the Company's earnings for the 52 weeks ended January 1, 2011 and the Company's financial position as at January 1, 2011 and January 3, 2010:

Net earnings impact	52 Weeks Ended January 1, 2011
Sales	$ (183,353)
Cost of goods sold	179,071
Gross profit	(4,282)
Income tax expense	1,204
Decrease in net earnings	$ (3,078)

	As at	
Balance sheet impact	January 1, 2011	January 3, 2010
Accounts payable and accrued liabilities	$ 19,735	$ 15,453
Deferred tax liabilities	(5,551)	(4,347)
Decrease in retained earnings	$ (14,184)	$ (11,106)

(ii) Sale-leaseback Transactions

Under previous GAAP, the Company had deferred gains on sale-leaseback transactions and was recognizing the gains in earnings over the lease term. Any losses were recognized in earnings immediately. Under IFRS, when sale-leaseback transactions result in operating leases, gains or losses on sale-leaseback transactions that are considered to be conducted at fair value are recognized in earnings immediately. When sale-leaseback transactions result in financing leases or if the gains or losses on sale-leaseback transactions arise on transactions that are not considered to have been transacted at fair value, the gains are deferred and recognized over the shorter of the lease term and the estimated useful life of the leased asset, while losses are recognized in earnings immediately.

The following is the impact of adopting IAS 17, "Leases" ("IAS 17"), on the Company's earnings for the 52 weeks ended January 1, 2011 and the Company's financial position as at January 1, 2011 and January 3, 2010 related to the Company's sale-leaseback transactions:

Net earnings impact	52 Weeks Ended January 1, 2011
Operating and administrative expenses	$ 10,906
Income tax expense	(2,029)
Increase in net earnings	$ 8,877

	As at	
Balance sheet impact	January 1, 2011	January 3, 2010
Other long-term liabilities	$ (18,242)	$ (7,336)
Deferred tax liabilities	3,446	1,417
Increase in retained earnings	$ 14,796	$ 5,919

(iii) Rent Expense during the Fixturing Period

Under previous GAAP, the Company capitalized rent expense incurred during a store's fixturing period to leasehold improvements in property and equipment. Under IFRS, rent expense during the fixturing period is no longer capitalized but, instead, is treated as occupancy expense, which is presented as part of operating and administrative expenses on the consolidated statements of earnings in the period in which the rent expense is incurred.

The following is the impact of adopting IAS 16, "Property, plant and equipment" ("IAS 16"), on the Company's earnings for the 52 weeks ended January 1, 2011 and the Company's financial position as at January 1, 2011 and January 3, 2010:

Net earnings impact	52 Weeks Ended January 1, 2011
Operating and administrative expenses	$ (2,946)
Income tax expense	521
Decrease in net earnings	$ (2,425)

	As at	
Balance sheet impact	January 1, 2011	January 3, 2010
Property and equipment	$ (49,726)	$ (48,162)
Other long-term liabilities	–	(1,382)
Deferred tax liabilities	(12,775)	(12,254)
Decrease in retained earnings	$ (36,951)	$ (34,526)

(iv) Financing Lease Classification

Under previous GAAP, leases for which substantially all the benefits and risks of ownership were transferred to the Company based on certain criteria were recorded as capital leases and classified as property and equipment, accounts payable and accrued liabilities and other long-term liabilities. Capital leases are referred to as financing leases under IFRS. Minimum lease payments were allocated between the land and building elements of a lease based on the fair value of the land and building in aggregate. All other leases were classified as operating leases under which minimum rent, including scheduled escalations, were expensed on a straight-line basis over the term of the lease, including any rent free periods. Under IFRS, minimum lease payments are allocated between the land and building elements of a lease in proportion to the relative fair values of the leasehold interests in the land and building. IFRS also provides additional indicators of a financing lease that were not provided under previous GAAP.

December 31, 2011 and January 1, 2011 (in thousands of Canadian dollars, except per share data)

30. EXPLANATION OF TRANSITION TO IFRS (continued)

The following is the impact of adopting IAS 17, "Leases" ("IAS 17"), on the Company's earnings for the 52 weeks ended January 1, 2011 and the Company's financial position as at January 1, 2011 and January 3, 2010 related to the Company's lease classification:

Net earnings impact	52 Weeks Ended January 1, 2011
Operating and administrative expenses	$ 3,967
Finance expenses	(4,597)
Income tax expense	(241)
Decrease in net earnings	$ (871)

	As at	
Balance sheet impact	January 1, 2011	January 3, 2010
Property and equipment	$ 58,741	$ 51,247
Accounts payable and accrued liabilities	1,580	1,267
Other long-term liabilities	61,079	53,268
Deferred tax liabilities	(1,243)	(1,484)
Decrease in retained earnings	$ (2,675)	$ (1,804)

(v) Impairment of Store Assets

Under previous GAAP, the Company tested long-lived assets or asset groups for impairment when events or circumstances indicated their carrying value exceeded the sum of the undiscounted cash flows expected from their use and eventual disposal. An impairment loss was measured as the amount by which the carrying values of long-lived assets (or asset groups) exceeded their fair values. The Company reviewed long-lived assets for impairment at least annually. Under IFRS, long-lived assets or asset groups are tested for impairment at the cash-generating unit level. A cash-generating unit ("CGU") is the smallest identifiable group of assets that generates cash flows that are largely independent of the cash inflows from other assets or group of assets. The Company has determined for parts of the business that the CGU level is different from the asset groupings previously used under previous GAAP.

Under IFRS, the Company reviewed its long-lived assets for indicators of impairment at the CGU level and determined that a test for impairment was necessary on assets in certain of its newer stores. The test resulted in the identification of an impairment loss under IFRS as at January 3, 2010. Accordingly, the Company has taken an opening balance sheet impairment charge to retained earnings. Further impairments associated with these same stores were identified during 2010 and charged to net earnings during 2010.

The following is the impact of adopting IAS 36, "Impairment of Assets" ("IAS 36"), on the Company's earnings for the 52 weeks ended January 1, 2011 and the Company's financial position as at January 1, 2011 and January 3, 2010:

Net earnings impact		52 Weeks Ended January 1, 2011
Operating and administrative expenses	$	(7,177)
Income tax expense		1,933
Decrease in net earnings	$	(5,244)

		As at		
Balance sheet impact		January 1, 2011		January 3, 2010
Property and equipment	$	(28,561)	$	(21,384)
Deferred tax liabilities		(7,129)		(5,196)
Decrease in retained earnings	$	(21,432)	$	(16,188)

(vi) Employee Benefits – Ongoing Recognition of Pension Expense

Under previous GAAP, the Company recognized as an expense the excess of the net actuarial gain or loss over 10% of the greater of the benefit obligation and the fair value of plan assets over the average remaining service period of active employees (the "corridor approach"). The Company has elected under IFRS 1 to recognize the cumulative actuarial gains and losses for all defined benefit plans, as determined under previous GAAP, in retained earnings. As a result, all previously unrecognized actuarial gains and losses and unrecognized plan amendments as at January 3, 2010 have been recognized in retained earnings in the opening IFRS balance sheet. As well, the impact of using the corridor approach under previous GAAP in the Company's 2010 financial year has been adjusted to reflect its policy under IFRS to recognize actuarial gains and losses immediately in other comprehensive income in the comparative IFRS statement of comprehensive income.

The Company also makes supplementary retirement benefits available to certain employees under a non-registered defined benefit pension plan ("Supplemental Plan" or "Plan"). The terms of the Supplemental Plan require the funding to be based on the wind-up provisions of the Plan. Under the wind-up provisions, plan members would receive benefits calculated using a discount rate equal to one-half of the discount rate used to determine the pension obligation. Under previous GAAP, the pension obligation associated with the Supplemental Plan could be calculated using the same methodology as the funding requirement. Under IFRS, the benefit obligation must be calculated using a going concern assumption, which requires the use of the full discount rate.

December 31, 2011 and January 1, 2011 (in thousands of Canadian dollars, except per share data)

30. EXPLANATION OF TRANSITION TO IFRS (continued)

The following is the impact of electing under IFRS 1 to recognize previously unrecognized actuarial gains and losses on defined benefit pension plans in retained earnings at the date of transition and adopting IAS 19, "Employee Benefits" ("IAS 19"), including using a full discount rate to determine the benefit obligation of the Supplemental Plan, on the Company's net earnings and other comprehensive income for the 52 weeks ended January 1, 2011 and the Company's financial position as at January 1, 2011 and January 3, 2010:

Net earnings impact		52 Weeks Ended January 1, 2011
Operating and administrative expenses	$	(59)
Income tax expense		(114)
Decrease in net earnings	$	(173)

Other comprehensive income impact		52 Weeks Ended January 1, 2011
Retirement benefit obligations actuarial losses (net of tax of $2,905)	$	(8,150)
Decrease in other comprehensive income	$	(8,150)

		As at		
Balance sheet impact		January 1, 2011		January 3, 2010
Other assets	$	(4,217)	$	–
Other long-term liabilities		1,488		(5,409)
Deferred tax liabilities		(1,538)		1,253
Accumulated other comprehensive income		(8,150)		–
Increase in retained earnings	$	3,983	$	4,156

(vii) Business Combinations

The Company has elected under IFRS 1 to apply IFRS 3, "Business Combinations" ("IFRS 3"), prospectively to business combinations that occurred on or after January 3, 2010. As a result, transaction costs that the Company capitalized in its 2010 financial year of $38 under the Company's previous GAAP have been expensed under IFRS.

The following is the impact of adopting IFRS 3 on the Company's earnings for the 52 weeks ended January 1, 2011, as a result of transaction costs associated with business acquisitions transacted during the financial year ended January 1, 2011 that had been capitalized under previous GAAP:

Net earnings impact		52 Weeks Ended January 1, 2011
Operating and administrative expenses	$	(38)
Income tax expense		11
Decrease in net earnings	$	(27)

The following is the impact of adopting IFRS 3 on the Company's financial position as at January 1, 2011 and January 3, 2010, as a result of restating the purchase price allocations of business acquisitions as at the acquisition date when purchase price adjustments were recorded in subsequent reporting periods under previous GAAP:

		As at
Balance sheet impact	January 1, 2011	January 3, 2010
Accounts receivable	$ –	$ (94)
Prepaid expenses and deposits	–	(1,367)
Goodwill	(38)	2,077
Accounts payable and accrued liabilities	–	384
Other long-term liabilities	–	232
Deferred tax liabilities	11	–
Decrease in retained earnings	$ (27)	$ –

There were no increases in provisions as at January 1, 2011 and January 3, 2010, to reflect assumed contingent liabilities at fair value at the date of acquisition.

As a condition to making the election under IFRS 1, goodwill relating to business combinations that occurred prior to January 3, 2010 must be tested for impairment, even though no impairment indicators were identified. At the date of transition, the Company performed an impairment test on goodwill and no impairment was identified.

(viii) Goodwill

The Company performed an impairment test under IFRS on goodwill as at January 3, 2010. No impairment was identified. See Note 16 to these consolidated financial statements for a discussion of the inputs and assumptions used in testing the recoverable amount of goodwill.

(ix) Deferred Tax Assets and Deferred Tax Liabilities

Under previous GAAP, the Company recognized a deferred (future income) tax asset on the temporary difference between the cost base and the tax base of inventory. This temporary difference related primarily to consideration received from vendors which is classified as a reduction to the cost of inventory on consolidation. Under IFRS, this adjustment is not considered a temporary difference and, as such, there is no deferred tax asset.

Under previous GAAP, deferred tax assets and liabilities were presented as current or long-term on the consolidated balance sheets in accordance with the assets or liabilities that gave rise to the deferred tax balances. Under IFRS, deferred tax assets and liabilities may not be presented as current. The Company has reclassified the deferred taxes into non-current assets and liabilities based on the net asset and liability positions of the entities that have generated the balances.

December 31, 2011 and January 1, 2011 (in thousands of Canadian dollars, except per share data)

30. EXPLANATION OF TRANSITION TO IFRS (continued)

The following is the impact of adopting IAS 12, "Income Taxes" ("IAS 12"), on the Company's earnings for the 52 weeks ended January 1, 2011 and the Company's financial position as at January 1, 2011 and January 3, 2010:

Net earnings impact	52 Weeks Ended January 1, 2011
Income tax expense	$ 4,049
Increase in net earnings	$ 4,049

	As at	
Balance sheet impact	January 1, 2011	January 3, 2010
Future income tax assets	$ (80,476)	$ (86,161)
Deferred tax assets	26,264	28,456
Future income tax liabilities	(48,992)	(42,858)
Deferred tax liabilities	51,408	45,830
Decrease in retained earnings	$ (56,628)	$ (60,677)

(c) Presentation Impacts of Adopting IFRS

(i) Investment Property

Under IFRS, investment property is presented separately from property and equipment. Investment property can be measured at cost less accumulated depreciation or fair value. The Company has chosen to continue to measure its investment property at cost less accumulated amortization and therefore this adjustment is solely a presentation impact.

(ii) Provisions

Under IFRS, provisions are presented separately. Under previous GAAP, the Company had included provisions within accounts payable and accrued liabilities and other long-term liabilities.

(iii) Associate Interest

Under previous GAAP, minority interest that arises as part of the consolidation process was presented separately on the balance sheet outside of equity. The consolidation of the stores under IAS 27 was determined based on the concept of control under IAS 27 considering the agreements in place with Associates (the "Associate Agreements"). The Company does not have any direct or indirect shareholdings in the Associates' corporations. The Associates have an investment in the net assets of their business that is included in the Company's consolidated balance sheets ("Associate interest"). The Company assessed the underlying nature of the Associate interest balance and determined that Associate interest has the characteristics of an obligation under the Associate Agreements. The Company does not expect to pay the amount recognized as a current liability to its Associates within the next 12 months due to the Company's long-term relationship with its Associates and the Company's past experience. However, the contractual ability to terminate an Associate Agreement means that the Company does not have an unconditional right to defer settlement of the liability for at least 12 months after the reporting period and therefore, under IFRS, the Associate interest balance is presented within current liabilities.

