SHOPPERS DRUG MART CORPORATION

2012 SECOND QUARTER REPORT TO SHAREHOLDERS

SHOPPERS DRUG MART CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS

As at July 19, 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 unaudited condensed consolidated financial statements of the Company and the notes thereto for the 12 and 24 week periods ended June 16, 2012. The Company's unaudited condensed consolidated financial statements and the notes thereto have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and are reported in Canadian dollars. These financial statements do not contain all disclosures required for annual financial statements and, accordingly, should also be read in conjunction with the most recently prepared annual consolidated financial statements for the 52 week period ended December 31, 2011.

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, its capital expenditure plans, its dividend and shareholder distribution policies and the ability to execute on its future operating, investing and financing strategies.

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 including, without limitation, the sections entitled "Risks and Risk Management" and "Risks Associated with Financial Instruments" in this document and in the Company's Management's Discussion and Analysis for the 52 week period ended December 31, 2011 and for the 12 week period ended March 24, 2012. The forward-looking information and statements contained in this discussion of the consolidated financial condition and results of operations of the Company represent the Company's views only as of the date hereof. Forward-looking information and statements contained in this 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 June 16, 2012, there were 1,215 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 56 medical clinic pharmacies operating under the name Shoppers Simply Pharmacy® (Pharmaprix Simplement Santé® in Québec) and six luxury beauty destinations operating as Murale™.

The Company has successfully leveraged its leadership position in pharmacy and its convenient store locations to capture a significant share of the market in front store merchandise. Front store merchandise categories include over-the-counter medications, health and beauty aids, cosmetics and fragrances (including prestige brands), everyday household needs and seasonal products. The Company also offers a broad range of high-quality private label products marketed under the trademarks Life Brand®, Quo®, Etival Laboratoire®, Balea®, 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 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.

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 pharmacy 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.

OVERALL FINANCIAL PERFORMANCE

Key Operating, Investing and Financial Metrics

The following provides an overview of the Company's operating performance for the 12 and 24 week periods ended June 16, 2012 compared to the 12 and 24 week periods ended June 18, 2011, as well as certain other metrics with respect to investing activities for the 12 and 24 week periods ended June 16, 2012 and financial position as at that same date.

- Second quarter sales of $2.457 billion, an increase of 2.6%.
  - First half sales of $4.851 billion, an increase of 2.3%.
- Second quarter comparable store total sales growth of 2.2%; comparable pharmacy sales growth of 0.8% and comparable front store sales growth of 3.4%.
  - First half comparable store total sales growth of 1.9%; comparable pharmacy sales growth of 1.0% and comparable front store sales growth of 2.7%.
- Second quarter retail prescription count growth of 4.2%; comparable store prescription count growth of 3.8%.
  - First half retail prescription count growth of 3.6%; comparable store prescription count growth of 3.2%.
- Second quarter EBITDA[(1)] of $285 million; adjusted EBITDA[(2)] of $290 million, an increase of 0.3%.
  - First half EBITDA of $532 million; adjusted EBITDA of $537 million, an increase of 0.3%.
- Second quarter EBITDA margin[(3)] of 11.58%; adjusted EBITDA margin[(4)] of 11.79%, a decrease of 27 basis points.
  - First half EBITDA margin of 10.97%; adjusted EBITDA margin of 11.08%, a decrease of 22 basis points.
- Second quarter net earnings of $146 million; adjusted net earnings[(5)] of $149 million compared to net earnings of $148 million in the second quarter of 2011.
  - First half net earnings of $265 million; adjusted net earnings of $269 million compared to net earnings of $265 million in the first half of 2011.
- Second quarter net earnings per share of $0.70; adjusted net earnings per share of $0.71, an increase of 4.4%.
  - First half net earnings per share of $1.26; adjusted net earnings per share of $1.28, an increase of 4.9%.
- Second quarter capital expenditure program of $85 million compared to $90 million in the same period of the prior year. Opened or acquired 15 new drug stores, seven of which were relocations, completed two major drug store expansions and remodelled/converted three drug stores to smaller prototype formats.
  - First half capital expenditure program of $148 million compared to $161 million in the same period of the prior year. Opened or acquired 29 new drug stores, 13 of which were relocations, completed five major drug store expansions and remodelled/converted 10 drug stores to smaller prototype formats.
  - Year-over-year increase in retail selling square footage of 4.0%.
- Second quarter share repurchases of 2,303,300 common shares at an aggregate cost of $96 million, representing an average repurchase price of $41.64 per common share.
  - First half share repurchases of 4,123,000 common shares at an aggregate cost of $171 million, representing an average repurchase price of $41.43 per common share.

