The Jean Coutu Group (PJC) Inc.

**FOURTH QUARTER AND ANNUAL REPORT TO SHAREHOLDERS**
For the 13-and 52-weeks ended May 27, 2006

To our shareholders:

The Jean Coutu Group is pleased to report its financial results for the fourth quarter and fiscal year 2006, representing the 13 and 52 weeks ended May 27, 2006.

For the fourth quarter, net earnings were $30.3 million ($0.12 per share) compared with $46.2 million ($0.18 per share) for the fourth quarter of the previous fiscal year and $31.6 million ($0.12 per share) for the third quarter of the current year. Earnings before unrealized losses on financing activities were $41.5 million ($0.16 per share) compared to $45.8 million ($0.18 per share) for the fourth quarter of the previous fiscal year and $31.9 million ($0.12 per share) for the third quarter of the current year.

Canadian network performance continues to improve while US network same-store sales growth has improved due to improving pharmacy sales trends. US network front-end sales show improvement in categories such as consumables, health and beauty products, but continue to be impacted by the significant decline in the photo category.

Fiscal 2006 net earnings were $103.8 million ($0.40 per share) compared with $104.4 million ($0.41 per share) in fiscal 2005. Earnings before unrealized losses on financing activities were $114.7 million ($0.44 per share) compared to $112.2 million ($0.44 per share) for the previous fiscal year. There was an unrealized foreign exchange loss recorded during fiscal 2006 on monetary items of $10.9 million included in financing expenses; this loss was largely offset by a $9.7 million realized foreign exchange gain on monetary items.

Total revenues increased to $2.875 billion for the 13-week period ended May 27, 2006 compared with $2.768 billion for the corresponding period last year. On a same store basis, when compared with last year, sales advanced by 5.5% in Canada and 2.7% in the United States. The impact of generic drugs replacing brand drugs on US pharmacy sales growth was 245 basis points for the fourth quarter. For fiscal 2006, the same store sales growth figures were 4.3% in Canada and 1.2% in the United States. Total revenues for fiscal 2006 increased by $1.526 billion or 15.9% to $11.143 billion from $9.617 billion in fiscal 2005. The increase is principally due to additional revenues from the acquired Eckerd drugstores for the full 52 weeks of fiscal 2006 compared with 43 weeks in fiscal 2005.

Operating income before amortization (OIBA) decreased for the fourth quarter of fiscal 2006 to $129.9 million from $148.4 million for the corresponding period of fiscal 2005. For the fourth quarter of fiscal 2005, OIBA was positively impacted by $21 million of favorable changes in estimates for some operating expenses and revenues on the basis of new information obtained during that quarter. Of these favorable changes in estimates, approximately $12 million impacted the cost of goods sold and $9 million the general and operating expenses. Excluding these changes of estimates accounted for prospectively for fiscal 2005, OIBA increased by $2.5 million compared to the corresponding period of fiscal 2005 and, as a percentage of revenues, ended the quarter at 4.5% compared with 4.6% for the same period of 2005. OIBA for the 52 weeks ended May 27, 2006 improved to $496.6 million compared with $452.7 million for fiscal 2005. OIBA as a percentage of revenues decreased to 4.5% for fiscal 2006 compared with 4.7% for the previous fiscal year.

As at May 27, 2006, The Jean Coutu Group operated 327 franchised drugstores in Canada and 1,858 corporate Brooks and Eckerd drugstores in the United States.

The Board of Directors of the Company declared a quarterly dividend of $C 0.03 per share. This dividend is payable on August 31, 2006 to all holders of Class A Subordinate Voting shares and holders of Class B shares listed in the Company's shareholder ledger as of August 17, 2006.

Over the coming fiscal year, we will strive to improve network performance and financial results to create value for our shareholders. The execution of strategic initiatives will ensure continued development of our Canadian and United States networks to grow our customer base, enhance customer loyalty, and improve store traffic. The quality of our service and staff and the originality of our customer offer will set us apart.

We would like to thank all of our employees for their perseverance and efforts over the past year. We would also like to thank our franchisees, shareholders, and customers for their unwavering support and trust. They are a lasting source of motivation for us in the pursuit of our growth, profitability, and value creation goals.

Yours truly,

Jean Coutu
Chairman of the Board,
President and Chief Executive Officer

# Management's Discussion and Analysis

This document provides an analysis of the consolidated operating results and financial position (Management's Discussion and Analysis - "MD&A") of The Jean Coutu Group (PJC) Inc. ("the Company" or the "Jean Coutu Group") for the 13-week period and 52-week year ended May 27, 2006.

The Jean Coutu Group is the fourth largest drugstore chain in North America and the second largest in the eastern United States and Canada with a network of 2,185 stores.

Management has presented certain non-Generally Accepted Accounting Principles ("GAAP") measures in this MD&A. Although operating income before amortization ("OIBA") and earnings (or earnings per share) before unrealized losses (gains) on financing activities are not performance measures defined by Canadian GAAP, management, investors and analysts use these measures to evaluate the operating and financial performance of the Company. Moreover, the Company's definition of these measures may differ from the ones used by other companies. These measures are reconciled with net earnings, a performance measure defined by Canadian GAAP, in this MD&A.

## PRESENTATION OF FINANCIAL STATEMENTS

All financial information appears in US dollars, in accordance with Canadian GAAP, considering our predominant operations in the United States and our US-dollar-denominated debt. The following discussion should be read in conjunction with the Consolidated Financial Statements and related notes as at May 27, 2006 as well as the Company's recent public filings.

Readers may access additional information and filings relating to the Company using the following links to the www.sedar.com (Canada) and www.sec.gov (United States) websites.

## FORWARD LOOKING STATEMENTS

Certain statements contained in this MD&A may constitute "forward-looking statements" within the meaning of the US Private Securities Litigation Reform Act of 1995. The words "looking forward," "looking ahead," "believe(s)," "should," "may," "expect(s)," "anticipate(s)," "likely," "opportunity," and similar expressions, among others, identify forward-looking statements. Such statements are not guarantees of the future performance of the Company or its segments, and involve known and unknown risks and uncertainties that may cause the outlook, the actual results or performance of the Company or of its reportable segments to be materially different from any future results or performance expressed or implied by such statements depending on, among others, such factors as changes in the regulatory environment as it relates to the sale of prescription drugs, competition, exposure to interest rate fluctuations, foreign currency risks, certain property and casualty risks, the ability to attract and retain pharmacists, risks in connection with third party service providers, seasonality risks, changes in federal, provincial and state laws, rules and regulations relating to the Company's business and environmental matters, changes in tax regulations and accounting pronouncements, the success of the Company's business model, supplier and brand reputations, and the accuracy of management's assumptions. This list is not exhaustive of the factors that may affect any of the Company's forward-looking statements. For further information, readers are referred to the section on Risks and uncertainties contained in this MD&A as well as in other Company filings. The Company disclaims any intention or obligation to update or revise any forward-looking information contained in its communications, whether as a result of new information, future events or otherwise.

## COMPANY PROFILE

We exercise our activities in the North American drugstore retailing industry in two broad geographic areas, Eastern Canada and the eastern United States, through corporate and franchised drugstores under the banners of Brooks, Eckerd, PJC Jean Coutu, PJC Santé Beauté and PJC Clinique.

As at May 27, 2006, our Canadian network of PJC Jean Coutu franchised stores (''PJC'') and our American network of Brooks Eckerd corporate drugstores broken down, geographically and by type of store, is as follows:

| | Canada | United States | 2006 total | 2005 total |
|---|---|---|---|---|
| Total stores | 327 | 1,858 | 2,185 | 2,243 |
| Freestanding stores or buildings | 80 | 986 | 1,066 | 1,087 |
| 24-hour stores | - | 34 | 34 | 34 |
| Drive-thru pharmacies | 25 | 876 | 901 | 891 |

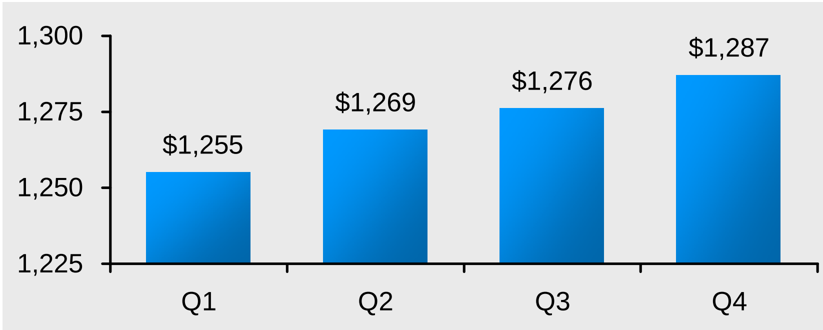
## CANADA

### Profile of the Canadian Network of Franchised Stores

The Jean Coutu Group is the second largest pharmacy chain in Canada with 327 stores in Québec, Ontario, and New Brunswick. Our franchising activities include operating two distribution centers and providing services to our PJC stores. These services comprise centralised purchasing, distribution, marketing, training, human resources, management, operational consulting and information systems, as well as participation in our private label program. Our PJC franchisees own and manage their stores and are responsible for merchandising and financing their inventory. They must provision their stores from our distribution centers, provided that the products requested are available and priced lower or equal to other suppliers. We supply our PJC franchisees with approximately 75% of their products, including almost all prescription drugs. Although PJC retail sales are not included in our revenues, an increase or decrease in this regard will directly affect our performance as it impacts distribution center sales and royalties.

The PJC Jean Coutu drugstores filled 50.4 million prescriptions during fiscal 2006, for a weekly average of 3,019 scripts per store. The front end of our drugstores is focused on customer wellness, offering a full choice of health and beauty products. What is more, approximately 8% of our front-end retail sales come from over 1,800 private label or exclusive products. These popular products are known to represent excellent value and help enhance margins, customer traffic and loyalty.

**Canadian Network – Retail sales per square foot**
(in Canadian dollars)




**2006**

Retail sales per square foot is a key performance indicator. By measuring last twelve-month total store sales divided by average square footage, the Company's management measures network performance. Sales growth is driven by the successful execution of the Company's strategies, as discussed herein.

The PJC drugstore network retail sales per square foot has grown each quarter over the past year, to $C1,287 per square foot for the fourth quarter, which is top in the Canadian drugstore market. The average PJC drugstore has annual sales of $C10.0 million.

## 2006 Strategic Initiatives

**Expansion and modernization of the Canadian network**
In fiscal 2006, we expanded our Canadian network with the opening and relocation of 12 stores. There were also 5 store acquisitions as well as 5 closings. The new PJC drugstore prototype was introduced during this period and several stores were renovated or expanded.

We also developed new store planograms in order to enhance our sales environment and to showcase products in attractive areas conducive to meeting customer needs. These new tools are crucial components and support our marketing strategies aimed at increasing pharmacy, front-end and seasonal sales in our Canadian network.

**New Ontario distribution center**
As planned, our new warehouse located in Ontario started its operations during fiscal 2006. These new facilities will help optimize our supply chain while providing the opportunity to increase the number of self-distributed products and to develop our own import program.

**Advertising**
A television ad campaign comprising two new commercials was introduced in the fall of 2005. This campaign, like the previous one, helped reinforce PJC's brand awareness.

**AIR MILES$^{tm}$ Reward Program**
Valued by our customers, the AIR MILES$^{tm}$ Reward Program is a key advantage for the Jean Coutu Group since it is the only pharmacy network in Quebec and New Brunswick to offer it. In January 2006, we launched the INSTANT AIR MILES$^{tm}$ REWARD redemption feature, a Canadian first. AIR MILES$^{tm}$ collectors can now instantly redeem reward miles in-store for PJC Jean Coutu gift cards. Since February 2006, AIR MILES$^{tm}$ members have also been able to collect their reward miles in our drugstores located in Ontario.

**Beauty Products**
Seventeen new Boutiques Passion Beauté were added to our network during the year, for a total of 27 boutiques at the end of fiscal 2006. We have also begun rolling out new and enhanced Dermo cosmetics displays, where our customers can choose from a larger selection of products and skin analysis tools, and obtain the expert advice of a professional cosmetician. There are now 162 PJC Jean Coutu drugstores that benefit from a Dermo cosmetics center. This initiative is in line with our goal of making our drugstores into destinations focused on customer wellness, while at the same time increasing our sales in promising niche and growth markets.

**Photo Solutions**
We are known as a leading destination for photo services and we are constantly innovating to provide our customers with rapid and accessible solutions such as in-store digital kiosks and print facilities, as well as web upload services.

**Private Label Program**
During fiscal 2006, we launched the new image of our *Personnelle* private label line. The new packaging is designed to highlight the quality and wide range of our private label products. This initiative targets higher sales by appealing to a larger number of customers. We are pursuing the development of this exclusive line and, each year, we introduce new products, always emphasizing health, an area with promising growth opportunities.

## New Initiatives in 2007

In fiscal 2007, we expect that sales of pharmacy, health-related, beauty and seasonal products will increase. A major building block in achieving these growth objectives will be the implementation of the new store support model to assist our Canadian stores in implementing tailored and targeted marketing initiatives better suited to local needs. Investments will also target staff training so as to improve operating efficiency while delivering high quality service throughout the network.

The new PJC Jean Coutu drugstore and the rollout of new development tools should assist in increasing sales while continuing the expansion of a high quality network. We plan to continue to develop and improve our network by investing in our drugstores while implementing leading technologies that enable us to increase sales, identify optimal store locations and enhance the value of our property holdings. In fiscal 2007, we plan to open 6 new stores and relocate 8 stores, and also launch several store renovation and expansion projects. We also plan to open several Boutiques Passion Beauté and Dermo cosmetics centers.

Finally, we will continue to promote the PJC Jean Coutu brand and make the most of the INSTANT AIR MILES$^{tm}$ REWARDS program to increase customer loyalty. We will also create promotions to allow us to optimize this program's potential.

## UNITED STATES

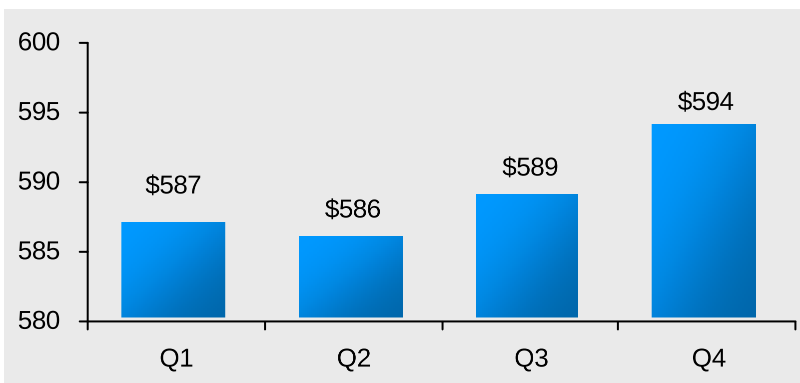
### Profile of the US network of corporate-owned stores

The US network comprises 1,858 corporate-owned stores operating under the Brooks Pharmacy and Eckerd Pharmacy banners and 6 distribution centers in 18 states in the eastern United States (1,922 corporate drugstores and 6 distribution centers in 2005). The head office of The Jean Coutu Group (PJC) USA, Inc. is located in Warwick, Rhode Island, where all corporate and support functions are centralized for the Brooks Eckerd drugstore network. These functions include finance, purchasing, distribution, marketing, human resources, information systems and support, real estate and other departments**.** About 50% of Brooks and Eckerd drugstores are the number one or number two retail drugstores in their respective markets.

In fiscal 2006, the US network filled more than 119.5 million prescriptions, with an average per store of 1,240 scripts per week.

The front-end sections offer a wide variety of health and beauty products including an increasingly wider range of private label products.

**United States Network – Retail sales per square foot**
(in US dollars)




**2006**

Retail sales per square foot is a key performance indicator. By measuring last twelve-month total store sales divided by average square footage, the Company's management measures network performance. Sales growth is driven by the successful execution of the Company's strategies, as discussed herein. The Brooks Eckerd network retail sales per square foot grew to $594 in the fourth quarter. At this point, the average annual sales per store at Brooks Eckerd Pharmacy has room to grow, representing a significant top line growth opportunity.

## 2006 Strategic Initiatives

**Brooks Eckerd Integration**
During fiscal 2006, our teams combined their talent and efforts in the pursuit of the integration of Eckerd and Brooks operations. From a technological standpoint, many steps were successfully completed. Among the many initiatives undertaken during the year, mention should be made of the following:

- The migration of the former Eckerd IT infrastructure from Kentucky and Florida to Rhode Island.
- The beginning of the rollout of the RX Care system and new point-of-sale systems in the Eckerd drugstores.

**Pharmacy:**

**Technology**
The RX Care pharmacy support system is already operating in all Brooks drugstores. Rollout of the system began during fiscal 2006 in several Eckerd drugstores located in the Northeast region. Training programs were set up to prepare pharmacy professionals and staff for the RX Care system rollout.

In order to continuously improve professional care performance, major projects have been undertaken to integrate the RX Care system with the point-of-sale system for Automatic Courtesy Prescription Refills. We have also expanded access to the online e-prescription system.

**Health Care Services**
Several new health-related initiatives were launched in the Brooks Eckerd network. For example, during the autumn of 2005, a number of specially trained pharmacists conducted a vaccination operation in stores.

Moreover, we initiated specific health education programs for customers and associates.

**Medicare Part D Drug Benefit program**
Introduced in January 2006, Medicare Part D Drug Benefit coverage represents a long-term growth opportunity for prescription and over-the-counter drug sales which can be strategically leveraged to enhance customer loyalty. We worked closely with pharmacy benefit managers in the eighteen Medicare Part D regions where the Company operates, and developed strategic alliances with various organizations and networks. During fiscal 2006, Brooks Eckerd entered into alliances with Humana, Ovations, CIGNA, Highmark, Instill and the Health Now Plan, among others.

**Promotion and Market Development**

- The *Pharmacy First* program put our commitment to community health and wellness up front. The main goal of this program is to emphasize the variety and quality of health services provided across the network and our expertise in Medicare Part D Drug Benefit coverage. That was the thrust of several initiatives undertaken during fiscal 2006.
- We implemented an information support call center as part of our Medicare Part D Drug Benefit program rollout. Thousands of calls have already been made by Medicare customers looking to obtain information on the choice of plans available to them.
- During fiscal 2006, Brooks Eckerd participated in more than 600 community events across the network. The goal of this initiative was to improve outreach at the local level and build ties with local communities. Through our participation in these events, we were able to directly promote our pharmacy services to over 100,000 people.