The impact of adopting IAS 27 on the Company's financial position is the removal of Associate interest from the mezzanine area on the consolidated balance sheets between liabilities and equity and instead, presenting Associate interest within current liabilities on the consolidated balance sheets as at January 1, 2011 and January 3, 2010.

	As at	
Balance sheet impact	January 1, 2011	January 3, 2010
Associate interest	$ 138,993	$ 130,189

(d) Adjustments to the Consolidated Statement of Cash Flows for the 52 Weeks Ended January 1, 2011

There are no material differences between the consolidated statements of cash flows presented under IFRS and the consolidated statements of cash flows presented under previous GAAP.

31. SUBSEQUENT EVENTS

Subsequent to the end of the financial year, on January 6, 2012, the Company filed with the securities regulators in each of the provinces of Canada, a final short form base shelf prospectus (the "Prospectus") for the issuance of up to $1,000,000 of medium-term notes. Subject to the requirements of applicable law, medium-term notes can be issued under the Prospectus for up to 25 months from the date of the final receipt. No incremental debt was incurred by the Company as a result of this filing.

On January 20, 2012, $250,000 of three-year medium-term notes (the "Series 3 Notes"), were repaid in full, along with all accrued and unpaid interest owing on the final semi-annual interest payment. The repayment was financed through the combination of available cash and commercial paper issued under the Company's commercial paper program. The net debt position of the Company remained substantially unchanged as a result of these refinancing activities.

On February 9, 2012, the Board of Directors declared a dividend of 26.5 cents per common share payable April 13, 2012 to shareholders of record as of the close of business on March 30, 2012.

The consolidated financial statements were authorized for issue by the Board of Directors on February 9, 2012.

Earnings Coverage Exhibit to the Consolidated Financial Statements

52 weeks ended December 31, 2011	
Earnings coverage ratio	**13.62 times**

The earnings coverage ratio is equal to earnings (before finance expenses and income taxes) divided by finance expenses. Finance expenses include finance expense capitalized to property and equipment.

Financial Section

annual management's discussion and analysis

as at March 1, 2012

The following is a discussion of the consolidated financial condition and results of operations of Shoppers Drug Mart Corporation (the "Company") for the periods indicated and of certain factors that the Company believes may affect its prospective financial condition, cash flows and results of operations. This discussion and analysis should be read in conjunction with the consolidated audited financial statements of the Company and the notes thereto for the 52 week period ended December 31, 2011 (the "consolidated financial statements"). The Company's consolidated financial statements and the notes thereto have been prepared in accordance with International Financial Reporting Standards ("IFRS") and are reported in Canadian dollars. (See "Transition to International Financial Reporting Standards" under "New Accounting Pronouncements" in this Management's Discussion and Analysis.) The fiscal year of the Company consists of a 52 or 53 week period ending on the Saturday closest to December 31.

Forward-looking Information and Statements

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

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

The material risk factors that could cause actual results to differ materially from the forward-looking information and statements contained herein include, without limitation: the risk of adverse changes to laws and regulations relating to prescription drugs and their sale, including pharmacy reimbursement programs and the availability of manufacturer allowances, or changes to such laws and regulations that increase compliance costs; the risk that the Company will be unable to implement successful strategies to manage the impact of the drug system reform initiatives implemented or proposed in a number of provinces; 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 or effectively manage succession planning; the risk of an inability of the Company's information technology systems to support the requirements of the Company's business; the risk of changes to estimated contributions of the Company in respect of its pension plans or post-employment benefit plans which may adversely impact the Company's financial performance; the risk of changes to the relationships of the Company with third-party service providers; the risk that the Company will not be able to lease or obtain suitable store locations on economically favourable terms; the risk of adverse changes to the Company's results of operations due to seasonal fluctuations; the risk of an inability of the Company to respond to changing consumer preferences that may result in excess inventory, inventory levels that are insufficient to meet demand or inventory obsolescence; risks associated with alternative arrangements for sourcing generic drug products, including intellectual property and product liability risks; the risk that new, or changes to current, federal and provincial laws, rules and regulations, including environmental and privacy laws, rules and regulations, may adversely impact the Company's business and operations; the risk that violations of law, breaches of Company policies or unethical behaviour may adversely impact the Company's financial performance; property and casualty risks; the risk of injuries at the workplace or health issues; the risk that changes in tax law, or changes in the way that tax law is expected to be interpreted, may adversely impact the Company's business and operations; the risk that new, or changes to existing, accounting pronouncements may adversely impact the Company; the risks associated with the performance of the Associate-owned store network; the risk of material adverse effects arising as a result of litigation; the risk of damage to the reputation of brands promoted by the Company, or to the reputation of any supplier or manufacturer of these brands; product quality and product safety risks which could expose the Company to product liability claims and negative publicity; the risk that events or a series of events may cause business interruptions; and the risk of disruptions to the Company's distribution operations or supply chain which could affect the cost, timely delivery and availability of merchandise.

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

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

Overview

The Company is the licensor of full-service retail drug stores operating under the name Shoppers Drug Mart® (Pharmaprix® in Québec). As at December 31, 2011, there were 1,199 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 58 medical clinic pharmacies operating under the name Shoppers Simply Pharmacy® (Pharmaprix Simplement Santé® in Québec) and eight luxury beauty destinations operating as Murale™.

The Company has successfully leveraged its leadership position in pharmacy and its convenient store locations to capture a significant share of the market in front store merchandise. Front store merchandise categories include over-the-counter medications ("OTC medications"), health and beauty aids ("HBA"), cosmetics and fragrances (including prestige brands), everyday household needs and seasonal products. The Company also offers a broad range of high-quality private label products marketed under the trademarks Life Brand®, Quo®, Etival™, Baléa®, Everyday Market®, Bio-Life®, Nativa®, Simply Food™ and Easypix®, among others, and value-added services such as the HealthWATCH® program, which offers patient counselling and advice on medications, disease management and health and wellness, and the Shoppers Optimum® program, one of the largest retail loyalty card programs in Canada. In fiscal 2011, the Company recorded consolidated sales of approximately $10.5 billion.

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

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

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

Associate-owned stores comprise the majority of the Company's store network. The Associate-owned stores are separate legal entities and the Company does not have any direct or indirect shareholdings in these Associate-owned stores. The Company consolidates the Associate-owned stores in accordance with International Accounting Standard 27, "Consolidated and Separate Financial Statements" ("IAS 27") based on the concept of control under IAS 27, determined primarily through the licensing arrangements that govern the relationship between the Company and the Associates. 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.

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

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

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

Strategies and Outlook

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

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

The dedication of the Company's Associate-owners, combined with its ability to recruit, develop and retain talented pharmacists and technicians, has been, and continues to be, the primary contributor to the Company establishing itself as a leader in the practice of community pharmacy and health. Going forward, the Company intends to build upon this leadership position by continuing to deliver innovative pharmacy products, services and programs, including, where permitted, its own private label generic drug products marketed under the trademark SANIS™, that aim to improve patient health outcomes, build loyalty with patients and third-party payers, increase market share and enhance profitability.

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

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

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

Sales growth is also being driven by the Company's store network investment program as it seeks to construct new stores, expand and remodel existing stores and relocate other stores to superior locations, albeit at a slower rate than in prior years in response to the drug system reform initiatives implemented or proposed in a number of provinces. The Company continues to pursue attractive opportunities in the marketplace to acquire drug stores and prescription files, although this activity also slowed in 2011 relative to prior years. In fiscal 2011, the Company opened or acquired 56 drug stores, 32 of which were relocations, and consolidated or closed 8 smaller drug stores. In addition to this activity, the Company also completed 25 major drug store expansions and remodeled 49 drug stores, converting them to smaller prototype formats. As a result of this activity, retail selling space increased by 3.8% during fiscal 2011 to in excess of 13.2 million square feet at year end. The Company intends to continue making investments in its store base, with the goal of increasing the number and average size of its full-service drug stores. These large-format stores offer customers greater convenience and a broader selection of front store products, while maintaining the high level of service for which Shoppers Drug Mart® and Pharmaprix® stores are known. As well, the Company will continue to remodel certain of its existing drug stores, converting them to smaller prototype formats. Historically, the Company's capital expenditures and acquisitions have been largely financed from internally generated cash flow, supplemented when necessary through additional borrowings.

In fiscal 2012, the Company expects total sales to increase by between 2.5% and 3.0%. This expectation is underpinned by anticipated same-store sales growth of between 0.5% to 1.5% in pharmacy and 2.0% to 2.5% in the front of the store. In pharmacy, it is expected that prescription count growth will remain strong at approximately 4.0%, however this growth will be largely offset by a continued reduction in average prescription value. The decline in average prescription value is mostly attributable to further reductions in generic prescription reimbursement rates as a result of recently implemented or announced drug system reform initiatives in a number of provinces. It is anticipated that increasing generic prescription utilization rates will also serve as a contributing factor to the decline in average prescription value. Furthermore, funding from transitional fees in certain provinces that was introduced to partially offset the impact of various drug system reform initiatives will be reduced or phased-out in 2012, while the introduction of additional paid services for community pharmacy have, for the most part, been slow to develop. In the front of the store, it is the Company's expectation that sustained investments in pricing and promotional activities will be required throughout the year in order to generate the anticipated rate of sales growth.

The Company plans to allocate approximately $350 million to its capital expenditure program in 2012, with approximately 75% of this amount to be invested in the store network. This activity should result in an increase in retail selling square footage of approximately 3.5%. It is expected that this will be accomplished through the addition of between 40 and 45 new drug stores, approximately 20 of which will be relocations, and through the completion of up to 15 major drug store expansions. The Company also plans to remodel between 25 and 30 existing drug stores, converting these stores to smaller prototype formats consistent with the brand identification, product offering and consumer proposition offered by the Company's large-format drug stores.

See "Industry and Regulatory", "Economic and Financial Conditions" and "Real Estate" under the "Risks and Risk Management" section herein and "Capital Management and Liquidity Risk" under the "Risks Associated with Financial Instruments" section herein for discussions of certain risks in the normal course of the Company's business that have the potential to affect its ability to successfully implement its plans respecting sales growth and capital expenditures, including the continued growth and expansion of its retail network. Subject to these factors and to the performance of the Canadian economy and financial market conditions in 2012, the Company is confident in its ability to execute upon its operating, investing and financing strategies in fiscal 2012 and beyond. The Company believes that the appropriate balance and successful implementation of these strategies and initiatives will result in long-term market share gains and lead to enhanced shareholder value, through a combination of share price appreciation and dividends that are sustainable over time.

Overall Financial Performance

Key Operating, Investing and Financial Metrics

The following provides an overview of the Company's operating performance for the 52 week period ended December 31, 2011 compared to the 52 week period ended January 1, 2011[(1)], as well as certain other metrics with respect to investing activities for the 52 week period ended December 31, 2011 and financial position as at December 31, 2011.

- Sales of $10.459 billion, an increase of 2.6%.
- Comparable store total sales growth of 1.9%.
  - > Comparable prescription sales growth of 0.6%.
  - > Comparable front store sales growth of 3.2%.
- Prescription count growth of 3.8%.
  - > Comparable store prescription count growth of 3.8%.
- EBITDA[(2)] of $1.209 billion, an increase of 1.6% compared to adjusted EBITDA[(3)] of $1.189 billion.
  - > EBITDA margin[(4)] of 11.56%, a decrease of 11 basis points compared to adjusted EBITDA margin[(5)] of 11.67%.
- Net earnings of $614 million, an increase of 3.7%. Adjusted net earnings of $611 million[(6)], an increase of 2.6% compared to adjusted net earnings of $596 million[(7)].
  - > Net earnings per common share of $2.84, an increase of 4.4%. Adjusted net earnings per common share of $2.82[(8)], an increase of 2.9% compared to adjusted net earnings per common share of $2.74[(9)].
- Capital expenditure program of $406 million compared to $483 million in the prior year.
  - > 56 new drug stores opened or acquired, 32 of which were relocations.
  - > 25 major drug store expansions.
  - > 49 drug stores remodelled, converting them to smaller prototype formats.
  - > 3.8% increase in retail selling space to in excess of 13.2 million square feet.
- Maintained desired capital structure and strengthened financial position.
  - > Net debt to equity ratio of 0.26:1 compared to 0.32:1 at the end of the prior year.
  - > Net debt to total capitalization ratio of 0.21:1 compared to 0.24:1 at the end of the prior year.
- Declared four quarterly dividends of 25 cents per share.
- Repurchased 5,202,100 common shares at an aggregate cost of $212 million, representing an average repurchase price of $40.65 per common share.

(1) In preparing its 2010 comparative information, the Company has adjusted amounts reported previously in financial statements prepared in accordance with Canadian Generally Accepted Accounting Principles ("previous Canadian GAAP"). (See note 30 to the consolidated financial statements of the Company.)

(2) Earnings before finance expenses, income taxes and depreciation and amortization. (See reconciliation to the most directly comparable IFRS measure under "Results of Operations – Fiscal 2011" in this Management's Discussion and Analysis.)

(3) EBITDA, excluding the impact of a $10 million (pre-tax) charge to settle a long-standing legal dispute related to a commercial arrangement with one of the Company's ancillary businesses.

(4) EBITDA divided by sales.

(5) Adjusted EBITDA divided by sales.

(6) Net earnings, excluding a gain on disposal of $3 million (pre-tax) in respect of a sale-leaseback transaction involving certain of the Company's retail properties.