- Maintained desired capital structure and financial position.
  - Net debt to equity ratio of 0.30:1 at June 16, 2012 compared to 0.28:1 a year ago.
  - Net debt to total capitalization ratio of 0.23:1 at June 16, 2012 compared to 0.22:1 a year ago.

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

(2) EBITDA, excluding the impact of a charge of $5 million (pre-tax) from the closure of two Murale™ stores.

(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 (2) above.

Results of Operations

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

($000s, except per share data)	12 Weeks Ended June 16, 2012 (unaudited)	12 Weeks Ended June 18, 2011 (unaudited)	24 Weeks Ended June 16, 2012 (unaudited)	24 Weeks Ended June 18, 2011 (unaudited)
Sales	$ 2,456,694	$ 2,394,145	$ 4,851,135	$ 4,741,166
Cost of goods sold	1,494,110	1,462,858	2,969,710	2,922,764
Gross profit	962,584	931,287	1,881,425	1,818,402
Operating and administrative expenses	751,655	711,037	1,495,533	1,420,260
Operating income	210,929	220,250	385,892	398,142
Finance expenses	13,355	14,798	26,647	29,439
Earnings before income taxes	197,574	205,452	359,245	368,703
Income taxes	51,863	57,527	94,302	103,237
Net earnings	$ 145,711	$ 147,925	$ 264,943	$ 265,466
Net earnings per common share				
- Basic	$ 0.70	$ 0.68	$ 1.26	$ 1.22
- Diluted	$ 0.70	$ 0.68	$ 1.26	$ 1.22
EBITDA Reconciliation				
Net earnings	$ 145,711	$ 147,925	$ 264,943	$ 265,466
Add the following:				
- Income taxes	51,863	57,527	94,302	103,237
- Finance expenses	13,355	14,798	26,647	29,439
Operating income	210,929	220,250	385,892	398,142
Add the following:				
- Depreciation and amortization expense	73,580	68,588	146,479	137,612
EBITDA	$ 284,509	$ 288,838	$ 532,371	$ 535,754

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 pharmacy 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 the second quarter of 2012 were $2.457 billion compared to $2.394 billion in the same period last year, an increase of $63 million or 2.6%, driven by modest sales growth in pharmacy and strong results in the front of the store where the Company experienced sales gains in all regions of the country. On a same-store basis, sales increased 2.2% during the second quarter of 2012. Year-to-date, sales were $4.851 billion, an increase of 2.3% over the same period last year. On a same-store basis, sales increased 1.9% during the first half of 2012.

Pharmacy sales were $1.172 billion in the second quarter of 2012 compared to $1.154 billion in the second quarter of 2011, an increase of $18 million or 1.5%. During the second quarter of 2012, pharmacy sales accounted for 47.7% of the Company's sales mix compared to 48.2% in the same period last year. On a same-store basis, pharmacy sales increased 0.8% during the second quarter of 2012, as solid growth in the number of prescriptions filled at retail, combined with strong sales growth in the Company's MediSystem Technologies and Specialty Health Network businesses, continues to be partially offset by a reduction in average prescription value. During the second quarter of 2012, the number of prescriptions dispensed at retail increased 4.2% compared to the same period last year and was up 3.8% on a same-store basis. The decrease in average prescription value can be largely attributed to further reductions in generic prescription reimbursement rates, the result of recently implemented and ongoing drug system reform initiatives in certain jurisdictions of Canada, along with increasing generic prescription utilization rates. In the second quarter of 2012, generic molecules represented 58.6% of prescriptions dispensed compared to 56.9% of prescriptions dispensed in the second quarter of 2011. Year-to-date, pharmacy sales increased 1.5% to $2.340 billion and accounted for 48.2% of the Company's sales mix compared to 48.6% in the same period last year. On a same-store basis, pharmacy sales increased 1.0% during the first half of 2012. Year-to-date, the number of prescriptions dispensed at retail increased 3.6% compared to the same period last year and was up 3.2% on a same-store basis. Generic molecules represented 58.1% of prescriptions dispensed in the first half of 2012 compared to 56.7% in the same period last year.

Front store sales were $1.285 billion in the second quarter of 2012 compared to $1.240 billion in the second quarter of 2011, an increase of $45 million or 3.6%, led by strong growth in cosmetics and in food and confection. The Company's store network development program, which resulted in a 4.2% increase in drug store selling space compared to a year ago, continues to have a positive effect on sales growth, particularly in the front of the store. Front store sales growth was also driven by effective marketing campaigns and impactful promotions, along with solid program execution at store level. On a same-store basis, front store sales increased 3.4% during the second quarter of 2012. Year-to-date, front store sales were $2.511 billion, an increase of 3.1% over the same period last year. On a same-store basis, front store sales increased 2.7% during the first half of 2012.