**Front-end Merchandising:**

**Management and Operations**

Several tools and applications were developed and rolled out during fiscal 2006 to improve operating performance in different areas of store activity. These include:

- Implementation and fine-tuning of the Selmor system, a computer-assisted in-store inventory and order management system that features several functions, including existing order and promotional products refills, as well as seasonal products store allocation.

- Launch of a new pharmacy accounting system enabling store managers to monitor all transactions related to inventory management, deliveries and supplier payments.

**Promotions**

The marketing team introduced new promotions to attract customers to our stores, including promotion of high-demand articles in circulars and newspapers, special new-store opening promotions, theme days and sale coupons, with all initiatives aimed at increasing customer traffic.

A radio and television advertising campaign was completed, positioning Brooks and Eckerd drugstores as pharmacy experts dedicated to people's health and wellness. This campaign also promoted our pharmacists' expertise on the new Medicare Part D Drug Benefit to increase customer awareness about the choice of plans offered.

**US Network Store Projects**

In fiscal 2006, we opened and relocated 38 stores and acquired another 2 stores.

Two programs were introduced to review and improve store layouts to meet evolving customer trends and tastes. Project Open View was focused on developing esthetic in-store visuals. Project Flip It relocated seasonal merchandise to the front of stores, resulting in an improvement of sales and margins in this product category during fiscal 2006.

Several Eckerd drugstores with suboptimal lighting received major investments under the Glow in the Dark project undertaken in fiscal 2006. These stores now have suitable exterior lighting to improve evening and overnight customers' shopping experience.

Moreover, we contained network operating costs while continuing to develop a high quality network. In this regard, we closed 78 non performing stores during the first quarter. We closed a total of 85 stores in fiscal 2006.

**Logistics and Distribution**

During fiscal 2006, we invested in our distribution network to improve productivity, reduce operating costs, and improve operating results. Moreover, we focused on improving service levels by implementing initiatives to optimize the supply chain and rationalize our distribution centers.

## New Initiatives in 2007

In fiscal 2007, through Medicare Part D Drug Benefit initiatives, we will continue our effort to position ourselves as leaders by developing new alliances with major US drug and health benefit managers serving our markets, and we will cultivate solid ties with those who have already shown confidence in us.

We will build on our determination to consolidate and simplify processes and improve the technological infrastructure throughout the organization. Our Eckerd drugstores will continue to receive attention in order to improve their financial performance. We also intend to improve margins through the optimization of our supply chain and distribution strategy, as well as other measures designed to achieve economies of scale.

Initiatives and programs will continue to be launched to build on lasting relationships through high levels of customer service that will stimulate growth in sales and improve market share. We plan to continue to expand our pharmacy and front-end programs so as to attract more customers and better meet their needs.

We plan to continue to develop and improve our network by investing in our drugstores while implementing leading technologies that enable us to increase sales, identify optimal store locations, and enhance the value of our property holdings. In fiscal 2007, we plan to open 9 new stores and relocate 19 stores, and also launch several store renovation projects.

## STRATEGIES AND OUTLOOK

The Jean Coutu Group believes that it is well positioned to capitalize on the growth in the North American drugstore retailing industry, based on its strong brands, a focus on excellence and customer service in pharmacy and front-end innovation with an emphasis on health and beauty. Demographic trends in Canada and the United States are expected to contribute to growth in the consumption of prescription drugs, and to the increased use of pharmaceuticals as the primary intervention in individual healthcare. Management believes that these trends will continue and that the Company will achieve sales growth through differentiation and quality of offering and service levels in its drugstore network.

The Company operates its Canadian and US networks with a focus on sales growth, its real estate program and operating efficiency to create shareholder value.

In fiscal 2007, the Company plans to allocate approximately $300 million to capital expenditures, with $50 million allocated to spending in Canada and $250 million in the United States.

Following an extensive review of its US drugstore network's overall competitiveness, the Company plans on deploying an aggressive capital expenditure program in the Brooks Eckerd network. The Company expects to spend $46 million on the addition of approximately 9 new drugstores and the relocation of another 19 stores in key strategic markets. Planned investments for the remodel and renovation program, which covers over 1,000 store projects, total $58 million. This program will give the selected Brooks Eckerd drugstores a new look and an improved shopping experience to build sales and market share. The Company expects to spend $24 million during fiscal 2007 to complete the construction of the new corporate headquarters. $78 million has been allocated for information technology systems centered on uniform pharmacy and point-of-sale systems. Finally, expenditures for other initiatives including distribution center, logistics, front-end and other initiatives are expected to total $44 million.

## FINANCIAL DATA

The following table presents selected data and operating results for the 52-week years ended May 27, 2006, and May 28, 2005.

| | 2006 | | | 2005 | | |
|---|---|---|---|---|---|---|
| *(in millions of US dollars, except per share amounts)* | **Canada $** | **United States $** | **Consolidated $** | Canada $ | United States $ | Consolidated $ |
| **Sales** | **1,458.2** | **9,495.9** | **10,954.1** | 1,248.0 | 8,200.4 | 9,448.4 |
| Cost of goods sold | **1,324.0** | **7,077.2** | **8,401.2** | 1,130.0 | 6,159.9 | 7,289.9 |
| **Gross profit** | **134.2** | **2,418.7** | **2,552.9** | 118.0 | 2,040.5 | 2,158.5 |
| As a % of sales | **9.2%** | **25.5%** | **23.3%** | 9.5% | 24.9% | 22.8% |
| Other revenues (1) | **181.0** | **11.8** | **192.8** | 161.7 | 10.8 | 172.5 |
| General and operating expenses | **150.2** | **2,098.9** | **2,249.1** | 132.4 | 1,745.9 | 1,878.3 |
| **Operating income before amortization** | **165.0** | **331.6** | **496.6** | 147.3 | 305.4 | 452.7 |
| Amortization (1) | **15.9** | **215.8** | **231.7** | 14.0 | 184.8 | 198.8 |
| **Operating income** | **149.1** | **115.8** | **264.9** | 133.3 | 120.6 | 253.9 |
| Financial expenses | | | **205.1** | | | 162.1 |
| **Earnings before income taxes** | | | **59.8** | | | 91.8 |
| Income tax recovery | | | **(44.0)** | | | (12.6) |
| **Net earnings** | | | **103.8** | | | 104.4 |
| **Net earnings per share** | | | **0.40** | | | 0.41 |
| **Earnings per share before unrealized losses (gains) on financing activities** | | | **0.44** | | | 0.44 |

(1) Amortization of incentives paid to franchisees is grouped with amortization instead of other revenues as in the Consolidated Financial Statements.

| *(in millions of US dollars, except for sales growth and per share figures)* | **2006**<br>**$** | 2005<br>$ |
|---|---|---|
| **Network performance - Retail sales** | | |
| Canada [1] | **2,441.8** | 2,173.4 |
| United States | **9,495.9** | 8,200.4 |
| | **11,937.7** | 10,373.8 |
| **Retail sales growth – same-store** [2] | | |
| **Canada** [1] | | |
| Total | **4.3%** | 5.5% |
| Pharmacy | **7.0%** | 8.0% |
| Front-end | **0.6%** | 2.1% |
| **United States** [3] | | |
| Total | **1.2%** | 2.8% |
| Pharmacy | **2.0%** | 3.9% |
| Front-end | **(1.1)%** | 0.4% |
| **Reconciliation of OIBA with net earnings** | | |
| **Net earnings** | **103.8** | 104.4 |
| Financial expenses | **205.1** | 162.1 |
| Income tax recovery | **(44.0)** | (12.6) |
| **Operating income** | **264.9** | 253.9 |
| Amortization per financial statements | **227.9** | 195.3 |
| Amortization of incentives paid to franchisees [4] | **3.8** | 3.5 |
| **Operating income before amortization ("OIBA")** | **496.6** | 452.7 |
| **Reconciliation of earnings and earnings per share before unrealized losses (gains) on financing activities** | | |
| **Net earnings** | **103.8** | 104.4 |
| Unrealized foreign exchange losses (gains) on monetary items | **10.9** | 7.8 |
| **Earnings before unrealized losses (gains) on financing activities** | **114.7** | 112.2 |
| **Net earnings per share** | **0.40** | 0.41 |
| Unrealized losses (gains) on financing activities | **0.04** | 0.03 |
| **Earnings per share before unrealized losses (gains) on financing activities** | **0.44** | 0.44 |

(1) Franchised outlets retail sales are not included in the Company's Consolidated Financial Statements.
(2) Growth is calculated in local currency and is based on comparable periods.
(3) This measure includes same-store sales for the acquired Eckerd corporate outlets as of August 1, 2005.
4) Amortization of incentives paid to franchisees is grouped with other revenues in the Consolidated Financial Statements.

## DEFINITION OF FINANCIAL DATA

### Revenues

Revenues consist of Canadian and US sales, plus other revenues derived from franchising and retail sales.

***Canada***. Merchandise sales by our distribution centers to PJC franchisees account for most of our sales in Canada. PJC retail store sales are not included in our revenues. However, changes in their retail sales directly affect our revenues since PJC franchisees purchase most of their inventory from our distribution centers. Other revenues consist of royalties from our franchisees based on a percentage of retail sales, rental revenues and charge-backs to our franchisees in exchange for certain services.

***United States***. US sales consist of retail sales generated by corporate stores operating under the Eckerd and Brooks banners. Other revenues include rental revenues from our properties leased to third parties.

### Gross profit

Gross profit is calculated as follows: sales minus the cost of goods sold from our distribution centers, for our Canadian operations, and the cost of goods sold (which includes distribution costs and estimated inventory losses) in our stores, for the US network.

### General and operating expenses

General and operating expenses comprise costs associated with salaries and benefits, rent, advertising, repairs and maintenance, insurance and professional fees.

### Operating income before amortization (''OIBA'')

OIBA is not a measure of performance under Canadian GAAP; however, management uses this performance measure in assessing the operating and financial performance of its reportable segments. We believe that OIBA is an additional measure used by investors to evaluate operating performance and capacity of a company to meet its financial obligations. However, OIBA is not and must not be used as an alternative to net earnings or cash flow generated by operating activities as defined by Canadian GAAP. OIBA is not necessarily an indication that cash flow will be sufficient to meet our financial obligations. Furthermore, our definition of OIBA may not be necessarily comparative to similar measures reported by other companies.

### Earnings (or earnings per share) before unrealized losses (gains) on financing activities

Earnings before unrealized losses (gains) on financing activities and earnings per share before unrealized losses (gains) on financing activities are non-GAAP measures. The Company believes that it is useful for investors to be aware of significant items of an unusual or non-recurring nature that have adversely or positively affected its GAAP measures, and that the above mentioned non-GAAP measures provide investors with a measure of performance with which to compare its results between periods without regard to these items. The Company's measures excluding certain items have no standardized meaning prescribed by GAAP and are not necessarily comparable to similar measures presented by other companies and therefore should not be considered in isolation.

### EXCHANGE RATE DATA

The Company's US dollar reporting currency provides shareholders with more relevant information, considering its predominant operations in the United States and US-dollar-denominated debt. The following table shows exchange rates based on the Federal Reserve Bank of New York closing rate expressed as US dollars per Canadian dollar.

| | **May 27, 2006** | May 28, 2005 | May 31, 2004 |
|---|---|---|---|
| Average rate (1) | **0.8513** | 0.7937 | 0.7446 |
| Closing rate | **0.9032** | 0.7946 | 0.7317 |

(1) Calculated using the average noon buying rates for each day of the relevant period.

### SELECTED ANNUAL FINANCIAL INFORMATION

| *(in millions of US dollars except per share amounts)* | **52 weeks ended May 27, 2006** **$** | 52 weeks ended May 28, 2005 $ | Year ended May 31, 2004 $ |
|---|---|---|---|
| **Revenues** | **11,143.1** | 9,617.4 | 3,043.0 |
| **OIBA** | **496.6** | 452.7 | 249.7 |
| **Net earnings** | **103.8** | 104.4 | 132.7 |
| **Net earnings per share (basic and diluted)** | **0.40** | 0.41 | 0.58 |
| **Earnings per share before unrealized losses (gains) on financing activities** | **0.44** | 0.44 | 0.58 |
| **Cash dividend per share ($C)** | **0.12** | 0.12 | 0.12 |
| **Total assets** | **5,591.0** | 5,694.9 | 1,343.8 |
| **Total long-term liabilities** | **2,719.1** | 2,976.6 | 179.4 |

## COMPARISON OF THE FISCAL YEARS ENDED MAY 27, 2006 AND MAY 28, 2005

**Net earnings**
For the 52 weeks ended May 27, 2006, net earnings were $103.8 million ($0.40 per share) compared with net earnings of $104.4 million ($0.41 per share) for the 52 weeks ended May 28, 2005. Earnings before unrealized losses on financing activities were $114.7 million ($0.44 per share) compared to $112.2 million ($0.44 per share) for the previous fiscal year. There was an unrealized foreign exchange loss recorded during fiscal 2006 on monetary items of $10.9 million included in financing expenses; this loss was largely offset by a $9.7 million realized foreign exchange gain on monetary items.

**Revenues**
Total revenues, which include sales and other income, increased by $1.526 billion or 15.9% to $11.143 billion for the 52-week year ended May 27, 2006 compared with $9.617 billion for the 52-week year ended May 28, 2005.

***Canada****.* Revenues from Canadian operations showed double digit growth during fiscal 2006, reaching $1.635 billion, an increase of $229.2 million or 16.3% from revenues of $1.406 billion for fiscal 2005. Canadian revenues increased by 8.5% excluding the impact of currency exchange rate fluctuations. During fiscal 2006, there were 12 openings, including 6 relocations as well as 5 acquisitions of stores in the PJC franchised store network compared with 7 openings and 5 relocations during fiscal 2005. In addition, 4 stores were significantly renovated and 4 were expanded during fiscal 2006 compared with 7 and 6 respectively during fiscal 2005. There were also 5 store closures during fiscal 2006. Sales increases reflect growth resulting from previous period openings, renovations or relocations of network stores and growth in PJC same-store retail sales. For the 52-week year ended May 27, 2006 compared with the 52-week year ended May 28, 2005, on a same-store basis and in local currency, total PJC retail sales grew 4.3%, pharmacy sales gained 7.0% and front-end sales picked up 0.6% year-over-year.

***United States****.* Revenues from US operations increased to $9.508 billion for the 52-week year ended May 27, 2006, up $1.297 billion or 15.8% from revenues of $8.211 billion for fiscal 2005. The increase is principally due to additional revenues of $1.297 billion from the acquired Eckerd drugstores during the full 52 weeks of fiscal 2006 compared with 43 weeks in fiscal 2005, net of the loss of sales from the 78 Eckerd drugstores closed during the first quarter of fiscal 2006. Total revenue from these closed stores was $156.8 million in fiscal 2005. Brooks Eckerd sales trends have improved in both the pharmacy and front-end. On a same-store basis, total retail sales grew 1.2%, pharmacy sales gained 2.0% and front-end sales decreased 1.1% year-over-year. This measure includes same-store sales for the acquired Eckerd drugstores as of August 1, 2005, the first anniversary of ownership by the Company. During fiscal 2006, there were 38 new store openings including 19 relocations, acquisition of 2 stores and 85 store closures, bringing our US network to 1,858 Brooks and Eckerd stores as at May 27, 2006. During fiscal 2005, in addition to the acquisition of 1,551 drugstores, there were 117 new store openings including 54 relocations and 28 store closures and our US network had 1,922 Brooks and Eckerd drugstores as at May 28, 2005.

Pharmacy sales were negatively impacted by the conversion of branded drugs to generics, which generally have a lower selling price, but higher gross profits for the drugstore retailer. Over fiscal 2005 and 2006, pharmacy sales were negatively impacted by the conversion of several popular branded drugs from prescription to generic and over-the-counter status. Generics as a percentage of total Brooks Eckerd pharmacy script count increased from 53.8% as at May 28, 2005 to 57.1% by May 27, 2006. The generic substitution rate, that is the rate at which Brooks Eckerd substitutes generics for branded drugs while filling prescriptions, increased from 93.8% in May 2005 to 95.6% in May 2006, with a positive effect on our pharmacy margins. The impact of generic drugs replacing branded drugs on pharmacy sales growth was 232 basis points during fiscal 2006. Third party health plans covered 95.6% of pharmacy sales in fiscal 2006. Front-end trends have improved, with growth in consumables, core health and beauty categories and private label products, with a slight decline in overall front-end sales year-over-year, principally due to the significant decline in the photo category**.**

**Gross profit**

***Canada****.* Total Canadian gross profit improved to $134.2 million for the 52-week year ended May 27, 2006 compared with $118.0 million for the previous fiscal year. Gross margin decreased slightly to 9.2% in fiscal 2006 compared with 9.5% during the previous fiscal year.

***United States***. United States gross profit amounted to $2.419 billion for the 52-week year ended May 27, 2006 compared with $2.041 billion for the previous corresponding fiscal year. The increase is attributable to the addition of the Eckerd business for the full 2006 fiscal year. The gross margin percentage of our US operations improved to 25.5% during fiscal 2006 compared with 24.9% in fiscal 2005. The improvement stems from the increased use of generics with a positive effect on pharmacy margins year-over-year and from reduced inventory losses as a result of loss prevention programs implemented across the US network. The Company's management believes that these programs will provide operational benefits and it expects future performance improvements in fiscal 2007.

**Other revenues**

Other revenues, which are included in total revenues in the Company's Consolidated Financial Statements, increased to $189.0 million in fiscal 2006 from $169.0 million the previous year due principally to currency exchange rate fluctuations.

**General and operating expenses**

General and operating expenses for the 52-week year ended May 27, 2006 were $2.249 billion, up from $1.878 billion in the previous fiscal year. The increase is mainly attributable to the addition of the Eckerd business for the full 2006 fiscal year.

***Canada.*** General and operating expenses performance for the fiscal year represented 9.2% of revenues versus 9.4% for fiscal 2005.