(7) Net earnings, excluding the after-tax impact of the aforementioned legal settlement charge referred to in footnote (3) above, the impact of a gain on disposal of $12 million (pre-tax) in respect of a sale-leaseback transaction involving certain of the Company's retail properties, as well as the impact of an asset impairment charge under IFRS of $7 million (pre-tax) related to certain of the Company's store assets.

(8) Net earnings per common share, excluding the after-tax impact of the gain on disposal referred to in footnote (6) above.

(9) Net earnings per common share, excluding the after-tax impact of the items referred to in footnote (7) above.

Results of Operations – Fiscal 2011

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

($000s, except per share data)	2011	2010[1]	$ Change	% Change
Sales	$ **10,458,652**	$ 10,192,714	$ 265,938	2.6%
Cost of goods sold	**6,416,208**	6,283,634	(132,574)	(2.1%)
Gross profit	**4,042,444**	3,909,080	133,364	3.4%
Operating and administrative expenses	**3,131,539**	3,011,758	(119,781)	(4.0%)
Operating income	**910,905**	897,322	13,583	1.5%
Finance expenses	**64,038**	60,633	(3,405)	(5.6%)
Earnings before income taxes	**846,867**	836,689	10,178	1.2%
Income taxes	**232,933**	244,838	11,905	4.9%
Net earnings	$ **613,934**	$ 591,851	$ 22,083	3.7%
Net earnings per common share				
– Basic	$ **2.84**	$ 2.72	$ 0.12	4.4%
– Diluted	$ **2.84**	$ 2.72	$ 0.12	4.4%

EBITDA Reconciliation

	2011	2010
Net earnings	$ **613,934**	$ 591,851
Add the following:		
– Income taxes	**232,933**	244,838
– Finance expenses	**64,038**	60,633
Operating income	**910,905**	897,322
Add the following:		
– Depreciation and amortization expense	**297,682**	281,505
EBITDA	$ **1,208,587**	$ 1,178,827

[1] In preparing its 2010 comparative information, the Company has adjusted amounts reported previously in financial statements prepared in accordance with previous Canadian GAAP. (See note 30 to the consolidated financial statements of the Company.)

Sales

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

Sales are recognized as revenue when the goods are sold to the customer. Revenue is net of returns and award credits. Where a sales transaction includes points awarded under the Shoppers Optimum® loyalty card program (the "Program"), revenue allocated to the Program points is deferred based on the fair value of the award credits and recognized as revenue when the Program points are redeemed and the Company fulfills its obligations to supply the awards.

Revenue is measured at the fair value of the consideration received or receivable from the customer for products sold or services supplied. However, for certain products or services, such as the sale of lottery tickets, third-party prepaid phone cards, third-party gift cards, postal products and services and public transportation tickets, the Company acts as an agent and, consequently, records only the amount of commission income in its sales.

Sales in 2011 were $10.459 billion compared to $10.193 billion in 2010, an increase of $266 million or 2.6%. Sales increased in all regions of the country, with the Company experiencing moderate sales growth in pharmacy and strong results in the front of the store. The Company's capital investment and store development program, which resulted in a year-over-year increase in selling space of 3.8%, continues to have a positive impact on sales growth. On a same-store basis, sales increased 1.9% in 2011.

Prescription sales were $4.997 billion in 2011 compared to $4.959 billion in 2010, an increase of $38 million or 0.8%, as strong growth in the number of prescriptions filled was largely offset by a further decline in average prescription value. On a same-store basis, prescription sales increased 0.6% during the year. During 2011, prescription counts increased 3.8% on both a total and a same-store basis over the prior year. A reduction in generic prescription reimbursement rates, the result of recently implemented and ongoing drug system reform initiatives in a number of provinces, combined with greater generic prescription utilization rates, had a negative impact on sales dollar growth in pharmacy. Generic molecules represented 56.9% of prescriptions dispensed in 2011 compared to 54.5% of prescriptions dispensed in the prior year. In 2011, prescription sales accounted for 47.8% of the Company's sales mix compared to 48.7% in the prior year.

Front store sales were $5.462 billion in 2011 compared to $5.234 billion in 2010, an increase of $228 million or 4.4%, with the Company posting sales gains in all core categories, led by cosmetics, food and confection, and other convenience categories. On a same-store basis, front store sales increased 3.2% in 2011. In addition to square footage growth, further investments in marketing, pricing and promotional activities throughout the year drove sales and market share gains in the front of the store.

Cost of Goods Sold

Cost of goods sold is comprised of the cost of goods sold at the retail drug stores owned by the Associates, the cost of goods sold at Murale™ and the cost of goods sold at the home health care business, Shoppers Drug Mart Specialty Health Network Inc. and MediSystem Technologies Inc.

Cost of goods sold was $6.416 billion in 2011 compared to $6.284 billion in 2010, an increase of $132 million or 2.1%. Expressed as a percentage of sales, cost of goods sold declined by 30 basis points in 2011 compared to the prior year, reflecting greater generic prescription utilization, as well as cost reductions in generic prescription molecules, largely the result of drug system reform initiatives implemented in a number of provinces, along with improved purchasing synergies and margins on front store merchandise.

Operating and Administrative Expenses

Operating and administrative expenses include corporate selling, general and administrative expenses, operating expenses at the retail drug stores owned by the Associates, including Associates' earnings, operating expenses at Murale™ and operating expenses at the home health care business, Shoppers Drug Mart Specialty Health Network Inc. and MediSystem Technologies Inc. Operating and administrative expenses also include depreciation and amortization expenses. (See note 13 to the accompanying consolidated financial statements of the Company.)

Operating and administrative expenses, excluding depreciation and amortization expense, were $2.834 billion in 2011 compared to an adjusted amount of $2.720 billion in 2010, an increase of $114 million or 4.2%, with the prior year's amount adjusted to exclude the impact of a charge of $10 million (pre-tax) to settle a long-standing legal dispute related to a commercial arrangement with one of the Company's ancillary businesses. This increase can be largely attributed to higher operating expenses at store level associated with the Company's network growth and expansion initiatives, along with increased Associate earnings, and stepped-up investments in marketing and promotional events. The benefits from cost reduction, productivity and efficiency initiatives in comparable stores served to partially offset these increases. Expressed as a percentage of sales, operating and administrative expenses, excluding depreciation and amortization expense, increased by 41 basis points in 2011 compared to the prior year's adjusted amount, an increase that also reflects, in part, the impact of top-line deflation stemming from the above referenced drug system reform initiatives and greater generic prescription utilization.

Depreciation and amortization expense, inclusive of a gain on disposal of $3 million (pre-tax) in respect of a sale-leaseback transaction involving certain of the Company's retail properties, was $298 million in 2011. Excluding the impact of this gain, adjusted depreciation and amortization expense was $301 million compared to adjusted depreciation and amortization expense of $286 million in 2010, an increase of $15 million or 5.3%. Adjusted depreciation and amortization expense for 2010 excludes the impact of a gain on disposal of $12 million (pre-tax) in respect of a sale-leaseback transaction involving certain of the Company's retail properties and an asset impairment charge under IFRS of $7 million (pre-tax) related to certain of the Company's store assets. Expressed as a percentage of sales, adjusted depreciation and amortization expense increased by seven basis points in 2011 compared to the prior year's adjusted amount, an increase which can be attributed to continued investments in the store network and supporting infrastructure.

Operating Income

Operating income was $911 million in 2011 compared to $897 million in 2010, an increase of $14 million or 1.5%. Excluding the impact of the gain on disposal of $3 million (pre-tax) in respect of the sale-leaseback transaction referred to above, adjusted operating income was $907 million in 2011. This compares to adjusted operating income of $903 million in 2010. Adjusted operating income for 2010 excludes the impact of the aforementioned legal settlement charge of $10 million (pre-tax), the gain on disposal of $12 million (pre-tax) in respect of the sale-leaseback transaction and the asset impairment charge under IFRS of $7 million (pre-tax). As described above, strong performance in the front of the store, which was supported by increased investments in pricing and promotional activities, was partially offset by additional downward pressure on sales and margins in the dispensary as a result of drug system reform initiatives implemented in a number of provinces. These results also reflect the benefits from cost reduction, productivity and efficiency initiatives in comparable stores, which served to partially offset higher operating expenses at store level associated with continued network growth and expansion initiatives, and increased Associate earnings. In 2011, adjusted operating margin (adjusted operating income divided by sales) declined by 18 basis points to 8.68% compared to an adjusted operating margin of 8.86% in 2010. The Company's EBITDA margin (EBITDA divided by sales) declined by 11 basis points to 11.56% in 2011 compared to the adjusted EBITDA margin of 11.67% posted in 2010. Adjusted EBITDA margin for 2010 excludes the impact of the $10 million (pre-tax) legal settlement charge referred to above.

Finance Expenses

Finance expenses are comprised of interest expense arising from borrowings at the Associate-owned stores and from debt obligations of the Company, interest associated with financing leases and the amortization of transaction costs incurred in conjunction with debt transactions.

Finance expenses were $64 million in 2011 compared to $61 million in 2010, an increase of $3 million or 5.6%. Interest expense was higher as a result of a market-driven increase in short-term interest rates on the Company's floating rate debt obligations, higher standby fees associated with the Company's revolving term bank credit facility which was refinanced in the fourth quarter of 2010, interest costs associated with financing leases and a decrease in the amount of capitalized interest due to the completion of the Cornwall distribution centre in 2010. These higher costs were partially offset by savings resulting from the Company having a lower average amount of consolidated net debt outstanding during the year and from the maturity, in the fourth quarter of 2010, of an interest rate derivative agreement that converted an aggregate notional principal amount of $50 million of floating rate debt into fixed rate debt. (See discussion under "Financing Activities" in this Management's Discussion and Analysis and notes 3(e) and 12 to the consolidated financial statements of the Company.)

Income Taxes

The Company's effective income tax rate in 2011 was 27.5% compared to a rate of 29.3% in the prior year. This decrease in the effective income tax rate can be primarily attributed to a reduction in statutory rates. (See discussion on "Income and Other Taxes" under "Critical Accounting Estimates" in this Management's Discussion and Analysis and notes 3(g) and 14 to the consolidated financial statements of the Company.)

Net Earnings

Net earnings in 2011 were $614 million compared to $592 million in 2010, an increase of $22 million or 3.7%. On a fully diluted basis, net earnings per share were $2.84 in 2011 compared to $2.72 in 2010, an increase of 4.4%. Net earnings for 2011 are inclusive of the gain on disposal of $3 million (pre-tax) in respect of the sale-leaseback transaction referred to above. Excluding the impact of this gain, adjusted net earnings for 2011 were $611 million or $2.82 per share compared to adjusted net earnings of $596 million or $2.74 per share in 2010. Adjusted net earnings for 2010 exclude the impact of the aforementioned legal settlement charge of $10 million (pre-tax), the gain on disposal of $12 million (pre-tax) in respect of a sale-leaseback transaction and the asset impairment charge under IFRS of $7 million (pre-tax). In addition to the earnings factors noted above, the cumulative impact of the Company's share repurchase program had a modestly positive impact on growth in earnings per share as there were 0.5% fewer fully diluted shares outstanding in 2011 compared to 2010.

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)	2011	2010[1]
Cash	$ (118,566)	$ (64,354)
Bank indebtedness	172,262	209,013
Commercial paper	–	127,828
Current portion of long-term debt	249,971	–
Long-term debt	695,675	943,412
Financing lease obligations	120,810	79,031
Net debt	1,120,152	1,294,930
Shareholders' equity	4,267,830	4,102,635
Total capitalization	$ 5,387,982	$ 5,397,565
Net debt:Shareholders' equity	0.26:1	0.32:1
Net debt:Total capitalization	0.21:1	0.24:1
Net debt:EBITDA	0.93:1	1.10:1
EBITDA:Cash interest expense[2]	18.73:1	18.62:1

[1] In preparing its 2010 comparative information, the Company has adjusted amounts reported previously in financial statements prepared in accordance with previous Canadian GAAP. (See note 30 to the consolidated financial statements of the Company.)

[2] Cash interest expense is comprised of finance expenses and excludes the amortization of deferred financing costs, but includes capitalized interest.

Financial Ratios and Credit Ratings

As measured by the ratios set out above, the Company strengthened its balance sheet and financial position in 2011. The Company is comfortable with its existing capital structure and financial position and expects to maintain similar ratios in 2012.

The following table provides a summary of the Company's credit ratings at the end of 2011.

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

There were no changes to any of the Company's credit ratings during fiscal 2011.

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 211,822,997 common shares outstanding at March 1, 2012. As at this same date, the Company had issued options to acquire 865,420 of its common shares pursuant to its stock-based compensation plans, of which 484,702 were exercisable. (See notes 24, 25 and 26 to the consolidated financial statements of the Company.)

Dividend Policy

On February 10, 2011, the Company announced that its Board of Directors had declared a dividend of 25.0 cents per common share, payable April 15, 2011 to shareholders of record as of the close of business on March 31, 2011. This represented an increase in the amount of the Company's quarterly dividend payments of 11.1%, resulting in an annualized dividend payment of $1.00 per common share, and equated to a dividend payout ratio, expressed as a percentage of fiscal 2010 net earnings, of 37%.