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 $1.494 billion in the second quarter of 2012 compared to $1.463 billion in the same period last year, an increase of $31 million or 2.1%. Expressed as a percentage of sales, cost of goods sold declined by 28 basis points in the second quarter of 2012 versus the same period last year, reflecting the Company's focus on promotional optimization and margin management, as well as enhanced purchasing synergies.

Year-to-date, cost of goods sold increased by 1.6% to $2.970 billion. Expressed as a percentage of sales, cost of goods sold declined by 43 basis points in the first half of 2012 versus the comparative prior year period.

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 7 to the accompanying unaudited condensed consolidated financial statements of the Company.)

Operating and administrative expenses, excluding depreciation and amortization expense, were $678 million in the second quarter of 2012. This amount is inclusive of a charge of $5 million (pre-tax) from the closure of two Murale™ stores. Excluding the impact of this charge, adjusted operating and administrative expenses, excluding depreciation and amortization expense, were $673 million compared to $642 million in the same period last year, an increase of $31 million or 4.8%. In addition to higher store-level expenses, primarily occupancy, wages and benefits related to network growth and expansion initiatives, this increase was also driven by higher Associate earnings and increased expenses in the Company's complementary health care businesses as a result of increased sales activity. Expressed as a percentage of sales, adjusted operating and administrative expenses, excluding depreciation and amortization expense, increased by 56 basis points in the second quarter of 2012 versus the comparative prior year period, an increase that also reflects, in part, the impact of further top-line deflation stemming from the above referenced drug system reform initiatives and greater generic prescription utilization.

Year-to-date, operating and administrative expenses, excluding depreciation and amortization expense, increased by 5.2% to $1.349 billion. Excluding the impact of the charge of $5 million (pre-tax) referred to above, adjusted operating and administrative expenses, excluding depreciation and amortization expense, were $1.344 billion in the first half of 2012, an increase of 4.8%. Expressed as a percentage of sales, adjusted operating and administrative expenses, excluding depreciation and amortization expense, increased by 65 basis points in the first half of 2012 versus the comparative prior year period.

Depreciation and amortization expense was $74 million in the second quarter of 2012 compared to $69 million in the same period last year, an increase of $5 million or 7.3%. Expressed as a percentage of sales, depreciation and amortization expense increased by 14 basis points in the second quarter of 2012 versus the comparative prior year period, an increase which can be attributed to continued investments in the store network and supporting infrastructure, including a new enterprise point-of-sale system at store level that was placed into use in the fourth quarter of 2011. This increase also reflects, in part, the impact of top-line deflation as a result of the above referenced drug system reform initiatives.

Year-to-date, depreciation and amortization expense was $146 million compared to $138 million in the same period last year, an increase of $8 million or 6.4%. Expressed as a percentage of sales, depreciation and amortization expense increased by 12 basis points in the first half of 2012 when compared to the same period of last year.

Operating Income

Operating income, inclusive of the aforementioned charge of $5 million (pre-tax) from the closure of two Murale™ stores, was $211 million in the second quarter of 2012. Excluding the impact of this charge, adjusted operating income was $216 in the second quarter of 2012 compared to $220 million in the same period last year, a decrease of $4 million or 1.9%. As described above, strong sales growth combined with a focus on promotional optimization and margin management, along with enhanced purchasing synergies, resulted in a 3.4% increase in gross profit dollars compared to the second quarter of last year. However, these gains were more than offset by higher adjusted operating and administrative expenses, inclusive of depreciation and amortization expense, which increased 5.0% compared to the same period last year. Second quarter adjusted operating margin (adjusted operating income divided by sales) declined by 41 basis points to 8.79% compared to an operating margin of 9.20% in the second quarter of 2011. The Company's EBITDA margin (EBITDA divided by sales) was 11.58% in the second quarter of 2012. Excluding the impact of the charge of $5 million (pre-tax) referred to above, adjusted EBITDA margin was 11.79% in the second quarter of 2012, a 27 basis point reduction compared to the EBITDA margin of 12.06% posted in the second quarter of last year.