***United States.*** General and operating expenses represented 22.1% of revenues in the United States versus 21.3% a year earlier. Normal inflationary increases in general and operating expenses were not covered by sales increases. In addition, wages increased, due to the Medicare Part D Drug Benefit program rollout and sales growth initiatives. The Company also incurred certain non-recurring integration expenses during both the 2006 and 2005 fiscal years.

**OIBA**

OIBA for the fiscal year ended May 27, 2006 improved to $496.6 million compared with $452.7 million for fiscal 2005. OIBA as a percentage of revenues decreased to 4.5% for fiscal 2006 compared with 4.7% for the previous fiscal year. The increase in OIBA for the current fiscal year reflects the operation of the acquired Eckerd drugstores for the full year compared with forty-three weeks for fiscal 2005, as well as the improving performance of existing Canadian operations.

**Amortization**

Amortization charges increased to $227.9 million during fiscal 2006, up $32.6 million from $195.3 million for fiscal 2005. The increase in the charges for fiscal 2006 reflects the operation of the acquired Eckerd drugstores for the full 2006 fiscal year.

**Financial expenses**

Financial expenses were $205.1 million in fiscal 2006, an increase of $43.0 million over $162.1 million in fiscal 2005, due principally to the financial expenses related to the Eckerd acquisition for the full 2006 fiscal year compared with 43 weeks in fiscal 2005 and to a year-over-year increase in interest costs on the $1.2 billion of debt which bears interest at floating rates (2005 - $1.3 billion). The weighted average interest rate on the Company's long-term debt was 7.4% during the current fiscal year compared with 6.3% for fiscal 2005.

**Income taxes**

There was an income tax recovery of $44.0 million in fiscal 2006 compared with a recovery of $12.6 million in fiscal 2005. The low effective tax rate of the current fiscal year is a result of the financing structure established as part of the Eckerd acquisition.

## COMPARISON OF THE FISCAL YEARS ENDED MAY 28, 2005 AND MAY 31, 2004

### Net earnings

For the 52-week year ended May 28, 2005, net earnings were $104.4 million ($0.41 per share) compared with net earnings of $132.7 million ($0.58 per share) for the fiscal year ended May 31, 2004. Earnings before unrealized losses on financing activities were $112.2 million ($0.44 per share) compared to $132.7 million ($0.58 per share) for the previous corresponding fiscal year. There was an unrealized $7.8 million ($0.03 per share) foreign exchange loss on monetary items recorded in fiscal 2005. During that fiscal year, the Company reviewed its arrangements and related documentation in order to ensure that all significant monetary items were properly hedged against future foreign exchange risk.

### Revenues

Total revenues, which include sales and other income, rose $6.574 billion or 216.1% to $9.617 billion for the 52-week year ended May 28, 2005 compared with $3.043 billion for the fiscal year ended May 31, 2004. This increase was essentially attributable to the US operations and to the operation of the acquired Eckerd drugstores.

***Canada.*** Revenues from Canadian operations showed double digit growth during the 2005 fiscal year, reaching $1.406 billion, an increase of $170.4 million or 13.8% from revenues of $1.236 billion in fiscal 2004. Canadian revenues increased by 6.6%, excluding the impact of currency exchange rate fluctuations. During this 52-week year there were 7 openings, including 5 relocations of PJC franchised stores, compared with 13 openings, 4 relocations and 1 closure during fiscal 2004. In addition, 7 stores were significantly renovated and 6 were expanded during fiscal 2005. Sales increases reflect growth resulting from previous period openings, renovations or relocations of network stores and growth in PJC same-store retail sales. For the 52-week year ended May 28, 2005, compared with the fiscal year ended May 31, 2004, on a same-store basis and in local currency, total PJC retail sales grew 5.5%, pharmacy sales gained 8.0% and front-end sales picked up 2.1% year-over-year.

***United States.*** Revenues from US operations increased substantially to $8.211 billion for the 52-week year ended May 28, 2005, up $6.404 billion or 354.4% from revenues of $1.807 billion in fiscal 2004. The increase is principally due to the additional revenue from the acquired Eckerd drugstores as of July 31, 2004. During fiscal 2005, Eckerd sales trends have improved significantly in both the pharmacy and the front-end. On a same-store basis, total retail sales grew 2.8%, pharmacy sales gained 3.9% and front-end sales increased 0.4% year-over-year. This measure did not include same-store sales for the acquired Eckerd drugstores, which were included in same-store sales beginning in the first quarter of fiscal 2006, after one year of ownership by the Company. During fiscal 2005, in addition to the acquisition of 1,551 drugstores, there were 117 new store openings, including 54 relocations and 28 store closures, bringing our US network to 1,922 Brooks and Eckerd stores as at May 28, 2005. During fiscal 2004, there were 4 net openings of Brooks drugstores, and our US network had 336 Brooks drugstores as at May 31, 2004.

Pharmacy sales were negatively impacted by the conversion of branded drugs to generics, which generally have a lower selling price but higher gross profits for the drugstore retailer. Over the past two fiscal years, the decrease in same-store pharmacy volume was partially due to the conversion of Claritin and Prilosec from prescription to over-the-counter status, and to the continued health concerns over women's hormone replacement therapy drugs. The Company made very good progress with Eckerd during this fiscal year. Generics as a percentage of total Eckerd pharmacy script count increased from 49% at the time of purchase to 53% by year-end with the generic substitution rate increasing from 84% to 92%. Third party health plans covered approximately 95% of pharmacy sales in fiscal 2005 and 2004. Front-end trends have improved, with strong growth in core health and beauty categories and private label products. We continued our shift towards the health and beauty and confectionery categories with a positive effect on gross margin, while we saw a decline in overall photography department sales due to the shift to digital photography.

**Gross profit**
***Canada.*** Total Canadian gross profit improved to $118.0 million for the 52-week year ended May 28, 2005, compared with $105.1 million for the previous fiscal year. Gross margin decreased slightly to 9.5% for fiscal 2005 compared with 9.6% for the previous corresponding fiscal year.

***United States.*** United States gross profit amounted to $2.041 billion for the 52-week year ended May 28, 2005, compared with $444.0 million for the previous corresponding fiscal year. This increase is attributable to the addition of the Eckerd business during our current fiscal year. The gross margin percentage of our US operations improved to 24.9% during the current fiscal year compared with 24.6% in fiscal 2004. The improvement is due to management's focus on optimal merchandising, mix and pricing in the front-end.

**Other revenues**
Other revenues, which are included in total revenue in the Company's Consolidated Financial Statements, increased to $169.0 million for fiscal 2005 from $149.9 million for the previous fiscal year, due principally to increased franchise fees, rental and other income.

**General and operating expenses**
General and operating expenses for the 52-week year ended May 28, 2005 were $1.878 billion, up from $452.3 million for the previous fiscal year. This increase is essentially attributable to the US operations and to the operation of the acquired Eckerd drugstores.

***Canada.*** General and operating expenses performance for the fiscal year represented 9.4% of revenues versus 9.6% in fiscal 2004.

***United States.*** General and operating expenses represented 21.3% of revenues in the United States versus 18.5% a year earlier. The Company incurred certain non-recurring acquisition and integration expenses during fiscal 2005. Also, since the acquired Eckerd drugstores had lower average sales per store than the then existing US network, general and operating expenses increased during the current fiscal year while we integrated and optimized headquarters, field staff and structure. In addition, the network undertook several store openings and other measures, which increased general and operating expenses, while store sales were being built.

**OIBA**
OIBA increased during fiscal 2005, advancing 81.3% to $452.7 million from $249.7 million in the corresponding 2004 fiscal year. OIBA as a percentage of revenues ended the year at 4.7% compared with 8.2% for the previous fiscal year. The decrease in OIBA margin for the 52-week year ended May 28, 2005 was affected by lower margins in the acquired Eckerd drugstores, as well as by our network integration and enhancement efforts during the fiscal year. This was partially offset by the continuing strong performance of existing Canadian operations.

**Amortization**
Amortization charges increased to $195.3 million during fiscal 2005, up $156.9 million from $38.4 million in fiscal 2004. The increase in the charges during fiscal 2005 reflects the Eckerd drugstore acquisition.

**Financial expenses**
Financial expenses were $162.1 million during fiscal 2005, an increase of $147.6 million over $14.5 million during fiscal 2004. The weighted average interest rate on the Company's long-term debt was 6.3% during the current fiscal year compared with 4.3% for fiscal 2004. The additional credit facilities and issuance of notes were used to provide the funds required for the Eckerd drugstore acquisition. During fiscal 2005, there was a $7.8 million unrealized foreign exchange loss on monetary items related to the Eckerd acquisition, reflecting the loss until the Company reviewed its arrangements and related documentation in order to ensure that all significant monetary items were properly hedged against future foreign exchange risk.

### *Income taxes*

There was an income tax recovery of $12.6 million in fiscal 2005 compared with an expense of $61.1 million for fiscal 2004. The low effective tax rate of the current fiscal year is a result of the financing structure established as part of the Eckerd acquisition.

## SELECTED UNAUDITED QUARTERLY FINANCIAL INFORMATION

| *(in millions of US dollars, except per share amounts)* | **52 weeks ended May 27, 2006 $** | **Q4 2006 $** | **Q3 2006 $** | **Q2 2006 $** | **Q1 2006 $** | 52 weeks ended May 28, 2005 $ | Q4 2005 $ | Q3 2005 $ | Q2 2005 $ | Q1 2005 $ |
|---|---|---|---|---|---|---|---|---|---|---|
| **Sales** | **10,954.1** | **2,826.3** | **2,826.7** | **2,663.3** | **2,637.8** | 9,448.4 | 2,725.6 | 2,771.3 | 2,653.3 | 1,298.2 |
| Cost of goods sold | **8,401.2** | **2,171.9** | **2,170.3** | **2,037.8** | **2,021.2** | 7,289.9 | 2,078.1 | 2,129.7 | 2,054.0 | 1,028.1 |
| **Gross profit** | **2,552.9** | **654.4** | **656.4** | **625.5** | **616.6** | 2,158.5 | 647.5 | 641.6 | 599.3 | 270.1 |
| As a % of sales | **23.3%** | **23.2%** | **23.2%** | **23.5%** | **23.4%** | 22.8% | 23.8% | 23.1% | 22.6% | 20.8% |
| Other revenues [1] | **192.8** | **49.8** | **49.9** | **46.9** | **46.2** | 172.5 | 43.7 | 45.0 | 44.5 | 39.3 |
| General and operating expenses | **2,249.1** | **574.3** | **569.1** | **547.3** | **558.4** | 1,878.3 | 542.8 | 561.3 | 526.7 | 247.5 |
| **Operating income before amortization** | **496.6** | **129.9** | **137.2** | **125.1** | **104.4** | 452.7 | 148.4 | 125.3 | 117.1 | 61.9 |
| Amortization [1] | **231.7** | **45.6** | **62.3** | **62.2** | **61.6** | 198.8 | 57.9 | 58.3 | 56.5 | 26.1 |
| **Operating income** | **264.9** | **84.3** | **74.9** | **62.9** | **42.8** | 253.9 | 90.5 | 67.0 | 60.6 | 35.8 |
| Financing expenses | **205.1** | **52.9** | **52.8** | **48.7** | **50.7** | 162.1 | 47.5 | 32.8 | 64.1 | 17.7 |
| **Earnings (losses) before income taxes** | **59.8** | **31.4** | **22.1** | **14.2** | **(7.9)** | 91.8 | 43.0 | 34.2 | (3.5) | 18.1 |
| Income taxes (recovery) | **(44.0)** | **1.1** | **(9.5)** | **(16.6)** | **(19.0)** | (12.6) | (3.2) | (5.7) | 0.5 | (4.2) |
| **Net earnings (losses)** | **103.8** | **30.3** | **31.6** | **30.8** | **11.1** | 104.4 | 46.2 | 39.9 | (4.0) | 22.3 |
| **Net earnings (losses) per share** | **0.40** | **0.12** | **0.12** | **0.12** | **0.04** | 0.41 | 0.18 | 0.15 | (0.02) | 0.09 |
| **Earnings per share before unrealized losses (gains) on financing activities** | **0.44** | **0.16** | **0.12** | **0.11** | **0.05** | 0.44 | 0.18 | 0.10 | 0.06 | 0.09 |

[1] Amortization of incentives paid to franchisees is grouped with amortization instead of other revenues as in the Consolidated Financial Statements.

- The Company acquired 1,549 Eckerd drugstores on July 31, 2004, during the first quarter of fiscal 2005, resulting in a substantial change in operations and operating results.
- During the second and third quarters of fiscal 2005, there was a $19.7 million unrealized foreign exchange loss followed by a $11.9 million unrealized foreign exchange gain on monetary items related to the Eckerd acquisition, reflecting the loss and gain until the Company reviewed its arrangements and related documentation in order to ensure that all significant monetary items were properly hedged against future foreign exchange risk. The fiscal 2005 unrealized loss amounted to $7.8 million.
- Fiscal 2005 fourth quarter OIBA was positively impacted by $21 million, due to changes in estimates for some Eckerd network operating expenses and revenues on the basis of new information obtained during the quarter. These changes in estimates were accounted for on a prospective basis.
- At the end of the fiscal year ended May 28, 2005, the Company announced the closing of 78 non performing Eckerd drugstores, which was completed during the first quarter of fiscal 2006. The net addition to the provision for store closures and to the write-down of related assets, which are included in the purchase price equation as at May 28, 2005, amounted to $100.5 million.

The weather has an effect on the general population's health and, by extension, on the Company's retail sales and those of our franchised outlets. For example, in winter, the Company sells more cold and flu medicine, while in summer allergy and sun protection products are in greater demand. Corporate and franchised outlet sales are affected by holidays such as Christmas, Easter, Thanksgiving, Valentine's Day, Mother's Day and Father's Day. The peak sales period is generally the Company's third quarter of its fiscal year, which includes Christmas.

## FINANCIAL DATA

The following table presents reconciliation of earnings for the 13-week periods ended May 27, 2006 and May 28, 2005.

| *(in millions of US dollars, except per share amounts)* | **Q4-2006**<br>**$** | Q4-2005<br>$ |
|---|---|---|
| **Reconciliation of OIBA with net earnings** | | |
| **Net earnings** | **30.3** | 46.2 |
| Financial expenses | **52.9** | 47.5 |
| Income taxes (recovery) | **1.1** | (3.2) |
| **Operating income** | **84.3** | 90.5 |
| Amortization per financial statements | **44.7** | 57.0 |
| Amortization of incentives paid to franchisees [1] | **0.9** | 0.9 |
| **Operating income before amortization (''OIBA'')** | **129.9** | 148.4 |
| **Reconciliation of earnings and earnings per share before unrealized losses (gains) on financing activities** | | |
| **Net earnings** | **30.3** | 46.2 |
| Unrealized foreign exchange losses (gains) on monetary items | **11.2** | (0.4) |
| **Earnings before unrealized losses (gains) on financing activities** | **41.5** | 45.8 |
| **Net earnings per share** | **0.12** | 0.18 |
| Unrealized losses (gains) on financing activities | **0.04** | - |
| **Earnings per share before unrealized losses (gains) on financing activities** | **0.16** | 0.18 |

[1] Amortization of incentives paid to franchisees is grouped with other revenues in the Consolidated Financial Statements.

## FOURTH QUARTER ENDED MAY 27, 2006 COMPARED WITH THE FOURTH QUARTER ENDED MAY 28, 2005

**Net earnings**

For the fourth quarter, net earnings were $30.3 million ($0.12 per share) compared with $46.2 million ($0.18 per share) for the fourth quarter of the previous fiscal year. Earnings before unrealized losses on financing activities were $41.5 million ($0.16 per share) compared to $45.8 million ($0.18 per share) for the fourth quarter of the previous fiscal year.

Canadian network performance continues to improve while US network same-store sales growth has improved due to improving pharmacy sales trends. US network front-end sales showed improvement in categories such as consumables, health and beauty products, but continue to be impacted by the significant decline in the photo category.

**Revenues**

Total revenues, which include sales and other income, rose $106.8 million or 3.9% to $2.875 billion for the 13-week period ended May 27, 2006 compared with $2.768 billion for the corresponding period in fiscal 2005.

***Canada***. Revenues from Canadian operations showed double digit growth, reaching $443.9 million, an increase of $75.4 million or 20.5%. Canadian revenues increased by 11.0%, excluding the impact of currency exchange rate fluctuations. During the 13-week period, there were 7 openings including 2 relocations as well as 3 acquisitions of stores and 1 store closure in the PJC franchised stores network. Sales increases reflected growth resulting from recent network development activity and previous period openings and renovations. For the fourth quarter ended May 27, 2006, on a same-store basis and in local currency, total PJC retail sales grew 5.5%, pharmacy sales gained 8.3% and front-end sales picked up 1.6% year-over-year.

***United States***. Revenues from US operations increased to $2.431 billion for the 13-week period ended May 27, 2006, up $31.4 million or 1.3% from the same period last fiscal year. The increase is principally due to growth in year-over-year pharmacy sales, net of the loss of sales from the 78 Eckerd drugstores closed during the first quarter of fiscal 2006. Total revenue from these closed stores was $47.2 million for the fourth quarter of fiscal 2005. During the fourth quarter of fiscal 2006 and on a same-store basis, total retail sales increased 2.7%, pharmacy sales gained 3.8% and front-end sales decreased 0.1% year-over-year. During the fourth quarter of fiscal 2006, there were 8 new store openings, including 5 relocations, 3 acquisitions and 1 store closure.

**Gross profit**

***Canada***. Gross profit from Canadian operations was $36.0 million for the fourth quarter compared to $32.0 million for the corresponding period of the previous fiscal year. Gross margin decreased to 9.1% for the 13-week period ended May 27, 2006 compared with 9.7% for the corresponding period in fiscal 2005, principally due to the timing of advertising revenue received during the fourth quarter of fiscal 2005.

***United States*****.** Gross profit from US operations amounted to $618.4 million for the 13-week period ended May 27, 2006 compared with $615.5 million for the corresponding period of the previous fiscal year. Gross margin decreased to 25.5% for the 13-week period ended May 27, 2006 compared with 25.7% for the corresponding period in fiscal 2005, due to pressures on pharmacy margins and the Company's efforts to reduce front-end inventory levels through promotional activities.

**Other revenues**

Other revenues, which are included in total revenues in the Company's Consolidated Financial Statements, increased to $48.9 million in the fourth quarter of fiscal 2006 from $42.8 million for the same period of the previous fiscal year. This increase is due principally to currency exchange rate fluctuations.