The following table provides a summary of dividends declared by the Company in 2011:

Declaration Date	Record Date	Payment Date	Dividend per Share
February 10, 2011	March 31, 2011	April 15, 2011	$ 0.25
April 27, 2011	June 30, 2011	July 15, 2011	$ 0.25
July 21, 2011	September 30, 2011	October 14, 2011	$ 0.25
November 9, 2011	December 30, 2011	January 13, 2012	$ 0.25

Subsequent to year end, the Company announced, on February 9, 2012, that its Board of Directors had declared a dividend of 26.5 cents per common share, payable April 13, 2012 to shareholders of record as of the close of business on March 30, 2012. This represents an increase in the amount of the Company's quarterly dividend payments of 6%, resulting in an annualized dividend payment of $1.06 per common share, and equates to a dividend payout ratio, expressed as a percentage of fiscal 2011 net earnings per common share, of 37%.

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

All dividends paid by the Company in 2011 and, unless otherwise indicated, all dividends to be paid by the Company subsequent to 2011, are designated as *eligible dividends* in accordance with subsection 89(14) of the *Income Tax Act* (Canada) and any applicable corresponding provincial or territorial provisions.

Normal Course Issuer Bid

On February 10, 2011, the Company's Board of Directors authorized the purchase of up to 8,700,000 of its common shares, representing approximately 4.0% of its common shares then outstanding, by way of normal course purchases effected through the facilities of the Toronto Stock Exchange (the "TSX"). The Company was able to commence purchases under this program on February 15, 2011. Under this program, which expired on February 14, 2012, the Company repurchased 5,202,100 common shares in fiscal 2011 at an aggregate cost of $212 million, representing an average repurchase price of $40.65 per common share. Purchases were made by the Company in accordance with the requirements of the TSX and the price which the Company paid for any such common shares was the market price of any such common shares at the time of acquisition. For purposes of the TSX rules, a maximum of 170,759 common shares could be purchased by the Company on any one day under the bid, except where purchases were made in accordance with the "block purchase exception" of the TSX rules. At the end of fiscal 2011, 5,086,200 of the repurchased common shares were cancelled, with the remaining 115,900 common shares cancelled upon settlement, which was subsequent to year-end. The premium paid over the average book value of the repurchased common shares has been charged to retained earnings. (See notes 24 and 25 to the accompanying consolidated financial statements of the Company.)

Subsequent to year end, the Company announced, on February 9, 2012, that its Board of Directors approved the renewal of its normal course issuer bid program and authorized the purchase of up to 10,600,000 of its common shares, representing approximately 5.0% of its common shares then outstanding, by way of normal course purchases effected through the facilities of the TSX. The Company was able to commence purchases under this program on February 15, 2012. The program will terminate on February 14, 2013, or on such earlier date as the Company may complete its purchases pursuant to a Notice of Intention filed with the TSX. Purchases will be made by the Company in accordance with the requirements of the TSX and the price which the Company will pay for any such common shares will be the market price of any such common shares at the time of acquisition, or such other price as may be permitted by the TSX. In connection with the normal course issuer bid program, the Company has entered into an automatic purchase plan with its designated broker to allow for purchases of its common shares during certain pre-determined black-out periods, subject to certain parameters as to price and number of shares. Outside of these pre-determined black-out periods, shares will be repurchased in accordance with management's discretion, subject to applicable law. For purposes of the TSX rules, a maximum of 178,466 common shares may be purchased by the Company on any one day under the bid, except where purchases are made in accordance with the "block purchase exception" of the TSX rules. Common shares purchased by the Company will be cancelled. A copy of the Notice of Intention filed with the TSX may be obtained, without charge, upon written request to the Vice President, Legal Affairs & Secretary of the Company.

Financing Activities

On October 27, 2011, the Company amended its previously existing $750 million revolving term credit facility that was to mature on December 10, 2014. The credit facility was amended to reduce the size of the credit facility to $725 million, extend the maturity date by one year to December 10, 2015, reduce the applicable stamping fee on bankers' acceptance borrowings from 150 basis points per annum to 100 basis points per annum, and reduce the applicable commitment fee rate on undrawn amounts to 20 basis points per annum from 37.5 basis points per annum. The consolidated net debt position of the Company remained substantially unchanged as a result of this refinancing. The amended credit facility is available for general corporate purposes, including backstopping the Company's $500 million commercial paper program. (See notes 19 and 20 to the consolidated financial statements of the Company.)

Subsequent to year end, on January 6, 2012, the Company filed, with the securities regulators in each of the provinces of Canada, a final short form base shelf prospectus (the "2012 Prospectus") for the issuance of up to $1 billion of medium-term notes. Subject to the requirements of applicable law, medium-term notes can be issued under the 2012 Prospectus for up to 25 months from the date of the final receipt. No incremental debt was incurred by the Company as a result of this filing. (See note 31 to the consolidated financial statements of the Company.)

Subsequent to year end, on January 20, 2012, $250 million of three-year medium-term notes matured and were repaid in full, along with all accrued and unpaid interest owing on the final semi-annual interest payment, with a combination of available cash and commercial paper issued under the Company's commercial paper program. After giving effect to the repayment of the maturing medium-term notes, the net debt position of the Company remained substantially unchanged as a result of this refinancing activity. (See note 31 to the consolidated financial statements of the Company.)

Liquidity and Capital Resources

Sources of Liquidity

The Company has the following sources of liquidity: (i) cash provided by operating activities; (ii) cash available from a committed $725 million revolving bank credit facility maturing December 10, 2015, 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 $725 million revolving bank credit facility. The Company does not currently foresee any reasonable circumstances under which this credit rating would not be maintained. At December 31, 2011, $9 million of the Company's $725 million revolving bank credit facility was utilized, all in respect of outstanding letters of credit. At the end of the prior year, $9 million of the Company's then existing $750 million revolving bank credit facility was utilized, all in respect of outstanding letters of credit. At December 31, 2011, the Company did not have any commercial paper issued and outstanding under its commercial paper program compared to $128 million at the end of the prior year. (See note 20 to the consolidated financial statements of the Company.)

The Company has also arranged for its Associates to obtain financing to facilitate their inventory purchases and fund their working capital requirements by providing guarantees to various Canadian chartered banks that support Associate loans. At the end of 2011, the Company's maximum obligation in respect of such guarantees was $520 million, unchanged from the end of the prior year. At December 31, 2011, an aggregate amount of $452 million in available lines of credit had been allocated to the Associates by the various banks compared to $440 million at the end of the prior year. At December 31, 2011, Associates had drawn an aggregate amount of $167 million against these available lines of credit compared to $176 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. (See note 19 to the consolidated financial statements of the Company.)

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

Cash Flows from Operating Activities

Cash flows from operating activities were $974 million in 2011, compared to $828 million in the prior year. This increase is the result of a number of factors, including modest growth in net earnings, adjusted for non-cash items, principally depreciation and amortization, partially offset by a reduction in the rate of increase in other long-term liabilities, primarily deferred rent obligations, as a result of the Company's scaled-back store network growth and expansion activity. A reduction in the amount invested in non-cash working capital balances compared to the prior year, combined with a shift in the timing of income taxes payable, were the largest contributing factors to the year-over-year increase in cash flows from operating activities. The reduction in the amount invested in non-cash working capital balances can be largely attributed to an increase in accounts payable and accrued liabilities, offset in part by an increase in accounts receivable. (See note 27 to the consolidated financial statements of the Company.)

Cash Flows Used in Investing Activities

Cash flows used in investing activities were $349 million in 2011 compared to $425 million in 2010, a decrease of $76 million or 17.8%. Of these totals, purchases of property and equipment, net of proceeds from any dispositions, amounted to $286 million in 2011 compared to $355 million in 2010, as the Company continues to invest in its store network and supporting infrastructure, albeit at a slower rate. Included in the net purchases of property and equipment in 2011 was $55 million of proceeds resulting from dispositions, $54 million of which related to sale/leaseback transactions involving certain of the Company's retail properties, compared to $61 million and $57 million, respectively, in the prior year. In 2011, the Company invested an additional $10 million in business acquisitions and a combined $52 million in the purchase and development of intangible and other assets compared to $12 million and $60 million, respectively, in 2010. Investments in business acquisitions relate primarily to acquisitions of drug stores and prescription files and while the Company has reduced such investments as of late in response to drug system reform initiatives implemented in a number of provinces, it will continue to pursue attractive opportunities in the marketplace.

During 2011, the Company opened or acquired 56 new drug stores, 32 of which were relocations, consolidated or closed 8 smaller drug stores and completed 25 major drug store expansions. In addition to this activity, 49 existing drug stores were remodeled, converting them to smaller prototype formats. At the end of 2011, there were 1,328 retail stores in the Company's network, comprised of 1,257 drug stores (1,199 Shoppers Drug Mart®/Pharmaprix® stores and 58 Shoppers Simply Pharmacy®/ Pharmaprix Simplement Santé® stores), 63 Shoppers Home Health Care® stores and eight Murale™ stores. During 2011, the retail selling space of the store network increased by 3.8% to in excess of 13.2 million square feet. At year end, the average selling space per drug store was approximately 10,300 square feet compared to 10,100 square feet at the end of the prior year.

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

	2011		2010	
	Drug Stores	**Home Health Care Stores**	Drug Stores	Home Health Care Stores
Store count – beginning of year	**1,241**	**63**	1,219	66
Stores opened/acquired	**24**	**–**	32	–
Stores consolidated/closed	**(8)**	**–**	(10)	(3)
Store count – end of year	**1,257**	**63**	1,241	63
Stores relocated	**32**	**1**	43	–
Stores expanded	**25**	**–**	27	–
Stores remodeled	**49**	**–**	5	–

Cash Flows Used in Financing Activities

Cash flows used in financing activities were $570 million in 2011, as cash outflows of $585 million were partially offset by cash inflows of $15 million. Cash outflows were comprised of $207 million to settle share repurchases, a $37 million decrease in bank indebtedness, a $128 million decrease in the amount of commercial paper issued and outstanding by the Company under its commercial paper program, $3 million of financing costs and obligations, and $211 million for the payment of dividends. Cash inflows were principally comprised of a $14 million increase in the amount of Associate investment. (See discussion on "Financing Activities" in this Management's Discussion and Analysis.)

In 2011, the net result of the Company's operating, investing and financing activities was an increase in cash balances of $54 million.

Future Liquidity

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

Contractual Obligations

The following table presents a summary of the maturity periods of the Company's long-term contractual obligations at the end of 2011.

($000s)	Payments Due During 2012	Payments Due in 2013 and 2014	Payments Due in 2015 and 2016	Payments Due After 2016	Obligations with No Fixed Maturity	Total
Long-term debt	$ 250,000	$ 700,000	$ 152	$ –	$ –	$ 950,152
Retirement benefit obligations[1]	–	–	–	–	38,104	38,104
Operating leases[2]	403,422	800,655	748,966	2,331,772	–	4,284,815
Financing leases[3]	2,899	6,712	8,494	102,705	–	120,810
Other	15,999	9,497	3,447	11,782	5,459	46,184
Total	$ 672,320	$ 1,516,864	$ 761,059	$ 2,446,259	$ 43,563	$ 5,440,065

(1) See discussion on "Retirement Benefit Obligations" under "Critical Accounting Estimates" in this Management's Discussion and Analysis and note 21 to the consolidated financial statements of the Company.

(2) Represents the minimum lease payments under long-term leases for store locations and office space as at December 31, 2011. (See note 28 to the consolidated financial statements of the Company.)

(3) Represents the minimum lease payments under financing leases for store locations as at December 31, 2011. (See note 28 to the consolidated financial statements of the Company.)

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

The Company has entered into an agreement with a third party to provide distribution services to the Company's store network. Under the terms of the distribution services agreement, which expires on December 31, 2012, the third party will charge the Company specified costs incurred to provide the distribution services, plus an annual management fee. In addition, the Company has entered into agreements with several third parties to provide certain information services activities to the Company. The Company has committed to average annual payments of approximately $6 million over the next five years in respect of these agreements. (See note 28 to the consolidated financial statements of the Company.)

Selected Annual Information

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

($000s, except per share data)	**2011 (52 weeks)**	2010 (52 weeks)	2009[(1)] (52 weeks)
Sales	**$ 10,458,652**	$ 10,192,714	$ 9,985,600
Net earnings	**$ 613,934**	$ 591,851	$ 584,908
Per common share			
– Basic net earnings	**$ 2.84**	$ 2.72	$ 2.69
– Diluted net earnings	**$ 2.84**	$ 2.72	$ 2.69
Dividends declared per common share	**$ 1.00**	$ 0.90	$ 0.86
Total assets	**$ 7,300,310**	$ 7,044,197	$ 6,852,454
Total long-term liabilities	**$ 1,256,242**	$ 1,413,995	$ 1,336,907

(1) The selected information that is presented for fiscal 2009 does not reflect the impact of the adoption of IFRS.

Sales

2011 Compared to 2010

Sales in 2011 were $10.459 billion compared to $10.193 billion in 2010, an increase of $266 million or 2.6%. Sales increased in all regions of the country, with the Company experiencing moderate sales growth in pharmacy and strong results in the front of the store. The Company's capital investment and store development program, which resulted in a year-over-year increase in selling space of 3.8%, continues to have a positive impact on sales growth. On a same-store basis, sales increased 1.9% in 2011.

Prescription sales were $4.997 billion in 2011 compared to $4.959 billion in 2010, an increase of $38 million or 0.8%, as strong growth in the number of prescriptions filled was largely offset by a further decline in average prescription value. On a same-store basis, prescription sales increased 0.6% during the year. During 2011, prescription counts increased 3.8% on both a total and a same-store basis over the prior year. A reduction in generic prescription reimbursement rates, the result of recently implemented and ongoing drug system reform initiatives in a number of provinces, combined with greater generic prescription utilization rates, had a negative impact on sales dollar growth in pharmacy. Generic molecules represented 56.9% of prescriptions dispensed in 2011 compared to 54.5% of prescriptions dispensed in the prior year. In 2011, prescription sales accounted for 47.8% of the Company's sales mix compared to 48.7% in the prior year.