Year-to-date, operating income, inclusive of the aforementioned charge of $5 million (pre-tax) from the closure of two Murale™ stores, was $386 million. Excluding the impact of this charge, adjusted operating income was $391 million in the first half of 2012 compared to $398 million in the same period last year, a decrease of $7 million or 1.8%. First half adjusted operating margin (adjusted operating income divided by sales) declined by 34 basis points to 8.06% compared to an operating margin of 8.40% in the first half of 2011. During the first half of 2012, the Company's EBITDA margin (EBITDA divided by sales) was 10.97%. Excluding the impact of the charge of $5 million (pre-tax) referred to above, adjusted EBITDA margin in the first half of 2012 was 11.08%, a 22 basis point reduction compared to the EBITDA margin of 11.30% posted in the same period of last year.

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 $13 million in the second quarter of 2012 compared to $15 million in the same period last year, a decrease of $2 million or 9.8%. In addition to the Company having a slightly lower average amount of consolidated net debt, interest expense declined largely as a result of savings realized from the refinancing of $250 million of medium-term notes with commercial paper in the first quarter of 2012, along with lower standby fees associated with the Company's revolving term credit facility which was refinanced in the fourth quarter of 2011. Year-to-date, interest expense was $27 million compared to $29 million in the first half of the prior year, a decrease of 9.5%.

Income Taxes

The Company's effective income tax rate in the second quarter and first half of 2012 was 26.3% compared to 28.0% in the same periods of the prior year. These decreases in the effective income tax rates can be attributed to a reduction in statutory rates.

Net Earnings

Second quarter net earnings, inclusive of the charge of $5 million (pre-tax) from the closure of two Murale™ stores, were $146 million compared to $148 million in the same period last year. On a fully diluted basis, net earnings per share were $0.70 in the second quarter of 2012 compared to $0.68 in the same period last year, an increase of 2.9%. Excluding the impact of the above referenced charge, adjusted net earnings for the second quarter of 2012 were $149 million or $0.71 per fully diluted share, an increase of 4.4%. 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 net earnings

per share during the second quarter of 2012, as there were 3.7% fewer fully diluted weighted average shares outstanding compared to the same period last year.

Year-to-date, net earnings, inclusive of the aforementioned charge of $5 million (pre-tax) from the closure of two Murale™ stores, were $265 million, essentially flat compared to the first half of last year. On a fully diluted basis, net earnings per share were $1.26 in the first half of 2012 compared to $1.22 in the same period last year. Excluding the impact of the aforementioned charge, adjusted net earnings in the first half of 2012 were $269 million or $1.28 per fully diluted share, an increase of 4.9%.

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 dates indicated.

($000s)	June 16, 2012	December 31, 2011
Cash	$ (47,971)	$ (118,566)
Bank indebtedness	271,196	172,262
Commercial paper	223,970	-
Current portion of long-term debt	449,529	249,971
Long-term debt	246,769	695,675
Financing lease obligations	126,472	120,810
Net debt	1,269,965	1,120,152
Shareholders' equity	4,252,165	4,267,830
Total capitalization	$ 5,522,130	$ 5,387,982
Net debt:Shareholders' equity	0.30:1	0.26:1
Net debt:Total capitalization	0.23:1	0.21:1
Net debt:EBITDA[(1)]	1.05:1	0.93:1
EBITDA:Cash interest expense[(1)(2)]	19.65:1	18.73:1

(1) For purposes of calculating the ratios, EBITDA is comprised of the EBITDA for each of the 52 week periods then ended.

(2) Cash interest expense is comprised of finance expenses for each of the 52 week periods then ended and excludes the amortization of deferred financing costs, but includes capitalized interest.

Financial Ratios and Credit Ratings

The following table provides a summary of the Company's credit ratings at June 16, 2012.

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

There were no changes to any of the Company's credit ratings during the first half of 2012.

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 207,828,070 common shares outstanding at July 19, 2012. As at this same date, the Company had issued options to acquire 823,929 of its common shares pursuant to its stock-based compensation plans, of which 443,211 were exercisable.

Normal Course Issuer Bid

On February 9, 2012, the Company announced 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 "2012 NCIB Program"). The Company was able to commence purchases under the 2012 NCIB Program on February 15, 2012. The 2012 NCIB 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 2012 NCIB 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 2012 NCIB Program, 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.