### General and operating expenses

General and operating expenses for the 13-week period ended May 27, 2006 were $574.3 million, up from $542.8 million for the same period last fiscal year, an increase of $31.5 million or 5.8%. It represented 20.0% of revenues compared with 19.6% a year earlier.

***Canada.*** General and operating expenses performance for the quarter represented 9.2% of revenues versus 8.8% last fiscal year.

***United States.*** General and operating expenses represented 21.9% of revenues in the United States versus 21.3% a year earlier. This item increased from $510.3 million in the fourth quarter of fiscal 2005 to $533.4 million in the fourth quarter of fiscal 2006, an increase of $23.1 million due principally to $9.0 million favorable changes in estimates for fiscal 2005 and a $11.0 million unfavorable change in the estimates of the cost of pre-acquisition Eckerd store closures recorded in fiscal 2006. The Company also incurred certain non-recurring integration expenses during both of these periods.

### OIBA

OIBA decreased in the fourth quarter of fiscal 2006 to $129.9 million from $148.4 million in the corresponding period of fiscal 2005. Fiscal 2005 fourth quarter OIBA was positively impacted by $21 million of favorable changes in estimates for some Eckerd network operating expenses and revenues on the basis of new information obtained in that quarter. Of these favorable changes in estimates, approximately $12 million impacted the cost of goods sold, and $9 million, the general and operating expenses. Excluding these changes of estimates accounted for prospectively in fiscal 2005, OIBA increased by $2.5 million compared to the corresponding period of fiscal 2005 and, as a percentage of revenues, ended the quarter at 4.5% compared with 4.6% for the same period in fiscal 2005.

Fiscal 2006 fourth quarter results were also impacted by some changes in estimates, with a minimal impact on OIBA. Approximately $11.0 million of these changes positively impacted gross profit but were offset by an $11.0 million charge to general and operating expenses due to the change in the estimates of the cost of pre-acquisition Eckerd store closures.

### Amortization

Amortization charges decreased to $44.7 million during the fourth quarter of fiscal 2006, down $12.3 million from the corresponding period in fiscal 2005. The decrease in the charges for the fourth quarter of fiscal 2006 is due principally to a change in estimates following the finalization of the detailed capital asset ledger with regard to the assets acquired as part of the Eckerd acquisition.

### Financial expenses

Financial expenses were $52.9 million during the fourth quarter of fiscal 2006, an increase of $5.4 million over the fourth quarter of fiscal 2005, due principally to a year-over-year increase in interest costs on the $1.2 billion of debt which bears interest at floating rates. The weighted average interest rate on the Company's long-term debt was 7.8% during the fourth quarter of fiscal 2006 compared with 6.6% for the corresponding period of fiscal 2005.

### Income taxes

There was an income tax expense of $1.1 million for the fourth quarter of fiscal 2006 compared with a tax recovery of $3.2 million for the corresponding period in fiscal 2005. The low effective tax rate of the current fiscal year is a result of the financing structure established as part of the Eckerd acquisition.

## FINANCIAL POSITION

Total assets were $5.591 billion as at May 27, 2006, a decrease of $103.9 million from May 28, 2005. Cash, cash equivalents and temporary investments, which amounted to $210.7 million as at May 28, 2005, decreased by $74.9 million during the year to $135.8 million as at May 27, 2006.

There was a use of cash due to net changes in non-cash asset and liability items of $164.0 million, excluding foreign currency translation adjustments during the 52-week year ended May 27, 2006, due principally to a $21.0 million increase in accounts receivable, prepaid expenses and income taxes receivable, a $68.2 million increase in inventories, a $48.3 million decrease in accounts payable, accrued liabilities and income taxes payable, and a $26.2 million decrease in other long-term liabilities. For further details, readers are referred to Note 24 of the Consolidated Financial Statements.

Inventories increased by $66.7 million during the fiscal year, from $1.678 billion at the end of fiscal 2005 to $1.745 billion at May 27, 2006. However, inventory levels decreased by $82.2 million during the fourth quarter of fiscal 2006 as a result of the US inventory reduction efforts.

During fiscal 2006, the Company purchased capital assets in the amount of $167.5 million and received proceeds of $130.5 million from the sale of certain real estate assets of its Canadian franchising segment, as well as of the former Eckerd headquarters.

Long-term debt decreased by $170.6 million during the fiscal year, from $2.561 billion at the end of fiscal 2005 to $2.391 billion at May 27, 2006. The Company used cash to repay long-term debt in the amount of $177.3 million during the year.

Shareholders' equity amounted to $1.566 billion as at May 27, 2006, an increase of $153.6 million from May 28, 2005, resulting principally from net earnings of $103.8 million, net of dividends of $27.0 million. In addition, there was a $74.8 million increase in the foreign currency translation adjustments account.

The following table provides a summary of information with respect to the Company's financial position at the end of the financial years indicated. Readers are also referred to the footnotes to the Consolidated Financial Statements, and to publicly available credit and debt agreements.

| | **As at May 27, 2006** | As at May 28, 2005 |
|---|---|---|
| Net debt/ Book capitalization | **59.0%** | 62.5% |
| Net debt / OIBA [(1)] | **4.5** | 4.8 |
| OIBA / Interest [(1)] | **2.4** | 2.6 |

(1) Pro forma in fiscal 2005, Eckerd and related financing on a 52-week basis.

## LIQUIDITY AND CAPITAL RESOURCES

The Company's cash flows are generated by: i) the sale of prescription drugs and other products by corporate-owned stores, ii) merchandise sales to, and rent received from, PJC franchised stores, iii) the collection of royalties from PJC franchisees, and iv) rent from properties leased to tenants other than franchisees. These cash flows are used: i) to purchase products and services for resale, ii) to finance operating expenses, iii) for debt service, iv) for real estate investments, and v) to finance capital expenditures incurred to renovate and open stores, and replace equipment. We have typically financed capital expenditures and working capital requirements through cash flow from operating activities. Our larger acquisitions have been financed through long-term debt and equity.

**Cash flow from operating activities**
Cash provided by operating activities was $164.7 million for the 52-week year ended May 27, 2006, compared with $222.1 million in fiscal 2005. The decrease in the year-over-year amounts results primarily from the cash generated from net cash earnings, net of changes in non-cash items. Cash was used for non-cash asset and liability items during both fiscal years, with almost half of the $164.0 million used during fiscal 2006 to fund an increase in US inventory levels as a result of supply chain disruptions. During the fourth quarter of fiscal 2006, these levels decreased by $82.2 million as a result of the US inventory reduction efforts.

**Cash flow from investing activities**
Cash provided by investing activities was $33.3 million for the 52-week year ended May 27, 2006 compared with a use of $2.754 billion in fiscal 2005. During fiscal 2005, $2.492 billion was used to acquire 1,549 Eckerd drugstores and related operations. During fiscal 2006, a total of $74.3 million was provided by the proceeds of the sale of investments and temporary investments, compared with a use of $75.1 million in fiscal 2005. $167.5 million was used to acquire capital assets in fiscal 2006 compared with $195.3 million in fiscal 2005. During fiscal 2006, 50 new drugstores were opened, of which 25 were relocations. 7 stores were acquired, 90 drugstores were closed and several others were expanded or renovated. During fiscal 2006, the Company received proceeds of $130.5 million from the disposal of certain real estate assets of its Canadian franchising segment, as well as of the former Eckerd headquarters. During fiscal 2005, it received $15.1 million of proceeds from the disposal of capital assets.

During the second quarter of fiscal 2006, the Company sold certain real estate assets of its Canadian franchising segment for a total consideration of $94.0 million ($C111.7 million) in cash and entered into leaseback agreements for the areas used by the Jean Coutu drugstores. The Company realized a pre-tax gain on disposal of $20.9 million ($C 24.8 million). Even though the leaseback portion represents only 41% of the leasable area sold, GAAP requires, under certain criteria, that the entire gain be deferred over the life of the new leases which have an average duration of approximately 16 years.

In fiscal 2007, the Company plans to allocate approximately $300 million to capital expenditures, with $50 million allocated to spending in Canada and $250 million in the United States.

Following an extensive review of its US drugstore network's overall competitiveness, the Company plans to deploy an aggressive capital expenditure program in the Brooks Eckerd network. The Company expects to spend $46 million on the addition of approximately 9 new drugstores and the relocation of another 19 stores in key strategic markets. Planned investments for the remodel and renovation program, which covers over 1,000 store projects, total $58 million. This program will give the selected Brooks Eckerd drugstores a new look and an improved shopping experience to build sales and market share. The Company expects to spend $24 million during fiscal 2007 to complete the construction of the new corporate headquarters. $78 million has been allocated for information technology systems integration centered on uniform pharmacy and point-of-sale systems. Finally, expenditures for other initiatives, including distribution center, logistics and front-end, are expected to total $44 million. In addition, in the ordinary course of business, the Company may acquire stores and related assets, including pharmacy customer lists or other complementary businesses.

**Cash flow from financing activities**
During the 52-week year ended May 27, 2006, $206.7 million was used in financing activities compared with $2.638 billion provided by these activities in fiscal 2005. During fiscal 2006, the Company repaid long-term debt in the amount of $177.3 million compared with a $2.237 billion net increase in long-term debt in fiscal 2005. During fiscal 2006, the Company received net proceeds of $0.4 million from the issuance of capital stock compared with net proceeds of $426.5 million in fiscal 2005. The Company paid dividends of $27.0 million in fiscal 2006, up from $25.4 million in fiscal 2005. The Company paid a quarterly dividend of $C0.03 per Class A subordinate voting share and Class B share, resulting in an annualized dividend payment of $C0.12 per share during fiscal 2006 and fiscal 2005.

Planned capital expenditures in fiscal 2007 will be funded entirely from internally generated cash flow. Remaining free cash flow will be used for the quarterly payment of dividends with the balance directed largely towards the repayment of debt.

The Company had $135.8 million of cash and cash equivalents as at May 27, 2006 compared with cash, cash equivalents and temporary investments of $210.7 million as at May 28, 2005. In addition, it had access to up to an unused $279.3 million of its $350.0 million secured revolving facility maturing in 2009, net of $70.7 million of outstanding letters of credit.

On March 10, 2006, the Company amended its senior secured credit facility maturing in 2011 in order to gain more flexibility to execute its business plan. The amended facility requires compliance with certain financial covenants, which include (a) a maximum leverage ratio of 5.25x through September 2, 2006, decreasing gradually over time to 2.50x as of March 1, 2009 and (b) a minimum fixed charge coverage ratio of 1.1x, increasing gradually over time to 1.4x for the fiscal quarter ended on or about May 31, 2010.

The Company has operating liquidities and access to credit facilities to finance its operating activities.

Current ratings for the Company's obligations, as confirmed by Standard & Poor's (S&P), Moody's Investors Service (Moody's), Fitch Ratings (Fitch) and Dominion Bond Rating Service (DBRS) are as follows:

| | S&P | Moody's | Fitch | DBRS |
|---|---|---|---|---|
| Secured credit facilities | BB- | $B_2$ | BB- | B (high) |
| Senior notes | | | | |
| • Unsecured | B- | $B_3$ | B+ | B |
| • Unsecured subordinated | B- | $Caa_2$ | CCC+ | B (low) |

In assessing the Company's financial strength, management believes that the rating agencies considered the Company's strategies, results, capital structure and financial policies, as well as its consolidated balance sheet. S&P and Moody's lowered their credit ratings while Fitch and DBRS initiated coverage during fiscal 2006. The Company does not subscribe to the services of Fitch and DBRS. The ratings downgrades did not result in any cash payment requirement or affect the Company's availability under its credit facilities.

The Company's existing bank covenants and interest rates are not based on corporate ratings; however, the Company's debt ratings have a direct impact on future borrowing costs, access to capital markets and new store operating leases.

## CAPITAL STOCK

During the 52-week year ended May 27, 2006, there were 0.1 million Class A subordinate voting shares issued due to the exercise of stock options.

As at August 3, 2006 the total number of Class A subordinate voting shares (TSX: PJC.A) issued and outstanding was 142.3 million (2005 – 142.2 million) and the number of Class B shares amounted to 119.4 million, for a total of 261.7 million shares outstanding (May 28, 2005 – 261.6 million).

For the 52-week year ended May 28, 2005, 33.3 million Class A subordinate voting shares were issued and outstanding at a price of $C17.45 per share for net proceeds of $C564.4 million or $US424.4 million. 0.9 million Class B shares were exchanged for an equivalent number of Class A subordinate voting shares and 1.4 million new Class A subordinate voting shares were issued due to the exercise of stock options.

## CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS

The table below presents a summary of our material contractual cash obligations as of May 27, 2006, for the periods indicated under our long-term debt, long-term leases, inventories, services and capital assets commitments:

| | **Payments due in fiscal years** | | | | |
|---|---|---|---|---|---|
| *(in millions of US dollars)* | **2007**<br>**$** | **2008-2009**<br>**$** | **2010-2011**<br>**$** | **2012 and thereafter**<br>**$** | **Total**<br>**$** |
| Long-term debt | 69.5 | 122.2 | 556.1 | 1,628.2 | 2,376.0 |
| Capital lease obligations | 9.6 | 5.7 | 0.2 | - | 15.5 |
| Operating lease obligations | 380.7 | 709.1 | 626.6 | 2,494.0 | 4,210.4 |
| Purchase commitments | 47.5 | 22.8 | 6.6 | - | 76.9 |
| Total | 507.3 | 859.8 | 1,189.5 | 4,122.2 | 6,678.8 |

**Long-term debt**
On July 31, 2004, the Company completed the Eckerd acquisition. This acquisition was funded by a combination of long-term credit facilities, notes and the issuance of subordinate voting shares. During fiscal 2006, the Company repaid a portion of such debt and, as a result, long-term debt, including current portion, decreased to $2,391 billion as at May 27, 2006 from $2.561 billion as at May 28, 2005.

**Capital lease obligations**
The Company has generally not used capital leases as a means of financing. The Company has capital leases for certain store and operating equipment. The information listed in the table above includes interest obligations under such capital lease obligations, and obligations in connection with these contracts and related assets are also included in our consolidated balance sheet.

**Operating lease obligations**
The Company leases a substantial portion of its real estate using conventional operating leases. Generally, the Company's real estate leases are for primary terms of 10 to 20 years with options to renew.

Operating lease obligations until 2047 amounted to $4.210 billion, and are mostly in connection with leased properties. The Company has also signed lease and sublease agreements under which it will receive minimum payments totaling $308.4 million until 2047; these payments are not included in the table of contractual commitments above.

## FINANCIAL INSTRUMENTS AND OFF-BALANCE SHEET ARRANGEMENTS

Other than the two interest rate swap contracts mentioned below, the Company does not make use of any off-balance sheet arrangements that currently have, or that we expect are reasonably likely to have, a material effect on financial condition, results of operations or cash flow. The Company uses operating leases for many of its Canadian and US store locations, and, from time to time, engages in sale-leaseback transactions for financing purposes. The Company does not use special purpose entities in any of its leasing arrangements.

We are exposed to market risk relating to changes in interest rates with regard to our variable rate debt. We have a significant amount of debt, $1.2 billion of which bears interest at floating rates (2005 - $1.3 billion).

The Company had a fixed interest rate swap contract that matured in January 2005 to hedge interest rate fluctuations on a term loan which was repaid as part of the Eckerd acquisition financing, which amounted to $180 million as at July 31, 2004. The Company recorded a $2.1 million pre-tax charge to fiscal 2005 results related to this contract.

During fiscal 2005, the Company entered into two interest rate swap transactions maturing in July 2011 to fix the LIBOR rate on a notional portion of $200 million of the Company's term loan facilities at 4.11%. These transactions qualified for hedge accounting.

Other than the transactions mentioned herein, the Company has not taken any other specific actions to cover its exposure to interest rate risk. Depending on the interest rate environment and subject to approval by the Board of Directors, the Company may make use of other derivative financial instruments or other interest rate management vehicles in the future. A change of 50 basis points in interest rate on the Company's floating rate debt for fiscal 2006 would have a $5.8 million pre-tax effect on results and cash flows for the 52-week year ended May 27, 2006.

**Guarantees and buyback agreements**

The Company has guaranteed reimbursement of certain bank loans contracted by franchisees to a total maximum amount of $5.0 million (2005 - $6.0 million). The Company is also committed to financial institutions to purchase the equipment and inventories of some of its franchisees. As at May 27, 2006, the maximum value of the equipment and inventories buyback agreements was approximately $22.3 million and $55.7 million respectively ($23.1 million and $46.1 million in 2005).

On July 31, 2004, the Company acquired the shares of three subsidiaries of TDI Consolidated Corporation to complete the acquisition of the Eckerd drugstore properties. The Company has entered into an indemnification agreement that is described in Note 18 of the Consolidated Financial Statements.

## FOREIGN EXCHANGE RISK MANAGEMENT

Even though the Company's reporting currency is the US dollar, non-Consolidated Financial Statements of the parent company and its subsidiaries are prepared based on their respective functional currencies, which is the US dollar for US operations and the Canadian dollar for Canadian operations and corporate activities.

Transactions denominated in currencies other than an entity's functional currency are translated according to the temporal method. Under this method, monetary assets and liabilities in foreign currencies are translated at the exchange rate in effect at the balance sheet date, non-monetary assets and liabilities in foreign currencies at their historical rates, and statement of earnings items in foreign currencies at the average monthly exchange rates. All exchange gains and losses are current in nature and are included in the consolidated statement of earnings, unless subject to hedge accounting.

In order to avoid the impact of foreign currency rate fluctuations, the Company reviewed its arrangements and related documentation during fiscal 2005 so as to ensure that all significant monetary items were properly hedged against foreign exchange risk.

## RELATED PARTY TRANSACTIONS

Our operations include transactions with an enterprise controlled by an executive with significant influence on the Company. As at May 27, 2006 and May 28, 2005, Mr François J. Coutu, President of Canadian Operations and Vice-Chairman of the Company, owned a PJC franchise.

The transactions between the Company and this enterprise are executed in the normal course of business and measured at the exchange amount. Details are included in Note 22 of the Consolidated Financial Statements.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

**Estimates**
This MD&A is based on the Company's Consolidated Financial Statements, which have been prepared in accordance with Canadian GAAP. The preparation of these Consolidated Financial Statements and related notes requires the Company's management to make estimates and assumptions that affect the reported amounts. These estimates are based on historical experience and various other assumptions that management believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources.