Front store sales were $5.462 billion in 2011 compared to $5.234 billion in 2010, an increase of $228 million or 4.4%, with the Company posting sales gains in all core categories, led by cosmetics, food and confection, and other convenience categories. On a same-store basis, front store sales increased 3.2% in 2011. In addition to square footage growth, further investments in marketing, pricing and promotional activities throughout the year drove sales and market share gains in the front of the store.

2010 Compared to 2009

Prior to the adoption of IFRS, under previous Canadian GAAP, when points were earned by a Shoppers Optimum® loyalty card program member the Company recorded an expense and established a liability for future redemptions by multiplying the number of points issued by the estimated cost per point. When points were redeemed, the actual cost of redemptions was charged against the liability account. Points were valued at cost.

Under IFRS, when points are earned by a Shoppers Optimum® loyalty card program member, the Company defers a portion of the revenue associated with the sales transaction equivalent to the fair value of the points issued to the customer (retail value of the points). When points are redeemed, the redemption value of the award is charged against the deferred revenue balance and the revenue is recognized. Points are valued at fair value.

Although not directly comparable to the prior year, sales were $10.193 billion in 2010. Adjusting for the impact of the adoption of IFRS, sales were $10.376 billion in 2010 compared to $9.986 billion in 2009, an increase of $390 million or 3.9%. During 2010, the Company continued to experience sales growth in all regions of the country, led by strong gains in Western Canada and Québec. The Company's capital investment and store development program, which resulted in a year-over-year increase in selling space of 6.4%, had a positive impact on sales growth. On a same-store basis, and adjusting for the impact of the adoption of IFRS, sales increased 2.1% in 2010.

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

While also not directly comparable to the prior year, front store sales were $5.234 billion in 2010. Adjusting for the impact of the adoption of IFRS, front store sales were $5.417 billion in 2010 compared to $5.162 billion in 2009, an increase of $255 million or 4.9%, with the Company posting sales gains in all core categories, led by food and confection, cosmetics and beverage. Sales gains in OTC medications were also strong, a particularly impressive result given that this category also performed well in 2009 during which time sales benefitted from customer and patient awareness of the H1N1 virus. On a same-store basis and adjusting for the impact of IFRS, front store sales increased 2.5% in 2010. In addition to square footage growth, the Company's investments in marketing, pricing and promotional activities drove sales and market share gains in the front of the store.

Net Earnings

2011 Compared to 2010

Net earnings in 2011 were $614 million compared to $592 million in 2010, an increase of $22 million or 3.7%. On a fully diluted basis, net earnings per share were $2.84 in 2011 compared to $2.72 in 2010, an increase of 4.4%. Net earnings for 2011 are inclusive of a gain on disposal of $3 million (pre-tax) in respect of a sale-leaseback transaction involving certain of the Company's properties. Excluding the impact of this gain, adjusted net earnings for 2011 were $611 million or $2.82 per share compared to adjusted net earnings of $596 million or $2.74 per share in 2010. Adjusted net earnings for 2010 exclude the impact of a charge of $10 million (pre-tax) to settle a long-standing legal dispute related to a commercial arrangement with one of the Company's ancillary businesses, a gain on disposal of $12 million (pre-tax) in respect of a sale-leaseback transaction involving certain of the Company's retail properties and an asset impairment charge under IFRS of $7 million (pre-tax) related to certain of the Company's store assets. During 2011, strong performance in the front of the store, which was supported by increased investments in pricing and promotional activities, was partially offset by additional downward pressure on sales and margins in the dispensary as a result of drug system reform initiatives implemented in a number of provinces. These results also reflect the benefits from improved purchasing synergies, along with cost reduction, productivity and efficiency initiatives in comparable stores, which served to partially offset higher operating expenses at store level associated with the Company's network growth and expansion initiatives, and increased Associate earnings. Net earnings growth in 2011 also benefitted from a reduction in the Company's effective income tax rate, partially offset by an increase in financing expenses. In addition to the earnings factors noted above, the cumulative impact of the Company's share repurchase program had a modestly positive impact on growth in earnings per share as there were 0.5% fewer fully diluted shares outstanding in 2011 compared to 2010.

2010 Compared to 2009

Although not directly comparable, net earnings in 2010, inclusive of the aforementioned legal settlement charge of $10 million (pre-tax), the gain on disposal of $12 million (pre-tax) and the asset impairment charge under IFRS of $7 million (pre-tax), were $592 million or $2.72 per diluted share. Excluding the impact of these items, the Company's adjusted net earnings were $596 million in 2010 compared to net earnings of $585 million in 2009, an increase of $11 million or 2.0%. On a diluted basis, adjusted net earnings per share were $2.74 in 2010 compared to net earnings per share of $2.69 in 2009. During 2010, the Company continued to deliver top-line growth, improved purchasing synergies and further gains in productivity and efficiency, the benefits of which were largely offset by increased amortization and higher operating expenses at store-level associated with the Company's network growth and expansion initiatives. Net earnings growth in 2010 also benefitted from a modest reduction in interest expense and from a decline in the Company's effective income tax rate.

Dividends Declared per Common Share

On February 10, 2011, the Company announced that its Board of Directors had declared a dividend of 25.0 cents per common share, payable April 15, 2011 to shareholders of record as of the close of business on March 31, 2011. This represented an increase in the amount of the Company's quarterly dividend payments of 11.1%, resulting in an annualized dividend payment of $1.00 per common share. Subject to financial results, capital requirements, available cash flow and any other factors that the Board of Directors may consider relevant, it is the intention of the Board of Directors to declare a comparable quarterly dividend on an ongoing basis.

The following table provides a summary of dividends declared by the Company in 2011 and 2010:

Declaration Date	Record Date	Payment Date	Dividend per Share
February 10, 2011	March 31, 2011	April 15, 2011	$ 0.25
April 27, 2011	June 30, 2011	July 15, 2011	$ 0.25
July 21, 2011	September 30, 2011	October 14, 2011	$ 0.25
November 9, 2011	December 30, 2011	January 13, 2012	$ 0.25
February 11, 2010	March 31, 2010	April 15, 2010	$ 0.225
April 28, 2010	June 30, 2010	July 15, 2010	$ 0.225
July 22, 2010	September 30, 2010	October 15, 2010	$ 0.225
November 10, 2010	December 31, 2010	January 14, 2011	$ 0.225

Total Assets

2011 Compared to 2010

Total assets were $7.300 billion at the end of 2011 compared to $7.044 billion at the end of 2010, an increase of $256 million or 3.6%. Higher current asset balances of cash, accounts receivable and inventory, partially offset by reductions in income taxes recoverable and prepaid expenses and deposits, accounted for $153 million of this increase. Growth in accounts receivable and inventory was tied largely to store network expansion and increased sales activity. The decrease in prepaid expenses and deposits can be largely attributed to a calendar shift that affected the timing of year end, resulting in a year-over-year reduction in the amount of prepaid rent. In 2011, net property and equipment, and investment property balances increased by $94 million or 5.6% over the prior year, reflecting the Company's continued investment in its store network and supporting infrastructure. (See note 15 to the consolidated financial statements of the Company.) Combined, the net balances of goodwill and intangible assets accounted for an additional $16 million of the increase in total assets in 2011, driven largely by software development costs, net of amortization, and a small amount related to acquisitions of drug stores and prescription files. (See notes 13, 16 and 17 to the consolidated financial statements of the Company.)

2010 Compared to 2009

Under IFRS, the Company identified a number of balance sheet presentation changes that had no retained earnings impact. These presentation changes included the reclassification of future income tax assets from current to non-current deferred tax assets and the separate identification on the balance sheet of investment properties (from property and equipment).

Although not directly comparable to the prior year, total assets were $7.044 billion at the end of 2010. Adjusting for the impact of the adoption of IFRS, total assets were $7.122 billion at the end of 2010 compared to $6.852 billion at the end of 2009, an increase of $270 million or 3.9%. Higher current asset balances, primarily cash, inventory and income taxes recoverable, partially offset by a reduction in accounts receivable, accounted for $94 million of this increase. Growth in inventory was tied largely to the continued expansion of the store network and increased sales activity. Accounts receivable declined as a result of timing of collections and a reduction in generic prescription reimbursement rates. In 2010, net property and equipment, and investment property balances increased by $144 million or 9.2% over the prior year, reflecting the Company's continued investment in its store network and supporting infrastructure. (See note 15 to the consolidated financial statements of the Company.) Combined, the net balances of goodwill and intangible assets accounted for an additional $25 million of the increase in total assets in 2010, driven by software development costs, net of amortization, along with the acquisition of drug stores and prescription files. (See notes 13, 16 and 17 to the consolidated financial statements of the Company.)

Total Long-term Liabilities

2011 Compared to 2010

Total long-term liabilities were $1.256 billion at the end of 2011 compared to $1.414 billion at the end of 2010, a decrease of $158 million or 11.2%. This decrease can be largely attributed to the reclassification of $250 million of medium-term notes due in January of 2012 from long-term debt to current portion of long-term debt, partially offset by a $78 million increase in other long-term liabilities and a $12 million increase in deferred tax liabilities. The increase in other long-term liabilities was driven primarily by the addition of financing lease obligations related to the Company's store network growth and expansion initiatives, along with an increase in the Company's retirement benefit obligations. (See note 23 to the consolidated financial statements of the Company.)

2010 Compared to 2009

Although not directly comparable to the prior year, total long-term liabilities were $1.414 billion at the end of 2010. Adjusting for the impact of the adoption of IFRS, total long-term liabilities were $1.392 billion at the end of 2010 compared to $1.337 billion at the end of 2009, an increase of $55 million or 4.1%. This increase can be primarily attributed to a $52 million increase in other long-term liabilities, driven largely by an increase in deferred rent obligations at store level as the Company continued to invest in its store network, along with capital lease obligations and related deferred gains tied to sale-leaseback transactions completed during the year. (See note 23 to the consolidated financial statements of the Company.)

Quarterly Information

Reporting Cycle

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

Summary of Quarterly Results

The following table provides a summary of certain selected consolidated financial information for the Company for each of the eight most recently completed fiscal quarters. This information has been prepared in accordance with International Financial Reporting Standards.

($000s, except per share data – unaudited)	Fourth Quarter 2011 (12 Weeks)	Fourth Quarter 2010 (12 Weeks)	Third Quarter 2011 (16 Weeks)	Third Quarter 2010 (16 Weeks)	Second Quarter 2011 (12 Weeks)	Second Quarter 2010 (12 Weeks)	First Quarter 2011 (12 Weeks)	First Quarter 2010 (12 Weeks)
Sales	**$2,606,896**	$2,499,965	**$3,110,590**	$3,047,429	**$2,394,145**	$2,360,887	**$2,347,021**	$2,284,433
Net earnings	**$ 176,019**	$ 168,908	**$ 172,449**	$ 154,724	**$ 147,925**	$ 145,967	**$ 117,541**	$ 122,252
Per common share								
– Basic net earnings	**$ 0.82**	$ 0.78	**$ 0.80**	$ 0.71	**$ 0.68**	$ 0.67	**$ 0.54**	$ 0.56
– Diluted net earnings	**$ 0.82**	$ 0.78	**$ 0.80**	$ 0.71	**$ 0.68**	$ 0.67	**$ 0.54**	$ 0.56

The Company experienced growth in sales in each of the four most recent quarters compared to the same quarters of the prior year.

Net earnings decreased in the first quarter of 2011 compared to the same quarter of 2010, due in part to the impact of drug system reform initiatives implemented in a number of provinces which negatively impacted pharmacy reimbursement and margin rates. Net earnings in the first quarter of 2010 also included a gain on disposal of $12 million (pre-tax) in respect of a sale-leaseback transaction involving certain of the Company's retail properties. Net earnings increased in the second quarter of 2011 compared to the same quarter of 2010, as continued strong performance in the front of the store served to partially mitigate further downward pressure on sales and margin dollars in the dispensary, and the Company realized benefits from cost reduction initiatives and further gains in productivity and efficiency in identical stores. Net earnings increased in the third quarter of 2011 compared to the same quarter of 2010, reflecting solid performance in the front of the store, partially offset by continued downward pressure on sales and margin dollars in the dispensary. As well, the Company continued to benefit from cost reduction, productivity and efficiency initiatives in comparable stores. Net earnings for the third quarter of 2011 also included a gain on disposal of $3 million (pre-tax) in respect of a sale-leaseback transaction involving certain of the Company's retail properties, while net earnings for the third quarter of 2010 included a charge of $10 million (pre-tax) to settle a long-standing legal dispute related to a commercial arrangement with one of the Company's ancillary businesses. Net earnings increased in the fourth quarter of 2011 compared to the same quarter of the prior year as strong performance in the front of the store, which was supported by increased investments in pricing and promotional activities, was partially offset by additional downward pressure on sales and margins in the dispensary. Net earnings for the fourth quarter of 2010 also included an asset impairment charge under IFRS of $7 million (pre-tax) related to certain of the Company's store assets.

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

Results of Operations – Fourth Quarter of Fiscal 2011

The Company released its unaudited financial statements and the notes thereto for the fourth quarter and fiscal year ended December 31, 2011 on February 9, 2012. This information can be found on the Canadian Securities Administrators' website at www.sedar.com.