During the second quarter of 2012, the Company repurchased 2,303,300 common shares under its 2012 NCIB Program at an aggregate cost of $96 million, representing an average repurchase price of $41.64 per common share. Year-to-date, the Company has repurchased a total of 4,123,000 common shares (comprised of 180,500 common shares under its previous normal course issuer bid program and 3,942,500 common shares under the 2012 NCIB program) at an aggregate cost of $171 million, representing an average repurchase price of $41.43 per common share. At the end of the second quarter, 3,975,600 of the repurchased common shares were cancelled, with the remaining 147,400 common shares cancelled subsequent to quarter-end. The premium paid over the average book value of the repurchased common shares has been charged to retained earnings. (See note 9 to the accompanying unaudited condensed 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. At June 16, 2012, $9 million of the Company's $725 million revolving bank credit facility was utilized, all in respect of outstanding letters of credit, unchanged from the end of the first quarter of 2012 and the end of the prior year. At June 16, 2012, the Company had $224 million of commercial paper issued and outstanding under its commercial paper program compared to $288 million at the end of the first quarter of 2012. At the end of fiscal 2011, the Company did not have any commercial paper issued and outstanding under its commercial paper program.

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 the second quarter of 2012, the Company's maximum obligation in respect of such

guarantees was $530 million compared to $530 million at the end of the first quarter of 2012 and $520 million at the end of the prior year. At June 16, 2012, an aggregate amount of $458 million in available lines of credit had been allocated to the Associates by the various banks compared to $454 million at the end of the first quarter of 2012 and $452 million at the end of the prior year. At June 16, 2012, Associates had drawn an aggregate amount of $280 million against these available lines of credit compared to $245 million at the end of the first quarter of 2012 and $167 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") 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.

Cash Flows From Operating Activities

Cash flows from operating activities were $285 million in the second quarter of 2012 compared to $253 million in the same period last year. This increase can be primarily attributed to a reduction in the amount invested in non-cash working capital balances compared to the same period last year, along with a reduction in the amount of income taxes paid. The variance in non-cash working capital balances can be primarily attributed to an increase in accounts payable and accrued liabilities, offset somewhat by the timing of inventory purchases.

Year-to-date, the Company has generated $315 million of cash from operating activities compared to $396 million in the first half of 2011.

Cash Flows Used in Investing Activities

Cash flows used in investing activities were $104 million in the second quarter of 2012 compared to $86 million in the same period last year, an increase of $18 million or 21.2%. Of these totals, purchases of property and equipment, net of proceeds from any dispositions, amounted to $58 million in the second quarter of 2012 compared to $74 million in the same period last year. The Company invested an additional $6 million in business acquisitions in the second quarter of 2012. Investments in business acquisitions relate primarily to acquisitions of drug stores and prescription files. The Company invested $13 million in the purchase and development of intangible and other assets during the second quarter of 2012 compared to $11 million in the same period last year. During the second quarter of 2012, the balance of funds deposited and held in escrow in respect of outstanding offers to purchase drug stores and land increased by $28 million.

Year-to-date, cash flows used in investing activities were $174 million compared to $161 million in the first half of 2011, an increase of $13 million or 8.2%. Of these totals, purchases of property and equipment, net of proceeds from any dispositions, amounted to $102 million in the first half of 2012 compared to $133 million in the same period last year. Investments in business acquisitions and in the purchase and development of intangible and other assets were $13 million and $25 million, respectively, in the first half of 2012 compared to $6 million and $21 million, respectively, in the same period last year. During the first half of 2012, the balance of funds deposited and held in escrow in respect of outstanding offers to purchase drug stores and land increased by $34 million.

During the second quarter of 2012, the Company opened or acquired 15 new drug stores, seven of which were relocations and completed two major drug store expansions. In addition to this activity, three existing drug stores

were remodeled, converting them to smaller prototype formats, and two Murale™ stores were closed. Year-to-date, 29 new drug stores have been opened or acquired, 13 of which were relocations, two smaller drug stores were closed, five major drug store expansions were completed and 10 drug stores were remodelled. At the end of the first half of 2012, there were 1,340 retail stores in the Company's network, comprised of 1,271 drug stores (1,215 Shoppers Drug Mart®/Pharmaprix® stores and 56 Shoppers Simply Pharmacy®/Pharmaprix Simplement Santé® stores), 63 Shoppers Home Health Care® stores and six Murale™ stores.

Cash Flows Used in Financing Activities

Cash flows used in financing activities were $185 million in the second quarter of 2012, as cash outflows of $212 million were partially offset by cash inflows of $27 million. Cash outflows were comprised of $91 million to settle share repurchases, a $64 million decrease in the amount of commercial paper issued and outstanding by the Company under its commercial paper program, a $1 million repayment of financing lease obligations and $56 million for the payment of dividends. Cash inflows were comprised of a $26 million increase in bank indebtedness and $1 million of proceeds received from the issuance of common shares under the Company's stock-based incentive program.

In the second quarter of 2012, the net result of the Company's operating, investing and financing activities was a decrease in cash balances of $4 million.