**Inventory**
Our inventory consists primarily of products acquired for resale, including prescription drugs and over-the-counter medications, as well as household, cosmetics and photography products. Inventory is valued at the lower of cost and net realizable value, the cost being determined using either the first in, first out method, the average unit cost or retail selling price less a normal gross profit method. Determining gross profit margins requires that management make judgments and estimates that could affect inventory valuation at the end of the fiscal year and related annual operating results.

**Intangible assets**
Intangible assets with a finite life are accounted for at cost and amortized on a straight-line basis. They are made up of customer prescription files, non-compete agreements and favorable leases. Prescription files are amortized over a period of five to ten years, non-compete agreements over the terms of the agreements, and favorable leases are amortized over the term of the leases. The use of different assumptions with regard to the duration of useful life could give rise to different book values for intangible assets.

**Goodwill and trade name**

Goodwill represents the excess of the acquisition cost of companies over the fair value of the identifiable net assets acquired, not subject to amortization. Trade name is an intangible asset with an indefinite life, not subject to amortization. Goodwill and trade name are tested for impairment annually or more frequently when changes in circumstances indicate a potential impairment. An impairment test may be necessary if a return is clearly insufficient in relation to historical or projected operating results, material changes in the use of acquired assets or in the Company's broad strategy, and significant negative economic or segmented trends. For the purposes of its analysis on impairment, the Company uses estimates and assumptions to establish the fair value of its reporting units. If these assumptions are incorrect, the carrying values of goodwill and trade name may have been overstated.

**Other long-term assets**

Other long-term assets are principally deferred costs related to financing fees and incentives paid to franchisees. Financing fees are amortized over the term of the long-term loan and incentives paid to franchisees are amortized over a 10-year period. The use of various assumptions with regard to useful life or term could give rise to different book values for these items that are included in long-term assets.

**Impairment of long-lived assets**

The Company determines the book value of long-lived assets on an ongoing basis. To determine the possibility of impairment, the Company examines the estimated undiscounted cash flows expected to be generated by these assets, as well as other indicators. Any permanent impairment in the carrying value of the assets is charged against earnings in the period the impairment is determined.

**Defined benefit pension plans**

The cost of pensions and other retirement benefits earned by employees is actuarially determined using the projected benefit method prorated on service and management's best estimate of expected plan investment performance, salary escalation and retirement age of employees. The use of different assumptions could result in different book values.

## CHANGES IN ACCOUNTING POLICIES AND RECENT PRONOUNCEMENTS

There were no changes in accounting policies that had a material impact on the Company's Consolidated Financial Statements in fiscal 2006. Readers are referred to Note 2 of the Consolidated Financial Statements for a full description of changes in accounting policies and recent pronouncements.

## RISKS AND UNCERTAINTIES

The Company is well positioned to capitalize on the growth in the North American retailing drugstore industry, based on its strong brands, a focus on excellence in customer service in pharmacy and front-end innovations with an emphasis on health and beauty. Demographic trends in Canada and the United States are expected to contribute to growth in the consumption of prescription drugs, and to the increased use of pharmaceuticals as the primary intervention in individual healthcare. Management believes that these trends will continue and that the Company will achieve sales growth through quality of offering and service levels in its drugstore network.

**Eckerd acquisition**

The Eckerd integration is the Company's largest to date. The Company could run into difficulties in realizing synergies and improving outlet performance in accordance with plan.

**The market for prescription drugs**

The Company is reliant on prescription drug sales for a significant and growing portion of its revenues and earnings. Prescription drug sales are subject to numerous federal, state, provincial and local laws and regulations governing many aspects of the sale and dispensing of prescription drugs, as well as the approval of new drugs. The Company's revenues are affected by the frequency and rate of introduction of successful prescription drugs. In addition, the conversion of prescription drugs to over-the-counter medication often creates a source of confusion for the customer that could result in a decrease in retail sales.

The continued efforts of health maintenance organizations, managed care organizations, pharmacy benefit management companies, governmental entities and organizations, and other third party payers to reduce prescription drug costs and pharmacy reimbursement rates could have an effect on revenue growth.

Pharmacy sales and gross margins will be affected by the 2006 introduction of Medicare Part D Drug Benefit coverage in the United States, as well as by the continued efforts by various government entities to reduce state Medicaid pharmacy reimbursement rates.

**Mail order pharmacy**

In the United States, the growth of mail order pharmacies and changes to pharmacy benefit plans requiring maintenance medications to be filled through a mandatory mail channel could hamper the Company's revenue growth.

**Competition**

The Company faces competition from all sides: local, regional, national and international companies, other drugstore chains and banners, independent pharmacies, supermarkets, discount retailers and Internet companies. This increased competition could lead to greater pricing pressure, a situation that would force us to increase sales volume and sell products and services at a lower price in order to remain competitive.

**Pharmacists and personnel**

The Company is known for its diversified approach which enables it to attract, hire and retain suitable pharmacists and management personnel. Over the past few years, the Company has successfully implemented pharmacist and management recruitment and retention programs.

**Pharmaceutical products supply chain**

Eckerd and Brooks drugstores obtain a majority of their pharmaceutical products from a single supplier, McKesson Corporation, with whom the Company has a long-term supply contract that is scheduled to expire in fiscal 2010. Any significant disruption in the Company's relationship with McKesson and related issues could have a material adverse effect on the Company. Failure to renew this contract with McKesson or another supplier under similar terms and conditions, or to move to a self-distribution model, could significantly disrupt operations and adversely affect the sales and profitability of US operations.

**Marketing programs**

The Company's ability to effectively establish effective marketing programs, including pricing strategies and price reduction programs implemented in response to competitive pressures and/or to stimulate demand, could affect sales.

**Variable rate debt**

Our credit facilities are subject to variable interest rates, thus exposing us to interest rate risk. Should interest rates rise, our variable rate debt service obligations would increase even if the amount borrowed remained the same.

**Currency fluctuation**
Our revenues are earned in US and Canadian dollars, whereas our credit facilities are denominated in US dollars only. Fluctuations in US and Canadian exchange rates could therefore expose the Company to currency risks.

**Seasonal nature of the business**
The weather has an effect on the general population's health and, by extension, on the Company's retail sales and those of our franchised outlets. For example, in winter, the Company sells more cold and flu medicine, while in summer, allergy and sun protection products are in greater demand. Corporate and franchised outlet sales are affected by holidays such as Christmas, Easter, Thanksgiving, Valentine's Day, Mother's Day and Father's Day. The peak sales period is generally the Company's third quarter of its fiscal year, which includes Christmas.

**Economic conditions**
Changes in economic conditions could adversely affect consumer buying patterns and reduce our revenues and profitability. The Company is affected by overall economic growth and unemployment.

## DISCLOSURE CONTROLS AND PROCEDURES

As at May 27, 2006, an evaluation was carried out, under the supervision of and with the participation of management, including the President and Chief Executive Officer, and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as defined under applicable law. Based on that evaluation, the President and Chief Executive Officer and Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective.

## COMPANY FILING UNDER THE *SARBANES-OXLEY ACT*

As required by the *Sarbanes-Oxley Act* enacted by the US Congress in July 2002 and the rules promulgated by the US Securities and Exchange Commission (SEC) thereunder, we have filed with the SEC certificates relating to, among others, the accuracy of the financial information contained in our 2006 MD&A and annual Consolidated Financial Statements and notes thereto, and the adequacy of our procedures and controls relating to disclosure and financial reporting.

As disclosed thereunder, there were no changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to have materially affected, the Company's internal control over financial reporting, for the 52-week year ended May 27, 2006.

The Company is reviewing its existing internal control over financial reporting in preparation for the reporting and attestation requirements of Section 404 of the *Sarbanes-Oxley Act* of 2002 becoming effective. In connection with such review, modifications will, as appropriate, be made to the Company's disclosure controls and procedures or internal control over financial reporting in the future.

August 3, 2006

# Management's report with respect to financial statements

The consolidated financial statements of The Jean Coutu Group (PJC) Inc. contained herewith are the responsibility of management, and have been prepared in accordance with Canadian generally accepted accounting principles. Where necessary, management has made judgements and estimates of the outcome of events and transactions, with due consideration given to materiality. Management is also responsible for all other information in this report and for ensuring that this information is consistent, where appropriate, with the information and data included in the consolidated financial statements.

To discharge its responsibility, management maintains a system of internal controls to provide reasonable assurance as to the reliability of financial information and the safeguarding of assets.

The Board of Directors carries out its responsibility relative to the consolidated financial statements principally through its Audit Committee, consisting solely of independent directors, which reviews the consolidated financial statements and reports thereon to the Board. The Committee meets periodically with the external auditors, internal auditors and management to review their respective activities and the discharge by each of their responsibilities. Both the external auditors and the internal auditors have free access to the Committee, with or without the presence of management, to discuss the scope of their audits, the adequacy of the system of internal controls and the adequacy of financial reporting.

The consolidated financial statements have been reviewed by the Audit Committee and approved by the Board of Directors. In addition, the Company's external auditors, Deloitte & Touche, LLP, are responsible for auditing the consolidated financial statements and providing an opinion thereon. Their report is provided herefater.

President and Chief Executive Officer

Senior Vice-President, Finances and Corporate Affairs

# Report of Independent Registered Chartered Accountants

To the Shareholders of
The Jean Coutu Group (PJC) Inc.

We have audited the consolidated balance sheets of The Jean Coutu Group (PJC) Inc. (the "Company") as at May 27, 2006 and May 28, 2005 and the consolidated statements of earnings, retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at May 27, 2006 and May 28, 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Deloitte & Touche LLP

Independent Registered Chartered Accountants

August 3, 2006

**THE JEAN COUTU GROUP (PJC) INC.**

## Consolidated statements of earnings

| For the years ended May 27, 2006 and May 28, 2005 | 2006 | 2005 |
|---|---|---|
| *(in millions of US dollars, unless otherwise noted)* | $ | $ |
| **Sales** | **10,954.1** | 9,448.4 |
| **Other revenues** (Note 3) | **189.0** | 169.0 |
| | **11,143.1** | 9,617.4 |
| **Operating expenses** | | |
| Cost of goods sold | **8,401.2** | 7,289.9 |
| General and operating expenses | **2,249.1** | 1,878.3 |
| Amortization (Note 4) | **227.9** | 195.3 |
| | **10,878.2** | 9,363.5 |
| **Operating income** | **264.9** | 253.9 |
| **Financing expenses** (Note 5) | **205.1** | 162.1 |
| **Earnings before income tax recovery** | **59.8** | 91.8 |
| **Income tax recovery** (Note 6) | **(44.0)** | (12.6) |
| **Net earnings** | **103.8** | 104.4 |
| **Net earnings per share,** in dollars (Note 7) | | |
| Basic | **0.40** | 0.41 |
| Diluted | **0.40** | 0.41 |

## Consolidated statements of retained earnings

| For the years ended May 27, 2006 and May 28, 2005 | 2006 | 2005 |
|---|---|---|
| *(in millions of US dollars)* | $ | $ |
| **Balance, beginning of year** | | |
| As previously reported | **787.6** | 709.4 |
| Restatement related to a change in accounting policy (Note 2d) | **-** | (0.8) |
| **Restated balance** | **787.6** | 708.6 |
| Net earnings | **103.8** | 104.4 |
| | **891.4** | 813.0 |
| Dividends | **27.0** | 25.4 |
| **Balance, end of year** | **864.4** | 787.6 |

The segmented information and the accompanying notes are an integral part of these consolidated financial statements.

**THE JEAN COUTU GROUP (PJC) INC.**

## Consolidated balance sheets

| *(in millions of US dollars)* | **As at May 27, 2006** **$** | As at May 28, 2005 $ |
|---|---|---|
| **Assets** | | |
| Current assets | | |
| Cash and cash equivalents | **135.8** | 132.2 |
| Temporary investments | **-** | 78.5 |
| Accounts receivable | **555.5** | 544.8 |
| Income taxes receivable | **16.5** | 6.8 |
| Inventories | **1,744.9** | 1,678.2 |
| Prepaid expenses and other | **47.3** | 41.0 |
| | **2,500.0** | 2,481.5 |
| **Investments** (Note 8) | **25.4** | 18.8 |
| **Capital assets** (Note 9) | **1,385.8** | 1,492.5 |
| **Intangible assets** (Note 10) | **689.4** | 729.6 |
| **Goodwill** (Note 11) | **876.8** | 866.5 |
| **Other long-term assets** (Note 12) | **113.6** | 106.0 |
| | **5,591.0** | 5,694.9 |
| **Liabilities** | | |
| Current liabilities | | |
| Accounts payable and accrued liabilities | **1,079.4** | 1,109.9 |
| Income taxes payable | **0.2** | 32.9 |
| Future income taxes (Note 6) | **147.8** | 97.8 |
| Current portion of long-term debt (Note 13) | **78.8** | 65.6 |
| | **1,306.2** | 1,306.2 |
| **Long-term debt** (Note 13) | **2,312.0** | 2,495.8 |
| **Other long-term liabilities** (Note 14) | **407.1** | 480.8 |
| | **4,025.3** | 4,282.8 |
| **Shareholders' equity** | | |
| Capital stock (Note 15) | **577.9** | 577.5 |
| Contributed surplus | **2.4** | 0.8 |
| Retained earnings | **864.4** | 787.6 |
| Foreign currency translation adjustments (Note 16) | **121.0** | 46.2 |
| | **1,565.7** | 1,412.1 |
| | **5,591.0** | 5,694.9 |

**Guarantees, contingencies and commitments** (Notes 18 and 19).

The segmented information and the accompanying notes are an integral part of these consolidated financial statements.

Approved by the Board

**Jean Coutu**
Director

**L. Denis Desautels**
Director

**THE JEAN COUTU GROUP (PJC) INC.**

## Consolidated statements of cash flows

| For the years ended May 27, 2006 and May 28, 2005 | 2006 | 2005 |
|---|---|---|
| *(in millions of US dollars)* | $ | $ |
| **Operating activities** | | |
| Net earnings | **103.8** | 104.4 |
| Items not affecting cash | | |
| Amortization | **227.9** | 195.3 |
| Amortization of deferred financing fees | **12.4** | 10.3 |
| Unrealized foreign exchange loss on monetary items | **10.9** | 7.8 |
| Future income taxes | **(29.9)** | (53.8) |
| Other | **3.6** | 5.7 |
| | **328.7** | 269.7 |
| Net changes in non-cash asset and liability items | **(164.0)** | (47.6) |
| Cash flow provided by operating activities | **164.7** | 222.1 |
| **Investing activities** | | |
| Business acquisitions (Note 21) | **-** | (2,491.8) |
| Investments and temporary investments | **74.3** | (75.1) |
| Purchase of capital assets | **(167.5)** | (195.3) |
| Proceeds from the disposal of capital assets | **130.5** | 15.1 |
| Purchase of intangible assets | **(10.8)** | (5.1) |
| Proceeds from the disposal of intangible assets | **8.7** | - |
| Other long-term assets | **(1.9)** | (1.8) |
| Cash flow provided by (used in) investing activities | **33.3** | (2,754.0) |
| **Financing activities** | | |
| Changes in bank loans | **-** | (15.0) |
| Issuance of long-term debt, net of expenses | **(2.8)** | 2,469.4 |
| Repayment of long-term debt | **( 177.3)** | (217.3) |
| Issuance of capital stock | **0.4** | 426.5 |
| Dividends | **( 27.0)** | (25.4) |
| Cash flow provided by (used in) financing activities | **( 206.7)** | 2,638.2 |
| **Foreign currency translation adjustments** | **12.3** | 11.3 |
| **Increase in cash and cash equivalents** | **3.6** | 117.6 |
| **Cash and cash equivalents, beginning of year** | **132.2** | 14.6 |
| **Cash and cash equivalents, end of year** | **135.8** | 132.2 |

See supplementary cash flow information in Note 24.

The segmented information and the accompanying notes are an integral part of these consolidated financial statements.

## Consolidated segmented information

**For the years ended May 27, 2006 and May 28, 2005**
*(in millions of US dollars)*

The Company has two reportable segments: franchising and retail sales. Within the franchising segment, the Company carries on the franchising activity of the "PJC Jean Coutu" banner, operates two distribution centers and coordinates several other services for the benefit of its franchisees. The Company operates retail sales outlets selling pharmaceutical and other products under the "Brooks" and "Eckerd" banners.

The Company analyzes the performance of its operating segments based on their operating income before amortization, which is not a measure of performance under Canadian generally accepted accounting principles ("GAAP"); however, management uses this performance measure for assessing the operating performance of its reportable segments.

Segmented information is summarized as follows:

| | **2006** | 2005 |
|---|---|---|
| | **$** | $ |
| **Revenues** [(1)] | | |
| Franchising | **1,635.4** | 1,406.2 |
| Retail sales | **9,507.7** | 8,211.2 |
| | **11,143.1** | 9,617.4 |
| **Operating income before amortization** | | |
| Franchising | **165.0** | 147.3 |
| Retail sales | **331.6** | 305.4 |
| | **496.6** | 452.7 |
| **Amortization** | | |
| Franchising [(2)] | **15.9** | 14.0 |
| Retail sales | **215.8** | 184.8 |
| | **231.7** | 198.8 |
| **Operating income** | | |
| Franchising | **149.1** | 133.3 |
| Retail sales | **115.8** | 120.6 |
| | **264.9** | 253.9 |

[(1)] Revenues include sales and other revenues.
[(2)] Including amortization of incentives paid to franchisees.

**THE JEAN COUTU GROUP (PJC) INC.**

## Consolidated segmented information

**For the years ended May 27, 2006 and May 28, 2005**

*(in millions of US dollars)*

| | **2006** | 2005 |
|---|---|---|
| | **$** | $ |
| **Acquisition of capital assets and intangible assets** (3) | | |
| Franchising | **43.2** | 33.0 |
| Retail sales | **135.1** | 167.4 |
| | **178.3** | 200.4 |

| | **As at May 27, 2006** | As at May 28, 2005 |
|---|---|---|
| | **$** | $ |
| **Capital assets, intangible assets and goodwill** | | |
| Franchising | **286.9** | 300.2 |
| Retail sales | **2,665.1** | 2,788.4 |
| | **2,952.0** | 3,088.6 |
| **Total assets** | | |
| Franchising | **729.5** | 737.2 |
| Retail sales | **4,861.5** | 4,957.7 |
| | **5,591.0** | 5,694.9 |

The Company's revenues, capital assets, intangible assets and goodwill as well as total assets for the geographic areas of Canada and the United States correspond respectively to the franchising and retail sales segments.