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

($000s, except per share data – unaudited)	Fourth Quarter Ended December 31, 2011 (12 weeks)	January 1, 2011[1] (12 weeks)
Sales	**$ 2,606,896**	$ 2,499,965
Cost of goods sold	**1,571,837**	1,501,359
Gross profit	**1,035,059**	998,606
Operating and administrative expenses	**779,070**	746,993
Operating income	**255,989**	251,613
Finance expenses	**14,867**	13,700
Earnings before income taxes	**241,122**	237,913
Income taxes	**65,103**	69,005
Net earnings	**$ 176,019**	$ 168,908
Net earnings per common share		
– Basic	**$ 0.82**	$ 0.78
– Diluted	**$ 0.82**	$ 0.78
EBITDA Reconciliation		
Net earnings	**$ 176,019**	$ 168,908
Add the following:		
– Income taxes	**65,103**	69,005
– Finance expenses	**14,867**	13,700
Operating income	**255,989**	251,613
Add the following:		
– Depreciation and amortization expense	**71,405**	75,246
EBITDA	**$ 327,394**	$ 326,859

(1) In preparing its 2010 comparative information, the Company has adjusted amounts reported previously in financial statements prepared in accordance with previous Canadian GAAP. (See note 30 to the consolidated financial statements of the Company.)

Sales

Sales in the fourth quarter of 2011 were $2.607 billion compared to $2.500 billion in the same period last year, an increase of $107 million or 4.3%, driven by moderate sales growth in pharmacy and strong results in the front of the store. The Company continued to experience sales growth in all regions of the country, led by gains in Western Canada. On a same-store basis, sales increased 3.4% during the fourth quarter of 2011.

Prescription sales were $1.177 billion in the fourth quarter of 2011 compared to $1.146 billion in the same period last year, an increase of $31 million or 2.8%. Growth in the number of prescriptions filled remained strong, however volume growth continues to be offset somewhat by a reduction in average prescription value. On a same-store basis, prescription sales increased 2.3% during the fourth quarter. During the fourth quarter of 2011, total prescription counts increased 3.9% compared to the same period last year and were up 3.8% on a same-store basis. The decrease in average prescription value can be attributed to a reduction in generic prescription reimbursement rates, the result of recently implemented and ongoing drug system reform initiatives in certain jurisdictions of Canada, combined with increasing generic prescription utilization rates. Generic molecules represented 57.1% of prescriptions dispensed in the fourth quarter of 2011 compared to 55.7% of prescriptions dispensed in the same period last year. In the fourth quarter of 2011, prescription sales accounted for 45.2% of the Company's sales mix compared to 45.8% of the Company's sales mix in the same quarter of last year.

Front store sales were $1.430 billion in the fourth quarter of 2011 compared to $1.354 billion in the same period last year, an increase of $76 million or 5.5%, with the Company experiencing particularly strong sales gains in the beauty, confection and convenient food categories. The Company's store network development program, which resulted in a 3.8% increase in selling space compared to a year ago, continues to have a positive impact on sales growth, particularly in the front of the store. Front store sales growth was also aided by effective marketing campaigns and impactful promotions, strong seasonal programs and solid execution at store-level. On a same-store basis, front store sales increased 4.4% during the fourth quarter of 2011.

Cost of Goods Sold

Cost of goods sold was $1.572 billion in the fourth quarter of 2011 compared to $1.501 billion in the same period last year, an increase of $71 million or 4.7%. Expressed as a percentage of sales, cost of goods sold increased by 24 basis points in the fourth quarter of 2011 versus the same period last year. These results reflect continued investments in pricing and promotional activities in the front of the store, along with further downward pressure on margins in the dispensary as a result of drug system reform initiatives implemented in a number of provinces.

Operating and Administrative Expenses

Operating and administrative expenses, excluding depreciation and amortization expense, were $708 million in the fourth quarter of 2011 compared to $672 million in the same period last year, an increase of $36 million or 5.3%. This increase can be largely attributed to higher operating expenses at store level associated with continued network growth and expansion initiatives, principally occupancy, wages and benefits, along with increased Associate earnings, partially offset by cost reduction, productivity and efficiency initiatives in comparable stores. Expressed as a percentage of sales, operating and administrative expenses, excluding depreciation and amortization expense, increased by 28 basis points in the fourth quarter of 2011 versus the same period last year, an increase that also reflects, in part, the impact of top-line deflation stemming from the above referenced drug system reform initiatives and greater generic prescription utilization.

Depreciation and amortization expense was $71 million in the fourth quarter of 2011 compared to $75 million in the same period last year, with last year's amount inclusive of an asset impairment charge under IFRS of $7 million (pre-tax) related to certain of the Company's stores assets. Excluding the impact of this charge from the comparative prior year period, depreciation and amortization expense increased by $3 million or 5.4% during the fourth quarter of 2011. Expressed as a percentage of sales, depreciation and amortization expense increased by three basis points in the fourth quarter of 2011 when compared to the adjusted depreciation and amortization expense in the same period of last year.

Operating Income

Operating income was $256 million in the fourth quarter of 2011 compared to $252 million in the same period last year. Excluding the impact of last year's asset impairment charge under IFRS of $7 million (pre-tax) referred to above, year-over-year operating income decreased by $3 million or 1.2% in the fourth quarter of 2011. As described above, strong performance in the front of the store was partially offset by continued investments in pricing and promotional activities. In the dispensary, further downward pressure on sales and margins, the result of drug system reform initiatives implemented in a number of provinces, negatively impacted operating results in the fourth quarter of 2011. These results also reflect the benefits from cost reduction, productivity and efficiency initiatives in comparable stores, which served to partially offset higher operating expenses at store level associated with continued network growth and expansion, and increased Associate earnings. Fourth quarter operating margin (operating income divided by sales) declined by 54 basis points to 9.82% compared to an adjusted operating margin of 10.36% in the fourth quarter of 2010. Adjusted operating margin for the fourth quarter of 2010 excludes the impact of the aforementioned asset impairment charge under IFRS. The Company's EBITDA margin (EBITDA divided by sales) was 12.56% in the fourth quarter of 2011 compared to the EBITDA margin of 13.07% posted in the fourth quarter of last year.

Finance Expenses

Finance expenses were $15 million in the fourth quarter of 2011 compared to $14 million in the same period last year, an increase of $1 million or 8.5%. Interest expense increased as a result of higher standby fees associated with the Company's revolving term bank credit facility which was refinanced in the fourth quarter of 2010, interest costs associated with financing leases and a decrease in the amount of capitalized interest due to the completion of the Cornwall distribution centre in the fourth quarter of last year. These higher costs were partially offset by savings resulting from the Company having a lower average amount of consolidated net debt outstanding during the fourth quarter of 2011 and from the maturity, in the fourth quarter of 2010, of an interest rate derivative agreement that converted an aggregate notional principal amount of $50 million of floating rate debt into fixed rate debt.

Income Taxes

The Company's effective income tax rate in the fourth quarter of 2011 was 27.0% compared to a rate of 29.0% in the same period of last year. This decrease in the effective income tax rate can be attributed to a reduction in statutory rates.

Net Earnings

Fourth quarter net earnings were $176 million compared to net earnings of $169 million in the fourth quarter of 2010, an increase of 4.2%. On a fully diluted basis, net earnings per share were 82 cents in the fourth quarter of 2011 compared to 78 cents per share in the same period last year, an increase of 5.1%. Excluding the impact of the aforementioned asset impairment charge under IFRS of $7 million (pre-tax) from the prior year's results, the Company's adjusted net earnings for the fourth quarter of 2010 were $175 million or 80 cents per fully diluted share. In addition to the earnings factors noted above, the cumulative impact of the Company's share repurchase program had a positive impact on growth in earnings per share as there were 1.5% fewer fully diluted shares outstanding in the fourth quarter of 2011 compared to the same period last year.

Cash Flows

Cash flows from operating activities were $369 million in the fourth quarter of 2011 compared to $243 million in the same period last year, an increase of $126 million or 51.7%. This increase is primarily the result of a reduction in the amount invested in non-cash working capital balances compared to the prior year, combined with a shift in the timing of income taxes payable. The reduction in the amount invested in non-cash working capital balances can be largely attributed to an increase in accounts payable and accrued liabilities and a decrease in prepaid expenses, offset in part by an increase in accounts receivable.

Cash flows used in investing activities were $103 million in the fourth quarter of 2011 compared to $118 million in the same period last year, a decrease of $15 million or 12.3%. Of these totals, purchases of property and equipment, net of proceeds of any dispositions, amounted to $84 million in the fourth quarter of 2011 compared to $94 million in the fourth quarter of 2010, as the Company continues to invest in its store network and supporting infrastructure, albeit at a slower rate than in prior years. Included in net purchases of property and equipment in the fourth quarter of 2011 were proceeds of $16 million resulting from dispositions, all of which related to a sale-leaseback transaction involving certain of the Company's properties, compared to $10 million in the prior year. In the fourth quarter of 2011, the Company invested an additional $4 million in business acquisitions and $17 million in the purchase and development of intangible assets. In the fourth quarter of 2010, while the Company was not active with respect to the acquisition of drug stores and prescription files, it did invest $22 million in the purchase and development of intangible assets. During the fourth quarter of 2011, the Company opened or acquired 10 new drug stores, seven of which were relocations, consolidated or closed three smaller drug stores and completed six major drug store expansions. In addition to this activity, eight existing drug stores were remodelled, converting them to smaller prototype formats.

Cash flows used in financing activities were $224 million in the fourth quarter of 2011, as cash outflows of $238 million were partially offset by cash inflows of $14 million. Cash outflows were comprised of $115 million to settle share repurchases, a $69 million decrease in bank indebtedness, $1 million of financing costs and obligations, and $54 million for the payment of dividends. Cash inflows were principally comprised of a $14 million increase in the amount of Associate investment.

In the fourth quarter of 2011, the net result of the Company's operating, investing and financing activities was an increase in cash balances of $42 million.

Critical Accounting Estimates

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

The Company's significant accounting policies are discussed in note 3 to the consolidated financial statements of the Company. The following accounting policies incorporate a higher degree of judgement and/or complexity and, accordingly, are considered to be critical accounting policies.

Inventory

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

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

Shoppers Optimum®

The Shoppers Optimum® loyalty card program (the "Program") allows members to earn points on their purchases in Shoppers Drug Mart®, Pharmaprix®, Shoppers Simply Pharmacy®, Pharmaprix Simplement Santé®, Shoppers Home Health Care® and Murale™ stores at a rate of 10 points for each dollar spent on eligible products and services, plus any applicable bonus points. Members can then redeem points, in accordance with the Program rewards schedule or other offers, for qualifying merchandise at the time of a future purchase transaction. When points are earned by Program members, the Company defers revenue equal to the fair value of the awards. The Program's deferred revenue is recognized within accounts payable and accrued liabilities in the Company's consolidated balance sheets. When awards are redeemed by Program members, the redemption value of the awards is charged against the deferred revenue balance and recognized as revenue.

The estimated fair value per point is determined based on the expected weighted average redemption levels for future redemptions based on the program reward schedule, including special redemption events. The trends in redemption rates (points redeemed as a percentage of points issued) are reviewed on an ongoing basis and the estimated fair value per point is adjusted based upon expected future activity. To the extent that estimates differ from actual experience, the Program costs could be higher or lower.

Retirement Benefit Obligations

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

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

	2011			2010		
	Registered Defined Benefit Pension Plans	**Non-registered Defined Benefit Pension Plan**	**Other Post-employment Benefit Plans**	Registered Defined Benefit Pension Plans	Non-registered Defined Benefit Pension Plan	Other Post-employment Benefit Plans
Accrued benefit obligation, end of period						
Discount rate	**4.25%**	**4.25%**	**4.25%**	5.25%	5.00%	5.00%
Compensation increase	**4.00%**	**4.00%**	**4.00%**	4.00%	4.00%	4.00%
Benefit expense for the period						
Discount rate	**5.25%**	**5.00%**	**5.00%**	6.00%	5.75%	5.25%
Expected return on assets	**7.50%**	**3.75%**	**N/A**	7.50%	3.75%	N/A
Compensation increase	**4.00%**	**4.00%**	**4.00%**	4.00%	4.00%	4.00%

The discount rate is based on current market interest rates at the end of the Company's fiscal year, assuming a portfolio of corporate AA rated bonds with terms to maturity that, on average, match the terms of the accrued retirement benefit obligations. A 1% increase in the assumed discount rate would decrease the amount of the Company's accrued retirement benefit obligations and retirement benefit expense in respect of its registered and non-registered defined benefit plans by $23 million and $2 million, respectively. Conversely, a 1% decrease in the assumed discount rate would increase the amount of the Company's accrued retirement benefit obligations and retirement benefit expense in respect of its registered and non-registered defined benefit plans by $27 million and $2 million, respectively.

The expected long-term rate of return on plan assets is based on the asset mix of invested assets and historical returns. A 1% increase in the assumed long-term rate of return on plan assets would decrease the amount of the Company's retirement benefit expense in respect of its registered and non-registered defined benefit plans by $1 million. Conversely, a 1% decrease in the assumed long-term rate of return on plan assets would increase the amount of the Company's retirement benefit expense in respect of its registered and non-registered defined benefit plans by $1 million. In calculating the retirement benefit expense for its registered and non-registered defined benefit plans for 2011, the Company has assumed a long-term rate of return on plan assets of 7.5%.

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

The expected inflation rate of health care costs is based on historical trends and external data. The growth rate assumption used by the Company in determining its accrued retirement benefit obligations and retirement benefit expense in respect of its other post-employment benefit plans was 8.0% in 2011 compared to 8.0% in 2010. This is the assumed growth rate for 2012, after which the trend rate is reduced by 0.5% in each of the following years until reaching the ultimate trend rate of 5.0% for 2018 and later years. A 1% change in the assumed growth rate of health care costs would not have a significant impact on the Company's accrued retirement benefit obligations and retirement benefit expense in respect of its other post-employment benefit plans.