Year-to-date, cash flows used in financing activities was $212 million and the net result of the Company's operating, investing and financing activities was a decrease in cash of $71 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.

NEW ACCOUNTING PRONOUNCEMENTS

Accounting Standards Implemented in 2012

Deferred Taxes – Recovery of Underlying Assets

The International Accounting Standards Board ("IASB") issued an amendment to IAS 12, "Income Taxes" (the "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 IAS 12 amendment did not have an impact on the Company's results of operations, financial position and disclosures.

Future Accounting Standards

Financial Instruments – Disclosures

The IASB has issued an amendment to IFRS 7, "Financial Instruments - Disclosures" ("IFRS 7"), 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 to its 2012 annual financial statement disclosures 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 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 IFRS 9 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 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.

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 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.

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.

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.

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.

Financial Instruments – Asset and Liability Offsetting

The IASB has issued amendments to IFRS 7 and IAS 32, "Financial Instruments - Presentation" ("IAS 32"), which clarify the requirements for offsetting financial instruments and require new disclosures on the effect of offsetting arrangements on an entity's financial position. The amendments to IFRS 7 are effective for annual periods beginning on or after January 1, 2013 and must be applied retrospectively. The amendments to IAS 32 are effective for annual periods beginning on or after January 1, 2014 and must be applied retrospectively. The Company is assessing the impact of the amendments to IFRS 7 and IAS 32 on its results of operations, financial position and disclosures.

SELECTED QUARTERLY INFORMATION

Reporting Cycle

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

Summary of Quarterly Results

The following table provides a summary of certain selected consolidated financial information for the Company for each of the eight most recently completed fiscal quarters.

	Second Quarter		First Quarter		Fourth Quarter		Third Quarter	
($000s, except per share data – unaudited)	2012 (12 Weeks)	2011 (12 Weeks)	2012 (12 Weeks)	2011 (12 Weeks)	2011 (12 Weeks)	2010 (12 Weeks)	2011 (16 Weeks)	2010 (16 Weeks)
Sales	$ 2,456,694	$ 2,394,145	$ 2,394,441	$ 2,347,021	$ 2,606,896	$ 2,499,965	$ 3,110,590	$ 3,047,429
Net earnings	$ 145,711	$ 147,925	$ 119,232	$ 117,541	$ 176,019	$ 168,908	$ 172,449	$ 154,724
Per common share								
- Basic net earnings	$ 0.70	$ 0.68	$ 0.56	$ 0.54	$ 0.82	$ 0.78	$ 0.80	$ 0.71
- Diluted net earnings	$ 0.70	$ 0.68	$ 0.56	$ 0.54	$ 0.82	$ 0.78	$ 0.80	$ 0.71

The Company experienced growth in sales and net earnings per common share in each of the four most recent quarters compared to the same quarters of the prior year.

Sales and 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 further 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.

Sales and 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 continued 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.

Sales and net earnings increased in the first quarter of 2012 compared to the same quarter of the prior year, as strong sales in the front of the store, combined with the benefits of improved pricing and promotional activities, served to more than offset additional downward pressure on sales and margins in the dispensary. While higher operating and administrative expenses, driven largely by higher store-level expenses associated with the Company's network growth and expansion initiatives offset an increase in gross profit dollars, lower finance expenses and a reduction in the Company's effective income tax rate were factors that contributed to the year-over-year growth in net earnings. Additionally, the cumulative impact of the Company's share repurchase program had a positive impact on growth in

net earnings per share as there were 2.6% fewer fully diluted weighted average shares outstanding in the first quarter of 2012 compared to the same period last year.

Sales increased in the second quarter of 2012 compared to the same quarter of last year, driven by modest sales growth in pharmacy and strong results in the front of the store where the Company experienced sales gains in all regions of the country. Strong sales growth, combined with a focus on promotional optimization and margin enhancement, along with enhanced purchasing synergies, resulted in a 3.4% increase in gross profit dollars. However, these gains were more than offset by higher operating and administrative expenses, inclusive of depreciation and amortization expense, driven by higher store-level expenses related to network growth and expansion initiatives, increased Associate earnings and additional expenses in the Company's complementary health care businesses as a result of increased sales activity. Operating and administrative expenses in the second quarter of 2012 also included a charge of $5 million (pre-tax) from the closure of two Murale™ stores. Other factors that positively impacted net earnings for the second quarter of 2012 were lower finance expenses and a reduction in the Company's effective income tax rate. The cumulative impact of the Company's share repurchase program had a positive impact on growth in net earnings per share in the second quarter of 2012, as there were 3.7% fewer fully diluted weighted average shares outstanding compared to the same period last year.