(1) Revenues include sales and other revenues.
(2) Including amortization of incentives paid to franchisees.
(3) Excluding business acquisitions.

## 1. Description of business and significant accounting policies

### a) *Description of business*

The Company is incorporated under the *Companies Act of Québec*. It has two reportable segments.

In Canada, the Company operates a franchisee network. Franchising activities include operating two distribution centers and providing various services to 327 franchised stores as of May 27, 2006 (May 28, 2005 - 321). In fiscal 2006, there were 11 new store openings (2005 - 2) and 5 closures of franchised stores (2005 - nil). The franchised store network retails pharmaceutical and parapharmaceutical products. The Company also manages all properties that house franchisee outlets.

In the United States, the Company operates a network comprising 1,858 corporate drugstores as at May 27, 2006 (May 28, 2005 - 1,922) that retail pharmaceutical and parapharmaceutical products, located in 18 states of the Northeast, mid-Atlantic and Southeast. During fiscal 2006, there were 21 new store openings (2005 - 1,614, of which 1,549 represented the acquisition of Eckerd drugstores) and 85 closures (2005 - 28).

### b) *Financial statements presentation*

The consolidated financial statements are prepared in accordance with Canadian GAAP.

The Company's reporting calendar is based on the US National Retail Federation 4-5-4 merchandising calendar. Accordingly, the Company's fiscal year is usually 52 weeks in duration but includes a 53rd week every 5 to 6 years. The years ended May 27, 2006 and May 28, 2005 each contained 52 weeks.

### c) *Basis of Consolidation*

The consolidated financial statements include the accounts of the parent company and all its subsidiaries. All intercompany transactions and balances have been eliminated on consolidation.

## 1. Description of business and significant accounting policies *(continued)*

### *d) Use of estimates*

The preparation of consolidated financial statements in conformity with Canadian GAAP requires management to make certain estimates and assumptions. These may affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements. They may also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The most significant areas requiring the use of management estimates relate to : inventory valuation, valuation of long-term assets, and reserves and allowances, specifically those related to store closures, workers' compensation and general liability, and income taxes.

### *e) Revenue recognition*

Sales to franchisees are recognized when merchandise is shipped. Retail sales are recognized at the time of the sale to the consumer. The Company recognizes its sales net of returns. Volume rebates and cash discounts granted to customers are accrued at the time of sale and recorded as a reduction of sales. The Company reports all direct merchandise shipment transactions on a net basis when acting as an agent between suppliers and franchisees.

Royalties are calculated based on a percentage of franchisees’ retail sales and are recorded as income as they are earned. The percentage is established in the franchisees' agreements.

Services to franchisees and rental income are recognized when services are rendered. When a lease contains a predetermined fixed escalation of the minimum rent, the Company recognizes the related rent income on a straight-line basis over the term of the lease.

Revenues are recognized when reasonable assurance exists regarding collectibility.

## 1. Description of business and significant accounting policies *(continued)*

### *f) Rate-regulated activities*

Certain of the Company’s franchising activities are rate-regulated. In the province of Quebec (Canada), in accordance with the Public Prescription Drug Insurance Plan, the Minister of Health and Social Services determines by statute the list of medications whose payment is covered by the plan and regulates the selling price of these medications. The list is comprised of the ministerally recognized prices of medications sold by manufacturers or wholesalers and the related price setting method. The preparation of the medication list is governed by the "Act respecting prescription drug insurance" and is updated periodically by ministerial statute after consultation with the *Conseil du médicament*.

The Company is obliged to sell the medications at such price, to which it has a right to add a mark-up, within a certain range determined by the government, in accordance with the "Regulation respecting the conditions on which manufacturers and wholesalers of medications shall be recognized".

### *g) Vendor allowance*

Cash considerations received from vendors represent a reduction of the prices of the vendors' products or services and are accounted for as a reduction of cost of goods sold and related inventory when recognized in the Company's consolidated statement of earnings and balance sheet. Certain exceptions apply when the cash considerations received are either a reimbursement of incremental costs incurred by the Company to sell the vendors' products, or is a payment for assets or services delivered to the vendors.

### *h) Foreign currency translation*

The non-consolidated financial statements of the parent company and its subsidiaries are prepared based on their respective functional currencies, which is the US dollar for US operations and the Canadian dollar for Canadian operations and corporate activities.

The financial statements of entities whose functional currency is not the US dollar are translated into the reporting currency according to the current rate method. Under this method, statement of earnings and statement of cash flow items of each year are translated to the reporting currency at the average monthly exchange rates and asset and liability items are translated at the exchange rate in effect at the balance sheet date. Translation adjustments resulting from exchange rate fluctuations are recorded in foreign currency translation adjustments in shareholders' equity.

## 1. Description of business and significant accounting policies *(continued)*

### *h) Foreign currency translation* *(continued)*

Transactions denominated in currencies other than an entity's functional currency are translated according to the temporal method. Under this method, monetary assets and liabilities are translated at the exchange rate in effect at the balance sheet date, non-monetary assets and liabilities at their historical rates and statement of earnings items at the average monthly exchange rates. All exchange gains and losses are current in nature and are included in the consolidated statements of earnings, unless subject to hedge accounting.

### *i) Net earnings per share*

Basic and diluted net earnings per share have been determined by dividing the consolidated net earnings for the year by the basic and diluted weighted average number of shares, respectively.

The diluted weighted average number of shares outstanding is calculated as if all dilutive options had been exercised at the later of the beginning of the reporting period or date of grant, using the treasury stock method.

### *j) Cash and cash equivalents*

Cash and cash equivalents are defined as cash and highly liquid investments that have maturities of less than three months at the date of acquisition.

### *k) Temporary investments*

Temporary investments are comprised of commercial paper that have maturities of more than three months and are valued at the lower of cost or market value.

### *l) Inventories*

Inventories are valued at the lower of cost and net realizable value, the cost being determined using either the first in, first out method, the average unit cost or retail selling price less a normal gross profit method.

### *m) Investments*

Investments in companies subject to significant influence are accounted for using the equity method. Other investments are accounted for using the cost method. Periodically, management analyzes each loan, advance and long-term receivable from franchisees and when a serious doubt as to their recovery is identified, a provision is applied to reduce their book value to the estimated realizable value.

## 1. Description of business and significant accounting policies *(continued)*

### *n) Capital assets*

Capital assets are accounted for at cost.

Amortization of buildings held for leasing was based on their estimated useful lives using the compound interest method until June 1, 2004. Since that date, the Company has used the straight-line method (Note 2e). Constructions in progress are not amortized until the asset is ready for its intended use. Amortization of other capital assets is based on their estimated useful lives using the straight-line and the diminishing balance methods at the following rates and terms:

| | **Methods** | **Rates and terms** |
|---|---|---|
| Buildings | Diminishing balance and straight-line | 5% and 12 to 31 years |
| Buildings held for leasing | Straight-line | 40 years |
| Leasehold improvements | Straight-line | Term of the lease or useful life, whichever is shorter |
| Equipment | Straight-line | 3 to 7 years |

Capital assets are tested for recoverability whenever events or changes in circumstances indicate that their carrying amount may not be recoverable.

### *o) Intangible assets*

Intangible assets with a finite service life are accounted for at cost. They consist mainly of customer prescription files, non-compete agreements and favorable leases. Intangible assets are amortized on a straight-line basis. Prescription files are amortized over a five to ten-year period. Non-compete agreements are amortized over the terms of the agreements. Favorable leases represent the value attributed to leases resulting from a business acquisition. The value of favorable leases is amortized over the remaining life of the leases.

Intangible assets with indefinite service life representing trade name are accounted for at cost and are not amortized. Trade name is tested for impairment annually or more frequently if changes in circumstances indicate a potential impairment. As at May 27, 2006 and May 28, 2005, the Company has performed impairment tests and no write-downs were necessary.

## 1. Description of business and significant accounting policies *(continued)*

### *p) Goodwill*

Goodwill represents the excess of the acquisition cost of businesses over the fair value of the identifiable net assets acquired and is not amortized. Goodwill is tested for impairment annually or more frequently if changes in circumstances indicate a potential impairment. As at May 27, 2006 and May 28, 2005, the Company has performed impairment tests and no write-downs were necessary.

### *q) Other long-term assets*

Other long-term assets are mainly the incentives paid to franchisees and deferred costs. Incentives paid to franchisees are amortized over a ten-year period and amortization is applied against royalties, included in other revenues. Deferred costs are accounted for at cost and are mainly financing fees. Amortization is calculated using the straight-line method over the term of the long-term loan and is recorded in the financing expenses.

### *r) Future income taxes*

The Company uses the tax asset and liability method to account for income taxes. Under this method, future tax assets and liabilities are determined according to differences between the carrying amounts and tax bases of assets and liabilities. They are measured by applying enacted or substantively enacted income tax rates and income tax laws at the date of the financial statements for the years in which the temporary differences are expected to reverse. Future tax assets are only recognized to the extent that, in the opinion of management, assets will more likely than not be realized.

### *s) Other long-term liabilities*

Except for the future income taxes, other long-term liabilities consist mainly of the deferred revenues, deferred lease obligations, unfavorable leases, workers' compensation and general liability and liabilities for store closures.

*Deferred revenues*: The Company receives allowances from its vendors as consideration for exclusivity agreements. The revenues related to these agreements are deferred when received and recognized as purchases are made, as stipulated by the agreement. Deferred revenues also include a deferred gain related to sale-leaseback, as described in Note 24.

*Deferred lease obligations*: The Company conducts a part of its operations in leased premises and recognizes minimum rent starting when possession of the property is taken from the landlord, which normally includes a pre-opening period. When a lease contains a predetermined fixed escalation of the minimum rent, the Company recognizes the related rent expense on a straight-line basis over the term of the lease and consequently, records the difference between the recognized rental expense and the amounts payable under the lease as deferred lease obligations. The Company also receives tenant allowances which are amortized on a straight-line basis over the term of the lease.

## 1. Description of business and significant accounting policies *(continued)*

### *s) Other long-term liabilities* *(continued)*

Lease payments that depend on factors that are not measurable at the inception of the lease, such as future sales volume, are contingent rentals in their entirety and are excluded from minimum lease payments and included in the determination of total rental expense when the expense has been incurred and the amount is reasonably estimable.

*Unfavorable leases*: The value attributed to unfavorable leases resulting from a business acquisition is amortized on a straight-line basis over the remaining life of the leases.

*Workers' compensation and gereral liability*: Workers' compensation and general liability reserves are based on actuarially determined estimates of reported and incurred but not reported claims resulting from historical experience and current data.

*Liabilities for store closures*: Store closure reserves are established at the present value of lease obligations, net of estimated sublease rental income and other exit costs.

### *t) Stock-based compensation plan*

The Company has a fixed stock option plan, which is described in Note 17. Since June 1, 2003, stock-based compensation cost is recorded under the fair value method. According to that method, awards of stock options are measured on their date of grant using the fair value based method, and are expensed and credited to contributed surplus over their vesting period. These credits are reclassified to capital stock when the related stock options are exercised.

### *u) Defined benefit pension plans*

The Company maintains defined benefit pension plans for some of its senior officers, which include a registered pension plan in Canada as well as non-registered supplemental pension plans in Canada and United States.

In Canada, the registered pension plan is funded as required by the applicable laws and the supplemental plan is partly funded through retirement compensation arrangements (RCA). The amount of contributions required for funding purposes is determined by actuarial valuations performed triennially. The most recent actuarial valuation was performed as at December 31, 2005 and the effective date of the next actuarial valuation is December 31, 2008.

The Company accrues its obligations under employee benefit plans and the related costs, net of plan assets. The cost of pensions and other retirement benefits earned by employees is actuarially determined using the projected benefit method prorated on service and management’s best estimate of expected plans’ investment performance, salary escalation and retirement age of employees. For the purpose of calculating the expected return on plan assets, those assets are valued at fair value. The fair value is market value.

## 1. Description of business and significant accounting policies *(continued)*

### *u) Defined benefit pension plans* *(continued)*

Past service costs are amortized on a straight-line basis over the average remaining service period of active employees, at the date of amendment.

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 is amortized over the average remaining service period of active employees. The average remaining service period of active employees covered by the pension plans was 9.6 years as at May 27, 2006 (9.6 years as at May 28, 2005).45

### *v) Defined contribution pension plans*

For defined contribution plans, the pension expense is equal to the contributions of the Company.

### *w) Derivative financial instruments*

The Company uses various derivative financial instruments to manage interest rate risk and foreign exchange rate risk. The Company does not use derivative financial instruments for speculative or trading purposes.

The Company formally documents all relationships between derivatives and the items it hedges, and its risk management objective and strategy for using various hedges. Derivatives that are economic hedges, but do not qualify for hedge accounting, are recognized at fair value with the changes in fair value recorded in earnings.

The Company uses interest rate swap agreements to help manage the fixed and floating interest rate mix of its total debt portfolio. These agreements involve exchanging interest payments without exchanging the notional principal amount that the payments are based on. The Company records the exchange of payments as an adjustment of interest expense on the hedged debt. The Company includes the related amount receivable or payable from counterparties in accounts receivable or in accounts payable and accrued liabilities.

The Company uses a portion of its US dollar liabilities as a foreign exchange hedge of its net investments in its US subsidiaries. Accordingly, corresponding foreign exchange gains and losses are recorded in foreign currency translation adjustments in the shareholders' equity to offset the foreign currency translation adjustments on the investments.

## 2. Accounting policies

## Changes in accounting policies

## 2006

### *a) Financial Instruments - Disclosure and Presentation*

In November 2003, the Accounting Standards Board approved a revision to Canadian Institute of Chartered Accountants (CICA) Handbook Section 3860, "Financial Instruments – Disclosure and Presentation." These revisions change the accounting for certain financial instruments that have liability and equity characteristics. It requires instruments that meet specific criteria to be classified as liabilities on the balance sheet. Some of these financial instruments were previously classified as equity. These revisions are effective for fiscal years beginning on or after November 1, 2004. Because the Company does not have any instruments with these characteristics, adopting these revisions on June 1, 2005 had no impact on its consolidated financial statements.

### *b) Non-monetary transactions*

In June 2005, the CICA revised the existing Section 3830, "Non-monetary transactions", and replaced it by Section 3831, "Non-monetary transactions". The revised standard has the goal of replacing the criteria based on the culmination of the earnings process with one based on commercial substance for the measurement of a non-monetary transactions at fair value. The revised standard is applied to non-monetary transactions initiated in periods beginning after January 1, 2006. The adoption of this Section had no material impact on the Company's consolidated financial statements.

### *c) Consideration given by a vendor to a customer*

In September 2005, the Emerging Issues Committee (EIC) of the CICA issued Abstract 156 (EIC-156), "Accounting by a Vendor for Consideration Given to a Customer (Including a Reseller of the Vendor's Products)". This EIC-156, which is harmonized with the equivalent United States Abstract of the Emerging Issues Task Force (EITF) 01-9 "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)", provides guidance on the accounting treatment and classification of sales incentives or other consideration given to a customer and indicates when these items should be recorded as a reduction of revenue or as an expense.

EIC-156 should be applied retroactively, with restatement of prior periods, to all interim and annual financial statements for fiscal years beginning on or after January 1, 2006. The adoption of EIC-156 had no material impact on the Company's consolidated financial statements.

*(Tabular amounts are in millions of US dollars, unless otherwise noted)*

## 2. Accounting policies (continued)

## 2005

### *d) Consideration received from a vendor*

In January 2004, the EIC of the CICA released Abstract 144 (EIC-144), "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor." EIC-144 specifies the accounting methods to be applied to certain consideration received from a vendor. EIC-144 should be applied retroactively to all financial statements for annual and interim periods ending after August 15, 2004.

EIC-144 stipulates that cash consideration received by a company from a vendor is presumed to be a reduction of the prices of the vendor's products or services and should, therefore, be accounted for as a reduction of cost of goods sold and related inventory when recognized in the company's statement of earnings and balance sheet. Certain exceptions apply when the cash consideration received is either a reimbursement of incremental costs incurred by the reseller to sell the vendor's products, or is a payment for assets or services delivered to the vendor.

The Company applied this new recommendation on June 1, 2004. The impact of this new recommendation for the year ended May 28, 2005 was as follows:

| | 2005 | |
|---|---|---|
| | Increase | Decrease |
| | $ | $ |
| Sales | 5.0 | - |
| Other revenues | - | 12.4 |
| Cost of goods sold | - | 47.5 |
| General and operating expenses | 40.1 | - |
| Net earnings | - | - |
| Retained earnings at beginning of year | - | 0.8 |

The impact of that change on the consolidated balance sheet as of May 28, 2005 is to decrease inventories by $1,454,000 and to increase income taxes by $451,000.

## 2. Accounting policies *(continued)*

### *e) Generally accepted accounting principles*

In July 2003, the CICA issued Handbook Section 1100, “Generally Accepted Accounting Principles.” This Section establishes standards for financial reporting in accordance with Canadian GAAP, and provides guidance on sources to consult when selecting accounting policies and determining appropriate disclosures when a matter is not dealt with explicitly in the primary sources of Canadian GAAP. The Company implemented the new section prospectively on June 1, 2004.

Effective June 1, 2004, the compounded interest method of amortization previously used for buildings held for leasing is no longer used. Accordingly, effective June 1, 2004, the Company amortizes the building costs of its buildings held for leasing on a straight-line basis over their useful lives. Building amortization is higher than it would have been reported under the prior policy by approximately $2,500,000 for the period ended May 28, 2005.

### *f) Hedging relationships*

On June 1, 2004, the Company adopted the provisions of Accounting Guideline 13 (AcG-13), "Hedging Relationships," that deals with the identification, designation, documentation and measurement of effectiveness of hedging relationships for the purposes of applying hedge accounting and EIC-128, "Accounting for Trading Speculative, or Non-Hedging Derivative Financial Instruments" issued in December 2001. Under EIC-128, derivative instruments that do not qualify as a hedge under AcG-13, are recorded in the balance sheet at fair value with changes in fair value recognized in net earnings. The effect of adopting the new recommendations had no material impact at time of adoption on the Company's consolidated financial statements.