These assumptions may change in the future and any changes could have a material impact on the accrued retirement benefit plan obligations of the Company and the cost of these plans, which is reflected in the Company's consolidated statements of earnings. However, the magnitude of any immediate impact on net earnings of the Company is mitigated by the fact that, in accordance with Canadian GAAP, the Company has elected to recognize actuarial gains and losses in other comprehensive income in the Company's statement of comprehensive income.

At December 31, 2011, the Company has recognized a liability under its registered and non-registered defined benefit pension plans and other post-employment benefit plans of $38 million, compared to a liability of $10 million at the end of the prior year. (See note 21 to the consolidated financial statements of the Company.)

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

Income and Other Taxes

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

Goodwill and Intangible Assets

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

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

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

Prescription files	7 to 12 years
Customer relationships	5 to 25 years
Computer software	3 to 10 years
Other	Lease term or 3 years

New Accounting Pronouncements

Transition to International Financial Reporting Standards

The Company has adopted International Financial Reporting Standards ("IFRS") for its 2011 fiscal year as required by the Accounting Standards Board of the Canadian Institute of Chartered Accountants.

The Company has provided a detailed explanation of the impacts of this transition in Note 30 of the Company's consolidated financial statements ("Note 30"). Note 30 includes reconciliations of the Company's balance sheet and shareholders' equity from previous Canadian GAAP to IFRS as at January 1, 2011 and January 3, 2010, and its fiscal 2010 net earnings and comprehensive income for the 52 weeks ended January 1, 2011. Explanations of the individual impacts of adopting IFRS identified in the reconciliations are also provided, as are the Company's elections under IFRS 1 "First-time Adoption of International Financial Reporting Standards".

Future Accounting Standards

Financial Instruments – Disclosures

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

Deferred Taxes – Recovery of Underlying Assets

The IASB has issued an amendment to IAS 12, "Income Taxes" (the "IAS 12 amendment"), that introduces an exception to the general measurement requirements of IAS 12 in respect of investment properties measured at fair value. The IAS 12 amendment is effective for annual periods beginning on or after January 1, 2012. The Company will apply the amendment at the beginning of its 2012 financial year and does not expect the implementation to have a significant impact on its results of operations, financial position and disclosures.

Financial Instruments

The IASB has issued a new standard, IFRS 9, "Financial Instruments" ("IFRS 9"), which will ultimately replace IAS 39, "Financial Instruments: Recognition and Measurement" ("IAS 39"). The replacement of IAS 39 is a multi-phase project with the objective of improving and simplifying the reporting for financial instruments and the issuance of IFRS 9 is part of the first phase of this project. IFRS 9 uses a single approach to determine whether a financial asset or liability is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. For financial assets, the approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. IFRS 9 requires a single impairment method to be used, replacing multiple impairment methods in IAS 39. For financial liabilities measured at fair value, fair value changes due to changes in an entity's credit risk are presented in other comprehensive income. IFRS 9 is effective for annual periods beginning on or after January 1, 2015 and must be applied retrospectively. The Company is assessing the impact of the new standard on its results of operations, financial position and disclosures.

Fair Value Measurement

The IASB has issued a new standard, IFRS 13, "Fair Value Measurement" ("IFRS 13"), which provides a standard definition of fair value, sets out a framework for measuring fair value and provides for specific disclosures about fair value measurements. IFRS 13 applies to all international financial reporting standards that require or permit fair value measurements or disclosures. IFRS 13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. IFRS 13 is effective for annual periods beginning on or after January 1, 2013 and must be applied retrospectively. The Company is assessing the impact of IFRS 13 on its results of operations, financial position and disclosures.

Consolidated Financial Statements

The IASB has issued a new standard, IFRS 10, "Consolidated Financial Statements" ("IFRS 10"), which establishes the principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. IFRS 10 establishes control as the basis for consolidation and defines the principle of control. An investor controls an investee if the investor has power over the investee, exposure or rights to variable returns from its involvement with the investee and the ability to use its power over the investee to affect the amount of the investor's returns. IFRS 10 was issued as part of the IASB's broader project on interests in all types of entities. This project also resulted in the issuance of the next four standards described below. IFRS 10 is effective for annual periods beginning on or after January 1, 2013 and must be applied retrospectively. The Company is assessing the impact of IFRS 10 on its results of operations, financial position and disclosures.

Joint Arrangements

The IASB has issued a new standard, IFRS 11, "Joint Arrangements" ("IFRS 11"), which establishes the principles for financial reporting by parties to a joint arrangement. IFRS 11 supersedes IAS 31, "Interests in Joint Ventures" and SIC 13, "Jointly Controlled Entities – Non-Monetary Contributions by Venturers". The standard defines a joint arrangement as an arrangement where two or more parties have joint control, with joint control being defined as the contractually agreed sharing of control where decisions about relevant activities require unanimous consent of the parties sharing control. The standard classifies joint arrangements as either joint operations or joint investments and the classification determines the accounting treatment. IFRS 11 is effective for annual periods beginning on or after January 1, 2013 and must be applied retrospectively. The Company is assessing the impact of IFRS 11 on its results of operations, financial position and disclosures.

Disclosure of Interests in Other Entities

The IASB has issued a new standard, IFRS 12, "Disclosure of Interests in Other Entities" ("IFRS 12"), which integrates and provides consistent disclosure requirements for all interests in other entities such as subsidiaries, joint arrangements, associates and unconsolidated structured entities. IFRS 12 is effective for annual periods beginning on or after January 1, 2013 and must be applied retrospectively. The Company is assessing the impact of IFRS 12 on its disclosures.

Separate Financial Statements

The IASB has issued a new standard, IAS 27, "Separate Financial Statements" ("IAS 27"), which contains the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate (non-consolidated) financial statements. IAS 27 is effective for annual periods beginning on or after January 1, 2013 and must be applied retrospectively. IAS 27 will not have an impact on the Company's consolidated results of operations, financial position and disclosures.

Investments in Associates and Joint Ventures

The IASB has issued a new standard, IAS 28, "Investments in Associates and Joint Ventures" ("IAS 28"), which prescribes the accounting for investments in associates and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures. IAS 28 is effective for annual periods beginning on or after January 1, 2013 and must be applied retrospectively. The Company is assessing the impact of IAS 28 on its results of operations, financial position and disclosures.

Presentation of Financial Statements – Other Comprehensive Income

The IASB issued an amendment to IAS 1, "Presentation of Financial Statements" ("IAS 1 amendment") to improve consistency and clarity of the presentation of items of other comprehensive income. A requirement has been added to present items in other comprehensive income grouped on the basis of whether they may be subsequently reclassified to earnings in order to more clearly show the effects the items of other comprehensive income may have on future earnings. The IAS 1 amendment is effective for annual periods beginning on or after July 1, 2012 and must be applied retrospectively. The Company is assessing the impact of the IAS 1 amendment on its presentation of other comprehensive income.

Post-Employment Benefits

The IASB has issued amendments to IAS 19, "Employee Benefits" ("IAS 19"), which eliminates the option to defer the recognition of actuarial gains and losses through the "corridor" approach, revises the presentation of changes in assets and liabilities arising from defined benefit plans and enhances the disclosures for defined benefit plans. IAS 19 is effective for annual periods beginning on or after January 1, 2013 and must be applied retrospectively. The Company is assessing the impact of IAS 19 on its results of operations, financial position and disclosures.

Risks and Risk Management

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

Industry and Regulatory

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

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

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

The majority of prescription drug sales are reimbursed or paid by third-party payers, such as governments, insurers or corporate employers. These third-party payers have pursued and continue to pursue measures to manage the costs of their drug plans. Some provincial jurisdictions have implemented legislation directed towards managing pharmacy service costs and controlling increasing drug costs incurred by public drug plans and private payers. In addition to legislative changes, other measures to control drug costs have been implemented by certain government payers, including restricting the number of interchangeable prescription drug products which are eligible for reimbursement under provincial drug plans or placing limitations on private label prescription drug products, which may impact pharmacy reimbursement levels and manufacturer allowances. Since the start of 2011, the following legislative changes or other regulatory initiatives, which are intended to lower overall costs incurred by public drug plans, have been implemented or announced in the following jurisdictions:

> ***British Columbia*** – On July 7, 2010, the British Columbia Ministry of Health Services, the British Columbia Pharmacy Association and the Canadian Association of Chain Drug Stores entered into a Pharmacy Services Agreement that lowered the cost of generic prescription drug products in the province. The pricing policy contained in the Pharmacy Services Agreement sets the current price of generic prescription drug products in the province at 40% of the price of the corresponding equivalent brand name drug and reduces this price to 35% of the price of the corresponding equivalent brand name drug on April 2, 2012. In addition, the Pharmacy Services Agreement provides that the 35% pricing that is to be applicable on April 2, 2012 is subject to renegotiation if the prevailing price for generic prescription drugs in the market varies from 35% of the price of the equivalent brand name drug.
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> On September 28, 2011, British Columbia's Health Minister stated that he had notified the pharmacy associations and the generic prescription drug manufacturers that the province would be reopening negotiations on generic prescription drug prices. The Health Minister stated that the Pharmacy Services Agreement was signed on the basis that over the life of the three-year agreement there would be savings of $170 million and that current projections were to only realize savings of $122 million, approximately $50 million less than the basis on which the agreement was signed. At that time,

the Health Minister indicated that unless those savings could be made up through renegotiation of the pricing policy for generic prescription drug products, the government would look at a legislated option.

Under the Pharmacy Services Agreement, the parties had sixty (60) days after the date of the issuance of the notice by the province in which to come to an agreement on the new pricing for generic prescription drug products. If the parties were unable to reach agreement, the Pharmacy Services Agreement could be terminated by either party on April 1, 2012. On February 29, 2012, the British Columbia Ministry of Health Services announced that it was terminating the Pharmacy Services Agreement effective April 1, 2012 and that through legislation, the Province will aim for a reduction in the price of generic prescription drug products to 25% of the price of the corresponding equivalent brand name drug by April 1, 2013.

Alberta – On February 13, 2012, the Alberta Ministry of Health and Wellness (the "Alberta Ministry") announced that, beginning on July 1, 2012, the price of generic prescription drug products would be reduced and as a result, the Alberta Ministry estimates that it will save approximately $85 million annually in the price they pay for generic drug product medications. In its announcement, the Alberta Ministry indicated that a new pharmacy compensation framework will be introduced on July 1, 2012, and as part of such framework, pharmacies in Alberta will be able to renew prescriptions for certain prescription drug products and receive reimbursement for such services from the Alberta Ministry. The Alberta Ministry estimates that approximately $20 million will be paid annually to pharmacists for such prescription renewal services. The Alberta Ministry also announced that, effective July 1, 2012, $5.3 million will be made available annually as part of a new three-year Remote Pharmacy Access Grant to help qualifying pharmacies in remote communities expand their services and adjust to the lower generic prescription drug product prices.

Saskatchewan – On May 4, 2011, the Saskatchewan government announced that it was implementing a plan to lower generic drug prices in Saskatchewan. As part of the plan, the price on most existing generic drug products was lowered to 45% of the equivalent brand name drug price by June 1, 2011 and will be lowered to 35% of the equivalent brand name drug price by April 1, 2012. As of April 1, 2011, prices for new multisource generic drugs are priced at 40% of the equivalent brand name drug price and will be lowered to 35% of the equivalent brand name drug price by April 1, 2012. As for generic drugs that have been procured under standing offer contracts, certain of those generic drugs will be transitioned out of standing offer contracts and will be priced at 35% of the equivalent brand name drug price. Generic drug pricing in Saskatchewan had been in the range of 50% to 70% of the equivalent brand name drug price. To recognize the impact of reduced generic prices on Saskatchewan pharmacies, the maximum dispensing fee was increased from $9.43 to $9.85 on May 1, 2011 and the dispensing fee will be further increased to $10.25 on April 1, 2012.

Manitoba – On October 25, 2011, the Manitoba Ministry of Health published amendments to the Manitoba Drug Benefits and Interchangeability Formulary (the "Manitoba Formulary") which, effective November 24, 2011, reduced the prices for a number of the generic drug products included on the Manitoba Formulary from between 59% and 63% to between 36% and 47% of the equivalent brand name drug price.

Ontario – On May 18, 2010, the Government of Ontario passed amendments to the Ontario Drug Benefit Act and the Drug Interchangeability and Dispensing Fee Act, and on June 7, 2010, filed amendments to Ontario Regulation 201/96 and Regulation 935 (collectively, the "Ontario Regulatory Amendments"). The Ontario Regulatory Amendments provide that a prescription drug product that falls under the definition of a "private label product" will not be designated as an interchangeable prescription drug product or as a listed drug product for the Ontario Drug Benefit Program. Designation as an interchangeable prescription drug product is generally necessary for market adoption of generic prescription drug products and designation as a listed drug product for the Ontario Drug Benefit Program is necessary for public reimbursement. The Company pursued a legal challenge to the validity of the prohibition under the current legislation. On February 3, 2011, the Ontario Divisional Court released its decision and found in favour of the Company and Katz Group Canada Inc. (the applicant in a parallel application) and declared the regulatory restrictions in respect of "private label products" to be invalid. The Ontario government appealed the Divisional Court's decision. In a decision released on December 23, 2011, the majority of the Court of Appeal of Ontario overturned the decision of the Ontario Divisional Court and restored the prohibition on private label generic drug products in the province of Ontario. The Company has filed an application for leave to appeal to the Supreme Court of Canada.