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.

RISKS AND RISK MANAGEMENT

Industry and Regulatory Developments

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 date of the Company's Interim Management Discussion and Analysis for the 12 week period ended March 24, 2012, 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

The *Pharmaceutical Services Act* (the "B.C. Act") received royal assent on May 31, 2012. The B.C. Act is intended to shift British Columbia's PharmaCare program, the public drug plan in British Columbia, from reliance on government policy to a program protected by legislation.

The B.C. Act provides the framework for the Ministry of Health to regulate drug prices in British Columbia. The British Columbia government has indicated that it plans to lower generic prescription drug prices to be in line with other provincial jurisdictions through regulations to be drafted under the B.C. Act over the next few months. Currently the cost of most generic prescription drug products in British Columbia is 35% of the manufacturer's list price of the equivalent brand name drug.

The B.C. Act also includes provisions that would allow the Ministry of Health to prohibit manufacturers, suppliers and prescribed persons, and their employees and agents, from offering, and a pharmacist, franchisor or a prescribed person, and their employees and agents, from accepting, incentives to be specified in the regulations.

Alberta

On July 4, 2012, the Alberta government announced that, effective July 1, 2012, the government has reduced the price it pays for most generic prescription drug products from 45% of the cost of the brand name drug to 35%. The government anticipates that as a result of these price reductions the Alberta government and Albertans will save approximately $85 million in 2012/2013.

Also, starting July 1, 2012, the Alberta government will compensate pharmacists for providing the seven new services set forth below:

- *Comprehensive Annual Care Plan* – a plan created by a pharmacist and his or her patient designed to help patients with complex health needs, such as patients with diabetes mixed with an addiction, understand their medication and how to use it.

- *Standard Medication Assessment* – similar to a Comprehensive Annual Care Plan but meant for patients who do not have complex health needs and do not meet the criteria used in a Comprehensive Annual Care Plan.

- *Assessment and Adaptation of a Prescription* – pharmacists may adapt a prescription or contact the original prescriber to have the prescription changed, based on the professional opinion of the pharmacist and the needs of the patient.

- *Patient Assessment for Prescription Renewal* – pharmacists may renew a patient's prescription, without requiring the patient to visit his or her physician, based on the professional opinion of the pharmacist and the needs of the patient.

- *Assessment and Administration of Medications by Injection* – pharmacists will be compensated for patient assessment, for administering the drug by injection, and for providing pre- and post-injection monitoring of the patient as dictated by the drugs being injected.

- *Patient Assessment for Initiating Medication Therapy* – if a pharmacist has additional prescribing authority, he or she will be compensated for assessing the patient and writing the prescription for medication, without that patient having to visit his or her physician.

- *Patient Assessment in a Medication-related Emergency* – in the case of an emergency situation where a pharmacist believes that medication is necessary and the patient does not have a prescription for the drug, the pharmacist can authorize the use of that drug.

The cost of expanding the services that pharmacists can bill for will be covered primarily from the savings gained from the reduction of generic prescription drug prices.

New Brunswick

The amendments to *New Brunswick Regulation 84-170* under the *Prescription Drug Payment Act* (the "N.B. Amendments") announced by the New Brunswick Minister of Health as part of New Brunswick's new generic prescription drug pricing policy on March 22, 2012 came into force on June 1, 2012.

The N.B. Amendments fix the price of generic prescription drug products as follows:

- from June 1, 2012 to November 30, 2012, inclusive, 40% of the manufacturer's list price of the equivalent brand name drug as of April 11, 2011;

- on and after December 1, 2012, 35% of the manufacturer's list price of the equivalent brand name drug as of April 11, 2011; or

- if there is no generic prescription drug product, other than the brand name prescription drug, with a notice of compliance on December 1, 2012, 35% of the manufacturer's list price of the equivalent brand name drug as of the date a notice of compliance is issued for the first generic prescription drug product.

Under the N.B. Amendments, the dispensing fee for generic prescription drug products was set at $10.40 and a 4% mark-up to a maximum of $50.

Although the N.B. Amendments came into force on June 1, 2012, the New Brunswick Minister of Health implemented a 10-day transition period to allow pharmacies to reduce inventory that was purchased at the higher pre-amendment prices.

Newfoundland and Labrador

Pursuant to Newfoundland's Minister of Health and Community Services announcement of the implementation of a new pricing model for generic drug products on March 26, 2012, the *Interchangeable Drug Products Formulary Regulations* under the *Pharmaceutical Services Act* came into force on April 16, 2012 (the "NFLD Regulations"). The NFLD Regulations implemented lower pricing for generic prescription drug products for all residents of Newfoundland and Labrador.