### *g) Consolidation of variable interest entities*

In June 2003, the CICA issued Accounting Guideline 15 (AcG-15), "Consolidation of Variable Interest Entities" (VIEs). This Guideline addresses consolidation of VIEs to which the usual condition for consolidation does not apply because the VIEs have no voting interests or are otherwise not subject to control through ownership of voting interests. It requires existing unconsolidated VIEs to be consolidated by the primary beneficiary. This Guideline is required for annual and interim periods beginning on or after November 1, 2004. The adoption of AcG-15 had no material impact on the Company's consolidated financial statements.

## 2. Accounting policies *(continued)*

### *h) Asset retirement obligations*

In March 2003, the CICA issued Handbook Section 3110, "Asset Retirement Obligations," which is effective for fiscal years beginning on or after January 1, 2004 with retroactive restatement. The new standard provides guidance for the recognition, measurement and disclosure of liabilities for asset retirement obligations and the associated retirement costs. It applies to legal obligations pertaining to the retirement of tangible long-lived assets from acquisition, construction, development or normal operations. The standard requires the recognition of the fair value of a liability for an asset retirement obligation in the year in which it is incurred and when a reasonable estimate of fair value can be made. The adoption of CICA Handbook Section 3110 had no material impact on the Company's consolidated financial statements.

## Recent pronouncements

### *i) Comprehensive Income*

In April 2005, the CICA issued Handbook Section 1530, "Comprehensive Income." This Section is effective for fiscal years beginning on or after October 1, 2006. It describes how to report and disclose comprehensive income and its components. Comprehensive income is the change in a company’s net assets that results from transactions, events and circumstances from sources other than the company’s shareholders. It includes items that would not normally be included in net earnings, such as:

- changes in the currency translation adjustments relating to self-sustaining foreign operations;
- unrealized gains or losses on available-for-sale investments.

In April 2005, the CICA also made changes to Handbook Section 3250, "Surplus," and reissued it as Section 3251, "Equity." This Section is also effective for fiscal years beginning on or after October 1, 2006. The changes in how to report and disclose equity and changes in equity are consistent with the new requirements of Section 1530, "Comprehensive Income."

Adopting these Sections on June 3, 2007 will require the Company to start reporting the following items in its consolidated financial statements:

- comprehensive income and its components;
- accumulated other comprehensive income and its components.

## 2. Accounting policies *(continued)*

### *j) Financial Instruments - Recognition and Measurement*

In April 2005, the CICA issued Handbook Section 3855, "Financial Instruments – Recognition and Measurement." This Section is effective for fiscal years beginning on or after October 1, 2006. It describes the standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives.

This Section requires that:

- all financial assets be measured at fair value, with certain exceptions like loans and investments that are classified as held-to-maturity;
- all financial liabilities be measured at fair value if they are derivatives or classified as held for trading purposes. Other financial liabilities are measured at their carrying value;
- all derivative financial instruments be measured at fair value, even when they are part of a hedging relationship.

The Company is evaluating the impact on its consolidated financial statements of adopting this Section on June 3, 2007.

### *k) Hedges*

In April 2005, the CICA issued Handbook Section 3865, "Hedges." This Section is effective for fiscal years beginning on or after October 1, 2006, and describes when and how hedge accounting can be used. Hedging is an activity used by a company to change an exposure to one or more risks by creating an offset between:

- changes in the fair value of a hedged item and a hedging item;
- changes in the cash flows attributable to a hedged item and a hedging item; or
- changes resulting from a risk exposure relating to a hedged item and a hedging item.

Hedge accounting makes sure that all gains, losses, revenues and expenses from the derivative and the item it hedges are recorded in the statement of earnings in the same period.

The Company is evaluating the impact on its consolidated financial statements of adopting this Section on June 3, 2007.

*(Tabular amounts are in millions of US dollars, unless otherwise noted)*

## 3. Other revenues

| | **2006** | 2005 |
|---|---|---|
| | **$** | $ |
| Royalties [1] | **86.2** | 75.1 |
| Rent | **57.7** | 54.3 |
| Sundry | **45.1** | 39.6 |
| | **189.0** | 169.0 |

[1] The amortization of incentives paid to franchisees of $3,853,000 is applied against royalties (2005 - $3,545,000).

## 4. Amortization

| | **2006** | 2005 |
|---|---|---|
| | **$** | $ |
| Capital assets | **173.0** | 150.5 |
| Intangible assets | **54.8** | 44.4 |
| Deferred costs | **0.1** | 0.4 |
| | **227.9** | 195.3 |

## 5. Financing expenses

| | **2006** | 2005 |
|---|---|---|
| | **$** | $ |
| Interest on long-term debt | **190.0** | 142.4 |
| Amortization of deferred financing fees | **12.4** | 10.3 |
| Unrealized foreign exchange loss on monetary items | **10.9** | 7.8 |
| Realized foreign exchange loss (gain) on monetary items | **(9.7)** | 1.9 |
| Other financing expenses, net | **1.5** | (0.3) |
| | **205.1** | 162.1 |

*(Tabular amounts are in millions of US dollars, unless otherwise noted)*

## 6. Income taxes

The income tax recovery is as follows:

| | **2006** | 2005 |
|---|---|---|
| | **$** | $ |
| Current income taxes | **(14.1)** | 41.2 |
| Future income taxes | **(29.9)** | (53.8) |
| | **(44.0)** | (12.6) |

The Company's effective tax rate differs from the combined statutory rate. The difference is attributable to the following items:

| | **2006** | 2005 |
|---|---|---|
| | **%** | % |
| Canadian combined statutory tax rate | **31.4** | 31.0 |
| Effect of tax rates of American subsidiaries | **18.0** | 9.5 |
| Global tax rate | **49.4** | 40.5 |
| Tax rate increase (decrease) resulting from: | | |
| Benefit arising from financing structures in relation with investments in subsidiaries | **(125.7)** | (58.0) |
| Other | **2.8** | 3.8 |
| | **(73.5)** | (13.7) |

*(Tabular amounts are in millions of US dollars, unless otherwise noted)*

## 6. Income taxes *(continued)*

Future income tax assets and liabilities are as follows:

| | **As at May 27, 2006** | As at May 28, 2005 |
|---|---|---|
| | **$** | $ |
| **Future income tax assets:** | | |
| Accounts receivable | **29.4** | 17.3 |
| Intangible assets, goodwill and incentives paid to franchisees | **5.4** | 4.7 |
| Current liabilities | **72.7** | 77.4 |
| Other long-term liabilities | **90.4** | 98.6 |
| Capital stock issuance expenses | **4.6** | 5.0 |
| Net operating losses carried forward | **27.1** | 2.2 |
| Interest carried forward | **78.2** | 6.0 |
| | **307.8** | 211.2 |
| **Future income tax liabilities:** | | |
| Inventories | **234.6** | 192.9 |
| Capital assets | **242.7** | 237.0 |
| Intangible assets and goodwill | **125.2** | 116.8 |
| Financing fees | **5.9** | 3.0 |
| Other | **12.8** | 5.8 |
| | **621.2** | 555.5 |
| **Future income tax liabilities, net** | **(313.4)** | (344.3) |
| **Allocated as follows:** | | |
| Long-term future income tax asset | **5.9** | - |
| Short-term future income tax liability | **(147.8)** | (97.8) |
| Long-term future income tax liability | **(171.5)** | (246.5) |
| | **(313.4)** | (344.3) |

At May 27, 2006, the Company had Federal net operating losses carryforwards of approximately $6,500,000 in the United States, the majority of which will expire in 2026 and State net operating losses of approximately $552,700,000 in the United States, the majority of which will expire between fiscal 2020 and 2026. No valuation allowance was recorded for these losses.

## 7. Net earnings per share

The reconciliation of the number of shares used to calculate the diluted net earnings per share is established as follows:

| | **2006** | 2005 |
|---|---|---|
| | ***(in millions)*** | *(in millions)* |
| Weighted average number of shares used to compute basic net earnings per share | **261.7** | 255.7 |
| Effect of dilutive stock options | **0.3** | 0.8 |
| Weighted average number of shares used to compute diluted net earnings per share | **262.0** | 256.5 |

As at May 27, 2006, 1,749,000 antidilutive stock options have been excluded from the computation of diluted earnings per share (May 28, 2005 - 42,000).

## 8. Investments

| | **As at May 27, 2006** | As at May 28, 2005 |
|---|---|---|
| | **$** | $ |
| Loans, advances and long-term operating receivables from franchisees, at variable interest rates, some of which carry repayment terms until 2013 and are renewable (net of a provision for losses of $2,759,000 as at May 27, 2006; May 28, 2005 - $1,760,000) | **28.3** | 19.1 |
| Other | **2.4** | 2.1 |
| | **30.7** | 21.2 |
| Current portion (included in accounts receivable) | **5.3** | 2.4 |
| | **25.4** | 18.8 |

*(Tabular amounts are in millions of US dollars, unless otherwise noted)*

## 9. Capital assets

| | As at May 27, 2006 | | |
|---|---|---|---|
| | **Cost** | **Accumulated amortization** | **Net book value** |
| | **$** | **$** | **$** |
| Land | **134.2** | **-** | **134.2** |
| Land held for leasing | **60.3** | **-** | **60.3** |
| Buildings | **349.9** | **59.5** | **290.4** |
| Buildings held for leasing | **169.9** | **22.4** | **147.5** |
| Leasehold improvements | **397.7** | **134.0** | **263.7** |
| Equipment | **666.8** | **251.5** | **415.3** |
| Equipment under capital leases | **49.1** | **19.6** | **29.5** |
| Construction in progress | **44.9** | **-** | **44.9** |
| | **1,872.8** | **487.0** | **1,385.8** |

Reclassification adjustments were made between line items within capital assets pursuant to the completion of a thorough review of the capital assets acquired as part of the acquisition of Eckerd (Note 21) which impacted the consolidated balance sheet as at May 28, 2005 as follows:

| | As at May 28, 2005 | | |
|---|---|---|---|
| | Cost (as reported) | Reclassification adjustments | Cost (adjusted) |
| | $ | $ | $ |
| Land | 174.7 | (37.9) | 136.8 |
| Land held for leasing | 68.8 | - | 68.8 |
| Buildings | 340.1 | 3.8 | 343.9 |
| Buildings held for leasing | 191.2 | - | 191.2 |
| Leasehold improvements | 355.6 | 12.5 | 368.1 |
| Equipment | 611.6 | 7.0 | 618.6 |
| Equipment under capital leases | 41.0 | 5.9 | 46.9 |
| Construction in progress | 32.1 | - | 32.1 |
| | 1,815.1 | (8.7) | 1,806.4 |

*(Tabular amounts are in millions of US dollars, unless otherwise noted)*

## 9. Capital assets *(continued)*

| | As at May 28, 2005 | | | | |
|---|---|---|---|---|---|
| | Accumulated amortization (as reported) | Reclassification adjustments | Accumulated amortization (adjusted) | Net book value (reported) | Net book value (adjusted) |
| | $ | $ | $ | $ | $ |
| Land | - | - | - | 174.7 | 136.8 |
| Land held for leasing | - | - | - | 68.8 | 68.8 |
| Buildings | 41.5 | 2.5 | 44.0 | 298.6 | 299.9 |
| Buildings held for leasing | 23.0 | - | 23.0 | 168.2 | 168.2 |
| Leasehold improvements | 83.0 | 1.4 | 84.4 | 272.6 | 283.7 |
| Equipment | 158.3 | (5.6) | 152.7 | 453.3 | 465.9 |
| Equipment under capital leases | 16.8 | (7.0) | 9.8 | 24.2 | 37.1 |
| Construction in progress | - | - | - | 32.1 | 32.1 |
| | 322.6 | (8.7) | 313.9 | 1,492.5 | 1,492.5 |

*(Tabular amounts are in millions of US dollars, unless otherwise noted)*

## 10. Intangible assets

Intangible assets are detailed as follows:

| | As at May 27, 2006 | | |
|---|---|---|---|
| | Cost | Accumulated amortization | Net book value |
| | $ | $ | $ |
| Prescription files | **337.8** | **87.9** | **249.9** |
| Non-compete agreements | **6.6** | **4.6** | **2.0** |
| Favorable leases | **113.2** | **28.7** | **84.5** |
| Trade name [(1)] | **353.0** | **-** | **353.0** |
| | **810.6** | **121.2** | **689.4** |

| | As at May 28, 2005 | | |
|---|---|---|---|
| | Cost | Accumulated amortization | Net book value |
| | $ | $ | $ |
| Prescription files | 332.6 | 54.7 | 277.9 |
| Non-compete agreements | 5.9 | 4.4 | 1.5 |
| Favorable leases | 113.2 | 16.0 | 97.2 |
| Trade name [(1)] | 353.0 | - | 353.0 |
| | 804.7 | 75.1 | 729.6 |

[(1)] Non-amortized indefinite service life intangible asset.

The Company acquired intangible assets for an amount of $10,859,000 (2005 - $752,328,000 of which $747,200,000 is related to the Eckerd acquisition as described in Note 21).

*(Tabular amounts are in millions of US dollars, unless otherwise noted)*

## 11. Goodwill

The changes in the book value of goodwill are as follows:

| | **As at May 27, 2006** | | |
|---|---|---|---|
| | **Franchising** | **Retail sales** | **Total** |
| | **$** | **$** | **$** |
| Balance, beginning of year | **17.2** | **849.3** | **866.5** |
| Acquisition (Note 21) | **-** | **9.4** | **9.4** |
| Transfer to assets held for sale [1] | **(1.4)** | **-** | **(1.4)** |
| Foreign currency translation adjustments | **2.3** | **-** | **2.3** |
| Balance, end of year | **18.1** | **858.7** | **876.8** |

[1] Included in prepaid expenses and other.

| | As at May 28, 2005 | | |
|---|---|---|---|
| | Franchising | Retail sales | Total |
| | $ | $ | $ |
| Balance, beginning of year | 15.8 | 79.5 | 95.3 |
| Acquisition (Note 21) | - | 769.8 | 769.8 |
| Foreign currency translation adjustments | 1.4 | - | 1.4 |
| Balance, end of year | 17.2 | 849.3 | 866.5 |

## 12. Other long-term assets

| | **As at May 27, 2006** | As at May 28, 2005 |
|---|---|---|
| | **$** | $ |
| Incentives paid to franchisees, net | **18.7** | 18.3 |
| Deferred costs, net | **75.5** | 75.8 |
| Future income taxes (Note 6) | **5.9** | - |
| Other | **13.5** | 11.9 |
| | **113.6** | 106.0 |

*(Tabular amounts are in millions of US dollars, unless otherwise noted)*

## 13. Long-term debt

| | **As at May 27, 2006** | As at May 28, 2005 |
|---|---|---|
| | **$** | $ |
| Term loan facility maturing on July 30, 2009, secured first rank, bearing interest at LIBOR rate plus a variable margin (totalling 7.6875% as of May 27, 2006; May 28, 2005 - 5.75%), repayable by quarterly instalments based on yearly tranches of 9% to 24% of the original loan balance. | **179.7** | 243.7 |
| Term loan facility maturing July 30, 2011, secured first rank, bearing interest at LIBOR rate plus a variable margin (totalling 7.625% as of May 27, 2006; May 28, 2005 - 5.50%), repayable by quarterly instalments based on yearly tranches of 1% of the original loan balance with the balance due in fiscal 2011 and 2012. | **994.6** | 1,094.5 |
| Unsecured senior notes, bearing interest at 7.625% and maturing on August 1, 2012, redeemable after August 1, 2008. | **350.0** | 350.0 |
| Unsecured senior subordinated notes, bearing interest at 8.50% and maturing on August 1, 2014, redeemable after August 1, 2009. | **850.0** | 850.0 |
| Computer equipment and software capital leases bearing interest at rates varying from 4.55% to 10.25% (4.55% to 10.75% as at May 28, 2005). | **14.7** | 17.1 |
| Other | **1.8** | 6.1 |
| | **2,390.8** | 2,561.4 |
| Current portion | **78.8** | 65.6 |
| | **2,312.0** | 2,495.8 |

*(Tabular amounts are in millions of US dollars, unless otherwise noted)*

## 13. Long-term debt *(continued)*

### Credit agreement

On July 30, 2004, the Company entered into a credit agreement which included credit facilities and two term loans. Under the terms of the credit agreement, the Company must satisfy certain restrictive covenants as to minimum financial ratios and must satisfy certain conditions. In March 2006, the covenants and the conditions of this credit agreement were amended. As at May 27, 2006 and May 28, 2005, the Company was in compliance with these covenants and conditions.

The credit agreement is secured by a first ranking security interest in substantially all of the Company's assets and a first ranking pledge of the capital stock of the Company's subsidiaries.

Maturing on July 30, 2009, an amount of $350,000,000 is available as a revolver loan or as letters of credit for an amount not to exceed $180,000,000. Revolver borrowings under the credit agreement bear interest at the Canadian or US prime rate plus a variable margin or at LIBOR rate plus a variable margin (varying from 0.50% to 2.50%). Margins depend on whether certain financial ratios are achieved. As at May 27, 2006 and May 28, 2005, available credit facilities were unused, with the exception of outstanding letters of credit in the amounts of $70,674,000 and $67,927,000, respectively.

### Minimum repayments

Minimum repayments to be made during the following fiscal years are as follows:

| | Long-term debt | Capital leases | |
|---|---|---|---|
| | Principal | Principal | Interest |
| | $ | $ | $ |
| 2007 | **69.5** | **9.3** | **0.3** |
| 2008 | **69.8** | **3.3** | **0.3** |
| 2009 | **52.4** | **1.9** | **0.2** |
| 2010 | **33.8** | **0.2** | **-** |
| 2011 | **522.3** | **-** | **-** |

Additional repayments in excess of the minimum amounts mentioned above may be made by the Company based on cash flow provided during the year.