Nova Scotia – On July 1, 2011, Bill 17, An Act Respecting an Insured Prescription Drug Plan, including Fair Drug Pricing (the "Fair Drug Pricing Act") became law in Nova Scotia. The Fair Drug Pricing Act creates stand-alone legislation to oversee the public drug plans in Nova Scotia and allows the government to regulate the cost of generic drugs dispensed under the public drug plans. The Fair Drug Pricing Act also allows the government to regulate the activities of providers of pharmacy services in relation to any matters under the legislation and includes the ability to impose rules, terms, restrictions or conditions respecting rebates and professional allowances. The Fair Drug Pricing Regulations which also came into force on July 1, 2011, set a cap on the price of most generic drugs, both new and existing, at a percentage of the price of the equivalent brand name drug as set out below:

- July 1, 2011 – generic drugs were priced at 45% of the manufacturer's list price of the equivalent brand name drug as of April 11, 2011;
- January 1, 2012 – generic drugs were priced at 40% of the manufacturer's list price of the equivalent brand name drug as of April 11, 2011; and
- July 1, 2012 – generic drugs will be priced at 35% of the price of the equivalent brand name drug as of April 11, 2011 or as of the date that the notice of compliance is issued for the first product in a new category of interchangeable products.

Also, on July 1, 2011, under a three year agreement reached between the Nova Scotia Department of Health and Wellness and the Pharmacy Association of Nova Scotia, the maximum dispensing fees were raised from $10.62 to $10.73 and will be further increased at periodic intervals to reach $11.05 on April 1, 2013. In addition to the dispensing fee, beginning on September 1, 2011, a transition fee of $0.10 per prescription will be provided to assist pharmacy operators during the transition period. This transition fee will be increased at periodic intervals to reach $1.05 on April 1, 2013. The maximum permitted mark-up on generic drugs increased from 2% to 6% on August 1, 2011, subject to a maximum of $250 per prescription. The Nova Scotia government also introduced four new payments for services: advanced medication review (maximum special services fee of $150); basic medication review (maximum special services fee of $52.50); prescription adaptation (maximum special services fee of $14.00); and therapeutic substitution (maximum special services fee of $26.25).

Newfoundland and Labrador – On July 29, 2011, the Minister of Health and Community Services announced in a press release that the provincial government was looking to develop a generic drug pricing model to ensure that the people of Newfoundland and Labrador get the best price possible for prescriptions. The press release also indicated that professional allowances are being reviewed but that the government recognizes that in order for some pharmacies to remain viable, they will have to be provided with other sources of revenue to replace the professional allowances they are currently receiving. The press release indicates that increased dispensing fees are being considered as a possible other source of revenue.

On January 16, 2012, the Department of Health and Community Services announced that it is moving forward with the development of a new generic drug pricing policy for residents of the province. The model, through a phased-in approach, will set the price of generic drugs at 35% of the manufacturer's list price of the equivalent brand name drug once fully implemented on April 1, 2013. Under the phased in approach, all multisource generic drugs will be priced at 45% of the manufacturer's list price of the equivalent brand name drug in the period between April 1, 2012 and September 30, 2012 and will be reduced to 40% of the manufacturer's list price of the equivalent brand name drug in the period between October 1, 2012 and March 31, 2013. In recognition of the need to protect the viability of pharmacies, particularly smaller independent pharmacies operating in under-serviced areas, the new model also includes plans for reinvestment of a portion of the savings into community pharmacy.

New Brunswick – On July 20, 2011, the New Brunswick Department of Health issued a press release announcing that a consultation process for generic prescription drug products was being initiated. One of the main benefits that is being sought through the consultation process is to reform drug pricing to ensure that residents of New Brunswick pay prices for generic prescription drugs that are similar to those paid in the other provinces.

As set forth in the companion document referenced in the announcement, Fair Drug Prices for New Brunswickers (the "Companion Document"), the consultation process has two goals: (i) to lower generic prescription drug prices; and (ii) to support pharmacy services. The Companion Document identifies the options being considered by the Department of Health to lower generic prescription drug prices as setting generic prescription drug prices and addressing pharmacy rebates. With respect to the setting of generic prescription drug prices, the Companion Document identifies capping the price of generic prescription drugs based on a percentage of the price of the equivalent brand name drugs as an option. With respect to pharmacy rebates, the options referenced in the Companion Document are to: (i) require generic prescription drug manufacturers to report the rebates paid to pharmacy and/or to limit the amount of these rebates; and/or (ii) to consider regulating the rebates paid by generic prescription drug manufacturers to pharmacies.

For pharmacy services, the Companion Document provides that the options being considered are: (i) the implementation of funding for New Brunswick PharmaCheck, a medication review service for seniors who are taking more than a specific number of chronic medications and who are New Brunswick Prescription Drug Program beneficiaries; and/or (ii) funding new pharmacy services, for example smoking cessation counselling services.

The consultation occurred from July 20, 2011 until August 15, 2011. As part of the consultation process, representatives of the Department of Health met with pharmacists and pharmacy owners, drug manufacturers, wholesalers and private insurers to get their input on how to get better drug prices for residents of New Brunswick. In addition, residents, pharmacists, pharmacy owners and other key stakeholders were encouraged to submit a brief on how to lower generic prescription drug prices in New Brunswick. The information received as part of the consultation process is being compiled and analyzed by the Department of Health and a recommendation is being prepared for the government.

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

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

Economic and Financial Conditions

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

Competition

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

Ability to Manage Growth and Maintain Profitability

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

Ability to Attract and Retain Pharmacists

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

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

Reliance on Key Personnel and Succession Planning

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

Effective succession planning for senior management is essential to sustaining the growth and success of the Company. The Company implemented initiatives in 2011 to assist in succession planning and development, and has a succession plan in place for the key positions in the Company.

Reliance on Information Systems and Technology

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

Retirement Benefit Obligations

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

Third-party Service Providers

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

Real Estate

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

Seasonality

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

Merchandising and Inventory Management

Customers' preferences may change over time. Failure by the Company to effectively anticipate the demand for products offered may result in the Company having inventory that customers do not want, is not reflective of customers' tastes or habits, or is priced at a level customers are not willing to pay. Inability of the Company to respond to changing consumer preferences may result in excess inventory, inventory levels that are insufficient to meet demand or merchandise that may have to be sold at lower prices. The Company monitors the impact of customer trends and inventory turnover and obsolescence. However, despite these efforts, inappropriate inventory levels may negatively impact the Company's financial performance.

Alternative Arrangements for Sourcing Generic Drug Products

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

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

Environmental Compliance

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

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

Ethical Business Conduct

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

Property and Casualty Exposures

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

Workplace Health and Safety

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

Legal, Tax and Accounting

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

Compliance with Privacy Laws

In Canada, the *Personal Information Protection and Electronic Documents Act* ("PIPEDA") was passed into law by the federal government effective as of January 1, 2001. Currently, this law applies to all organizations that collect, use or disclose personal information in the course of commercial activities, except to the extent that provincial privacy legislation has been enacted and declared substantially similar to the federal legislation. To date, the provinces of Québec, British Columbia and Alberta have enacted substantially similar private sector privacy legislation. In addition, the provinces of Ontario and New Brunswick enacted comprehensive personal health information protection legislation substantially similar to PIPEDA. Other provinces, namely Alberta, Saskatchewan, Manitoba and Newfoundland and Labrador, have also enacted personal health information protection legislation, but these laws have not yet been declared substantially similar to PIPEDA. As a result, both PIPEDA and these provincial statutes may apply to private sector organizations in relation to personal health information in these four provinces. The federal privacy legislation, PIPEDA, also regulates the inter-provincial collection, use and disclosure of personal information. Applicable Canadian privacy laws create certain obligations on organizations that handle personal information, including obligations relating to obtaining appropriate consent, limitations on use and disclosure of personal information and ensuring that appropriate security safeguards are in place. In the course of its business, the Company maintains records containing sensitive information identifying or relating to individual customers and employees. Although the Company has implemented systems to comply with applicable privacy laws in connection with the collection, use and disclosure of such personal information, if a significant failure of such systems were to occur, the Company's business and reputation could be adversely affected.

Associate-owned Store Network

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

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

Supplier and Brand Reputations

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

Product Quality and Product Safety

The Company is subject to potential liabilities and costs associated with defective products, product handling and product safety. These risks could expose the Company to product liability claims, negative publicity, damage to the Company's brands and potentially lead to product recalls. Although the Company has policies and controls in place to manage these risks, including insurance covering product liability, any of these events could negatively impact the Company's revenues and financial performance.

Business Continuity

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

Distribution and Supply Chain

The Company's distribution operations and supply chain are exposed to potential disruptions which could affect the cost and timely delivery of merchandise, and could result in shortages or interruptions in the availability or supply of merchandise. The Company manages this risk through effective supplier selection and the use of multiple logistics providers such that in the event of a disruption of service from one supplier, another supplier may be used. However, any disruption to these services could negatively affect the Company's sales and financial performance.

Litigation

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

Other

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

Risks Associated with Financial Instruments

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

Exposure to Interest Rate Fluctuations

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

The Company monitors market conditions and the impact of interest rate fluctuations on its fixed and floating rate debt instruments on an ongoing basis and may use interest rate derivatives to manage this exposure. In 2011, the Company did not use interest rate derivative agreements to manage its exposure to interest rate fluctuations. In 2010, the Company used an interest rate derivative agreement to convert an aggregate notional principal amount of $50 million of floating rate debt into fixed rate debt. The fixed rate payable by the Company under this agreement was 4.18% and contained reset terms of one month. This agreement matured in December 2010.

Furthermore, the Company may be exposed to losses should any counterparty to its derivative agreements fail to fulfill its obligations. The Company has sought to minimize counterparty risk by transacting with counterparties that are large, well-capitalized financial institutions. There was no unrecognized exposure as at December 31, 2011, as the Company was not party to any interest rate derivative agreements as at that date.

As at December 31, 2011, the Company had $167 million (2010 – $304 million) of unhedged floating rate debt. During the 52 weeks ended December 31, 2011, the Company's average outstanding unhedged floating rate debt was $386 million (2010 – $538 million). Had interest rates been higher or lower by 50 basis points during the period, net earnings would have decreased or increased, respectively, by approximately $1.4 million (2010 – $1.9 million) as a result of the Company's exposure to interest rate fluctuations on its unhedged floating rate debt.

Foreign Currency Exchange Risk

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

Credit Risk

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

Other Price Risk

The Company may use cash-settled equity forward agreements to limit its exposure to future changes in the market price of its common shares by virtue of its obligations under its long-term incentive plan ("LTIP") and restricted share units plan ("RSUP"). 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 December 31, 2011, the Company recognized a liability of $0.9 million, of which $0.8 million was presented in accounts payable and accrued liabilities and $0.1 million was presented in other long-term liabilities. Based on market values of the equity forward agreements in place at January 1, 2011, the Company recognized a liability of $2.3 million, of which $0.7 million was presented in accounts payable and accrued liabilities and $1.6 million was presented in other long-term liabilities. During the 52 week periods ended December 31, 2011 and January 1, 2011, the Company assessed that the percentage of the equity forward agreements in place related to unearned units under the LTIP and RSUP were effective hedges for its exposure to future changes in the market price of its common shares in respect of the unearned units. Market values were determined based on information received from the Company's counterparty to these equity forward agreements. The Company does not consider its exposure to other price risk to be material.

Capital Management and Liquidity Risk

The Company's primary objectives when managing its capital are to profitably grow its business while maintaining adequate financing flexibility to fund attractive new investment opportunities and other unanticipated requirements or opportunities that may arise. Profitable growth is defined as earnings growth commensurate with the additional capital being invested in the business in order that the Company earns an attractive rate of return on that capital. The primary investments undertaken by the Company to drive profitable growth include additions to the selling square footage of its store network via the construction of new, relocated and expanded stores, including related leasehold improvements and fixtures, renovations to existing stores, 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), financing leases and shareholders' equity, net of cash. The Company also gives consideration to its obligations under operating leases when assessing its total capitalization. The Company manages its capital structure with a view to maintaining investment grade credit ratings from two credit rating agencies. In order to maintain its desired capital structure, the Company may adjust the level of dividends paid to shareholders, issue additional equity, repurchase shares for cancellation or issue or repay indebtedness. The Company has certain debt covenants and is in compliance with those covenants.

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

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

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

The contractual maturities of the Company's financial liabilities as at December 31, 2011 are as follows:

($000s)	Payments Due in the Next 90 Days	Payments Due Between 90 Days and Less Than a Year	Payments Due Between 1 Year and Less Than 2 Years	Payments Due After 2 Years	Total
Bank indebtedness	$ 172,262	$ –	$ –	$ –	$ 172,262
Accounts payable and accrued liabilities	1,032,431	23,460	–	–	1,055,891
Derivatives	–	793	122	–	915
Dividends payable	53,119	–	–	–	53,119
Medium-term notes	262,488	28,943	474,202	256,487	1,022,120
Revolving bank credit facility	–	–	–	152	152
Other long-term liabilities	–	–	18,478	213,492	231,970
Total	$ 1,520,300	$ 53,196	$ 492,802	$ 470,131	$ 2,536,429

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

Disclosure Controls and Procedures

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

Management, with the participation of the CEO and CFO and members of the Company's Disclosure Committee, has evaluated the effectiveness of the Company's disclosure controls and procedures as of December 31, 2011 and has concluded that the disclosure controls and procedures are designed and operating effectively to provide reasonable assurance that information required to be disclosed relating to the Company, including its consolidated subsidiaries and Associate-owned store network, is recorded, processed, summarized and reported to the CEO and CFO by others within the Company, particularly during the period in which the annual filings were being prepared.

Internal Controls over Financial Reporting

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

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

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

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

Management, with the participation of the CEO and CFO, has evaluated the effectiveness of the Company’s internal controls over financial reporting as at December 31, 2011 and has concluded that internal controls over financial reporting are designed and operating effectively to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. Management’s assessment was based on the framework established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

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

Non-GAAP Financial Measures

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

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

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

EXHIBIT "D"

[Redacted]

PUBLIC

EXHIBIT "E"

[Redacted]