The NFLD Regulations implement a maximum price for generic prescription drug products as follows:

- from April 16, 2012 to September 30, 2012, all generic prescription drug products, except for those approved for exemption, will be priced at no more than 45% of the manufacturer's list price of the equivalent brand name drug;

- from October 1, 2012 to March 31, 2013, all generic prescription drug products, except for those approved for exemption, will be priced at no more than 40% of the manufacturer's list price of the equivalent brand name drug; and

- as of April 1, 2013, all generic prescription drug products, except for those approved for exemption, will be priced at no more than 35% of the manufacturer's list price of the equivalent brand name drug.

Notwithstanding the 45% maximum price for generic prescription drug products implemented on April 16, 2012, manufacturers of generic prescription drug products listed on the formulary when the NFLD Regulations came into force were permitted to maintain their previous formulary price for such products until July 1, 2012.

Prince Edward Island

On July 1, 2012, the *Drug Product Interchangeability and Pricing Act* (the "P.E.I. Act") came into force in Prince Edward Island. The P.E.I. Act permits the government to designate a generic drug product as interchangeable and also requires that the Minister of Health and Wellness establish a maximum reimbursable price for prescription drug products listed in the formulary for the public drug plan. For interchangeable drug products, with limited exceptions, in order to be listed in the formulary and to remain listed in the formulary, the P.E.I. Act requires that the cost from a manufacturer to the pharmacy operator cannot exceed a percentage, to be established by the Minister, of the manufacturer list price of the equivalent brand name product. For interchangeable drug products, the percentage established by the Minister as of July 1, 2012 is 35%.

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.

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. Currently, the Company is not party to interest rate derivative agreements and interest rate derivative agreements were not used in 2011 to manage the Company's exposure to interest rate fluctuations.

Furthermore, the Company may be exposed to losses should any counterparty to its derivative agreements fail to fulfill its obligations. The Company seeks to minimize counterparty risk by transacting with counterparties that are large financial institutions. There was no such exposure as at June 16, 2012, as the Company was not party to any interest rate derivative agreements as at that date.

As at June 16, 2012, the Company had $504 million (2011 - $255 million) of unhedged floating rate debt. During the 12 and 24 week periods ended June 16, 2012, the Company's average outstanding unhedged floating rate debt was $629 million and $587 million (2011 - $408 million and $444 million), respectively. Had interest rates been higher or lower by 50 basis points during the 12 and 24 week periods ended June 16, 2012, net earnings would have decreased or increased, respectively, by approximately $0.5 million and $1.0 million (2011 - $0.3 million and $0.7 million), respectively, as a result of the Company's exposure to interest rate fluctuations on its unhedged floating rate debt.

Foreign Currency Exchange Risk

The Company conducts the vast majority of its business in Canadian dollars. The Company's foreign currency exchange risk principally relates to purchases made in U.S. dollars and this risk is tied to fluctuations in the exchange rate of the Canadian dollar vis-à-vis the U.S. dollar. The Company monitors its foreign currency purchases in order to monitor 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 restricted share unit plan ("RSU Plan"). The income or expense arising from the use of these instruments is included in operating and administrative expenses.

Based on market values of the equity forward agreements in place at June 16, 2012, the Company recognized a liability of $1.6 million, of which $1.2 million is presented in accounts payable and accrued liabilities and $0.4 million is presented in other long-term liabilities. Based on market values of the equity forward agreements in place at June 18, 2011, the Company recognized a liability of $1.7 million, of which $0.4 million was presented in accounts payable and accrued liabilities and $1.3 million was presented in other long-term liabilities. During the 12 and 24 week periods ended June 16, 2012 and June 18, 2011, the Company assessed that the percentages of the equity forward agreements in place related to unearned units under the 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, 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.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

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

There were no changes in internal 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 control over financial reporting.

NON-GAAP FINANCIAL MEASURES

The Company reports its financial results in accordance with Canadian GAAP. However, the foregoing contains references to non-GAAP financial measures, such as adjusted operating and administrative expenses, adjusted operating income, operating margin, adjusted operating margin, EBITDA (earnings before finance expenses, income taxes and depreciation and amortization), adjusted EBITDA, EBITDA margin, adjusted EBITDA margin, adjusted net earnings, adjusted net earnings per share and cash interest expense. These non-GAAP financial measures do not have standardized meanings prescribed by GAAP and, therefore, may not be comparable to similarly titled 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.