*(Tabular amounts are in millions of US dollars, unless otherwise noted)*

## 14. Other long-term liabilities

| | **As at May 27, 2006** | As at May 28, 2005 |
|---|---|---|
| | **$** | $ |
| Deferred revenues | **31.3** | 9.8 |
| Deferred lease obligations | **29.0** | 17.8 |
| Unfavorable leases | **29.6** | 32.3 |
| Workers' compensation and general liability | **64.5** | 68.8 |
| Liabilities for store closures (1) | **72.4** | 96.6 |
| Future income taxes (Note 6) | **171.5** | 246.5 |
| Other | **8.8** | 9.0 |
| | **407.1** | 480.8 |

(1) Liabilities for store closures consist of the present value of lease obligations, net of estimated sublease rental income and other exit costs. For the year ended May 27, 2006, payments of $32,426,000 ($10,135,000 in 2005) were applied against the provision (including short-term portion). Also, for the year ended May 27, 2006, a charge of $3,568,000 ($4,726,000 in 2005) was recorded in the results to reflect other store closures. A provision for store closures of $128,227,000 arose in relation to the Eckerd acquisition in fiscal 2005.

## 15. Capital stock

Authorized, unlimited number:

Class A subordinate voting shares, participating, one vote per share, exchangeable, at the option of the holder, for the same number of Class B shares in the event of a take-over bid being made in respect to Class B shares, without par value, dividend declared in Canadian dollars.

Class B shares, participating, ten votes per share, exchangeable for Class A subordinate voting shares on the basis of one Class A subordinate voting share for one Class B share, without par value, dividend declared in Canadian dollars.

Class C shares, to be issued in one or more series subject to rights, privileges, conditions and restrictions to be determined, non-participating, non voting, without par value.

## 15. Capital stock *(continued)*

Changes that occurred in capital stock are presented as follows:

| | **2006** | | 2005 | |
|---|---|---|---|---|
| | **Shares *(in millions)*** | **$** | Shares *(in millions)* | $ |
| **Class A subordinate voting shares** | | | | |
| Outstanding shares, beginning of year | **142.2** | **577.5** | 106.6 | 145.0 |
| Issuance of shares for cash [(1)] | **-** | **-** | 33.3 | 424.4 |
| Class B shares converted into Class A subordinate voting shares | **-** | **-** | 0.9 | - |
| Options exercised | **0.1** | **0.4** | 1.4 | 8.1 |
| Outstanding shares, end of year | **142.3** | **577.9** | 142.2 | 577.5 |
| **Class B shares** | | | | |
| Outstanding shares, beginning of year | **119.4** | **-** | 120.3 | - |
| Class B shares converted into Class A subordinate voting shares | **-** | **-** | (0.9) | - |
| Outstanding shares, end of year | **119.4** | **-** | 119.4 | - |
| **Total oustanding shares, end of year** | **261.7** | **577.9** | 261.6 | 577.5 |

(1) Net of share issuance fees of $19.3 million less related income taxes of $6.0 million.

*(Tabular amounts are in millions of US dollars, unless otherwise noted)*

## 16. Foreign currency translation adjustments

The net change in the foreign currency translation adjustments is as follows:

| | **As at May 27, 2006** | As at May 28, 2005 |
|---|---|---|
| | **$** | $ |
| Balance, beginning of year | **46.2** | (0.3) |
| Effect of changes in exchange rates during the year: | | |
| On the net investment in self-sustaining foreign subsidiaries | **(122.6)** | (42.0) |
| On the translation into the reporting currency of financial statements of the parent company and its Canadian subsidiaries | **197.4** | 88.7 |
| On certain US dollar denominated long-term debt designated as a hedge of the net investment in self-sustaining foreign subsidiaries | **-** | (0.2) |
| Balance, end of year | **121.0** | 46.2 |

## 17. Stock-based compensation plan

The Company has a fixed stock option plan. Under the 1995 Executive Officer Stock Option Plan, the Company may grant options to those employees totalling up to 8 million Class A subordinate voting shares. Under the plan, the exercise price of each option may not be lower than the weighted average price based on volume of the Company's shares on the Toronto Stock Exchange for the five days preceding the date of the granting of the options, and an option's maximum term is 10 years. Granted options vest annually over a maximum period of 4 years.

## 17. Stock-based compensation plan *(continued)*

Changes that occurred in the number of options are presented as follows:

| | **2006** | | 2005 | |
|---|---|---|---|---|
| | **Number of options** | **Weighted average exercise price** | Number of options | Weighted average exercise price |
| | ***(in millions)*** | ***(in Canadian dollars)*** | *(in millions)* | *(in Canadian dollars)* |
| Options outstanding, beginning of year | **1.9** | **13.05** | 2.9 | 10.15 |
| Options granted | **0.7** | **14.69** | 0.5 | 15.76 |
| Options exercised | **(0.1)** | **10.53** | (1.4) | 7.53 |
| Options cancelled | **-** | **16.29** | (0.1) | 15.98 |
| Options outstanding, end of year | **2.5** | **13.47** | 1.9 | 13.05 |
| Options exercisable, end of year | **1.6** | **12.48** | 1.2 | 11.34 |

The following table summarizes information about the fixed stock options outstanding at May 27, 2006:

| | **Options outstanding** | | | **Options exercisable** | |
|---|---|---|---|---|---|
| Range of exercise price | **Number of options** | **Weighted average remaining contractual life** | **Weighted average exercise price** | **Number of options** | **Weighted average exercise price** |
| *(in Canadian dollars)* | ***(in millions)*** | ***(years)*** | ***(in Canadian dollars)*** | ***(in millions)*** | ***(in Canadian dollars)*** |
| Below $10 | **0.7** | **4.1** | **8.55** | **0.7** | **8.55** |
| $10 - $15 | **0.9** | **8.6** | **14.15** | **0.4** | **13.80** |
| $15 - $20 | **0.9** | **7.7** | **16.53** | **0.5** | **16.75** |
| | **2.5** | **7.0** | **13.47** | **1.6** | **12.48** |

*(Tabular amounts are in millions of US dollars, unless otherwise noted)*

## 17. Stock-based compensation plan *(continued)*

The following data represents the weighted average assumptions used in the stock option valuation in accordance with the Black-Scholes model:

| | **2006** | 2005 |
|---|---|---|
| Dividend yield | **0.81%** | 0.70% |
| Expected volatility | **29.59%** | 27.10% |
| Risk-free interest rate | **3.88%** | 4.01% |
| Expected life (years) | **6** | 6 |

During the year ended May 27, 2006, the Company granted 694,657 stock options (2005 - 492,780). The weighted average fair value of those options is $C5.21 as at May 27, 2006 (2005 - $C5.07). An amount of $1,647,000 for the year ended May 27, 2006 was expensed for the stock option plan (2005 - $623,000).

Had compensation cost been determined using the fair value based method at the date of grant for awards granted during the year ended May 31, 2003, the Company's net earnings for the year ended May 27, 2006 would have been reduced by $322,000 (2005 - $300,000). Basic net earnings per share and diluted net earnings per share for those years would have been unchanged.

## 18. Guarantees and contingencies

***Guarantees***

On July 31, 2004, the Company acquired the shares of three subsidiaries of TDI Consolidated Corporation (Note 21). Pursuant to the stock purchase agreement, the Company agreed to enter into certain customary indemnification obligations in favor of the Seller. The Company has agreed to indemnify the Seller for taxes, damages and certain liabilities related to the business acquired. Certain portions of the Company’s indemnification obligations are capped at $350 million while other provisions are not subject to such a limit. Certain of the indemnification obligations survived the closing date of the acquisition until April 2006 and still others will survive until the expiration of the applicable statute of limitations. The maximum amount of future payments cannot be estimated as it results from future events that cannot be predicted.

Certain debt agreements require the Company to indemnify the parties in the event of changes in elements such as withholding tax regulations. The nature and scope of such indemnifications is contingent on future events, none of which can be foreseen as at May 27, 2006 and May 28, 2005. Also, the structure of such transactions makes these events unlikely. Consequently, no provisions have been recorded in the consolidated financial statements.

## 18. Guarantees and contingencies *(continued)*

The Company has guaranteed the reimbursement of certain bank loans contracted by franchisees for a maximum amount of $5,033,000 as at May 27, 2006 (May 28, 2005 - $5,981,000). Most of those guarantees apply to loans with a maximum maturity of eight years. Those loans are also personally guaranteed by the franchisees.

***Buyback agreements***

Under buyback agreements, the Company is committed to financial institutions to purchase the inventories of certain of its franchisees up to the amount of advances made by those financial institutions to the franchisees. As of May 27, 2006, financing related to these inventories amounted to $55,670,000 (May 28, 2005 - $46,122,000). However, under these agreements, the Company is not committed to cover any deficit that may arise should the value of these inventories be less than the amount of the advances.

Under buyback agreements, the Company is committed to financial institutions to purchase equipment held by franchisees and financed by capital leases not exceeding five years and loans not exceeding eight years. For capital leases, the buyback value is linked to the net balance of the lease at the date of the buyback. For equipment financed by bank loans, the minimum buyback value is set by contract with the financial institutions. As at May 27, 2006, financing related to the equipment amounts to $22,338,000 (May 28, 2005 - $23,132,000). However, it is the opinion of management that the realizable value of the assets cannot be lower than the eventual amount of the buyback.

Historically, the Company has not made any indemnification payments under such agreements and no amount has been accrued with respect to these guarantees in its consolidated financial statements for May 27, 2006 and May 28, 2005.

***Contingencies***

Various claims and legal proceedings have been initiated against the Company in the normal course of its operating activities. Although the outcome of these proceedings cannot be determined with certainty, management estimates that any payments resulting from their outcome are not likely to have a substantial negative impact on the Company's consolidated financial statements.

(Tabular amounts are in millions of US dollars, unless otherwise noted)

## 19. Commitments

The balance of the commitments under the terms of building and vehicle operating leases maturing up to the year 2047 totals $4,210,412,000. The Company also has commitments for the construction of buildings with contractors totalling $20,022,000 and agreements with suppliers to purchase inventory and services totalling $56,843,000. Minimum payments payable over the next five years are as follows:

| | Operating leases | Other commercial commitments |
|---|---|---|
| | $ | $ |
| 2007 | **380.7** | **47.5** |
| 2008 | **363.8** | **15.7** |
| 2009 | **345.3** | **7.1** |
| 2010 | **323.3** | **3.3** |
| 2011 | **303.3** | **3.3** |

Under the terms of building leases and subleases, the Company will receive, up to the year 2047, minimum payments totalling $308,374,000. This amount takes into account the renewal of subleases at the same terms and conditions as the lease agreements.

## 20. Pension plans

The Company offers defined benefit and defined contribution pension plans providing pension benefits to its employees. The measurement date used for financial reporting purposes of the plan assets and benefit obligations is May 27, 2006 (May 28 in 2005).

*(Tabular amounts are in millions of US dollars, unless otherwise noted)*

## 20. Pension plans *(continued)*

The defined benefit and defined contribution plans expenses are as follows:

| | **2006** | 2005 |
|---|---|---|
| | **$** | $ |
| Defined contribution plans expense | **23.5** | 18.2 |
| Defined benefit plans | | |
| Current service costs | **0.6** | 0.5 |
| Interest expense | **0.5** | 0.4 |
| Actual return on plan assets | **(0.3)** | (0.1) |
| Amortization of past service cost | **0.2** | 0.9 |
| Actuarial gains | **(0.1)** | (0.2) |
| Foreign currency translation adjustments | **0.2** | - |
| Defined benefit plans expense | **1.1** | 1.5 |

Information about the Company's defined benefit plans is as follows:

| | **As at May 27, 2006** | As at May 28, 2005 |
|---|---|---|
| | **$** | $ |
| Accrued benefit obligations | | |
| Balance, beginning of year | **7.1** | 6.7 |
| Current service cost | **0.6** | 0.5 |
| Interest expense | **0.5** | 0.4 |
| Past service cost | **3.0** | - |
| Benefits paid | **(0.1)** | (0.1) |
| Settlements | **(0.2)** | (0.7) |
| Actuarial losses (gains) | **0.9** | (0.2) |
| Foreign currency translation adjustments | **1.0** | 0.5 |
| Balance, end of year | **12.8** | 7.1 |

*(Tabular amounts are in millions of US dollars, unless otherwise noted)*

## 20. Pension plans *(continued)*

| | **As at May 27, 2006** | As at May 28, 2005 |
|---|---|---|
| | **$** | $ |
| Plan assets | | |
| Fair value, beginning of year | **3.3** | 3.1 |
| Actual return on plan assets | **0.3** | 0.1 |
| Employer contributions | **1.3** | 0.7 |
| Benefits paid | **(0.1)** | (0.1) |
| Settlements | **(0.2)** | (0.7) |
| Foreign currency translation adjustments | **0.5** | 0.2 |
| Fair value, end of year | **5.1** | 3.3 |
| Accrued benefit obligations | **12.8** | 7.1 |
| Plan assets | **(5.1)** | (3.3) |
| | **7.7** | 3.8 |
| Unamortized net actuarial losses | **1.0** | - |
| Unamortized past service cost | **4.8** | 2.0 |
| Accrued benefit liability (included in accounts payable and accrued liabilities) | **1.9** | 1.8 |

As at May 27, 2006 and May 28, 2005, all pension plans had individually accrued benefit obligations in excess of plan assets.

As at May 27, 2006, 35% (2005 - 36%) of the plan assets at fair value was deposited as Canadian refundable tax and 65% (2005 - 64%) was invested. The balance invested consists of the following allocations:

| | **2006** | 2005 |
|---|---|---|
| | **%** | % |
| Balanced funds | 66 | 57 |
| Equity income and insured annuity | 26 | 34 |
| Equity funds | 6 | 7 |
| Other | 2 | 2 |

*(Tabular amounts are in millions of US dollars, unless otherwise noted)*

## 20. Pension plans *(continued)*

No plan assets are directly invested in the parent company and its subsidiaries' securities.

The main actuarial assumptions adopted in measuring the Company's accrued benefit obligations and the benefits costs are as follows (weighted average) :

| | **2006** | 2005 |
|---|---|---|
| | **%** | % |
| Accrued benefit obligations | | |
| Discount rate | **5.42** | 6.00 |
| Expected long-term rate of return on plan assets | **6.00** | 6.75 |
| Rate of compensation increase | **4.00** | 4.00 |
| Defined benefit expense | | |
| Discount rate | **5.93** | 6.00 |
| Rate of compensation increase | **4.00** | 4.00 |

## 21. Business acquisition

On July 31, 2004, the Company acquired the shares of three subsidiaries of TDI Consolidated Corporation, a wholly-owned subsidiary of J.C. Penney Corporation, Inc., that owned 1,549 outlets of the Eckerd drugstore chain located throughout 13 states in Northeastern, mid-Atlantic and Southeastern United States. The acquisition has been accounted for under the purchase method and the results of operations have been included in the consolidated financial statements since the acquisition date.

*(Tabular amounts are in millions of US dollars, unless otherwise noted)*

## 21. Business acquisition *(continued)*

The Company completed its allocation of the purchase price based on information available, and on the basis of evaluations. For the year ended May 27, 2006, the Company recorded an increase of $9.4 million in goodwill corresponding to a decrease of $1.0 million in future income tax liabilities and of $10.4 million in capital assets. The acquired goodwill is not deductible for income tax purposes.

Purchase price allocation:

| | Final |
|---|---|
| | $ |
| Net assets acquired | |
| Non-cash working capital | **751.9** |
| Capital assets | **887.7** |
| Intangible assets: | |
| Trade name (not subject to amortization) | **353.0** |
| Prescription files (amortized over a 10-year period) | **286.4** |
| Favorable leases (amortized over the term of the leases) [1] | **75.9** |
| Goodwill | **779.2** |
| Future income tax liabilities | **(424.8)** |
| Liabilities for store closures [2] | **(111.5)** |
| Other long-term liabilities | **(106.0)** |
| Non-cash net assets acquired | **2,491.8** |
| Cash | **4.3** |
| Net assets acquired | **2,496.1** |
| Cash consideration and acquisition costs | **2,496.1** |

[1] Net of $31.9 million of unfavorable leases.

[2] Long-term portion.

*(Tabular amounts are in millions of US dollars, unless otherwise noted)*

## 22. Related party transactions

The Company entered into the following transactions with enterprises controlled by an executive having a significant influence over the Company:

| | **2006** | 2005 |
|---|---|---|
| | **$** | $ |
| Revenues | | |
| Sales | **6.3** | 6.1 |
| Royalties | **0.4** | 0.3 |
| Rent | **0.3** | 0.4 |
| Sundry | **-** | 0.2 |
| | **7.0** | 7.0 |

As at May 27, 2006, accounts receivable include an amount of $581,000 (May 28, 2005 - $598,000) resulting from these transactions. This amount is presented in the Company's accounts receivable. These transactions are carried out in the ordinary course of business and are measured at the exchange amount.

## 23. Financial instruments

### Fair value

The fair value of cash and cash equivalents, temporary investments, accounts receivables and accounts payable and accrued liabilities approximates their book value because of their forthcoming maturity.

The fair value of loans, advances and long-term receivables from franchisees was not determined, since these balances result from transactions carried out in the context of privileged commercial relationships and under terms and conditions that may differ from those that could be negotiated with non-franchisees.

*(Tabular amounts are in millions of US dollars, unless otherwise noted)*

## 23. Financial instruments *(continued)*

The estimated fair value of other financial instruments subject to fair value disclosure is determined based on quoted market prices or interest rates for the same or similar instruments. Estimated fair value and carrying amount of those instruments are as follows:

| | **As at May 27, 2006** | | As at May 28, 2005 | |
|---|---|---|---|---|
| | **Fair value** | **Carrying amount** | Fair value | Carrying amount |
| | **$** | **$** | $ | $ |
| Long-term debt | **2,325.3** | **2,390.8** | 2,540.3 | 2,561.4 |
| Derivative financial instruments, asset position: | | | | |
| Interest rate swap agreements | **11.4** | **-** | 0.9 | - |

### Interest rate risk

*Interest rate swap agreements*

The Company enters into interest rate swap agreements in order to reduce the impact of fluctuating interest rates on a portion of its long-term debt. As at May 27, 2006 and May 28, 2005, its interest rate swaps maturing in July 2011, fix the LIBOR interest rate on a notional portion of $200.0 million at 4.11%. These swaps require the periodic exchange of payments without the exchange of the notional principal amount on which the payments are based. The Company designates these interest rate swap agreements as hedges of the interest on the underlying debt. Interest expense on the debt is adjusted to include the payments made or received under the interest rate swap agreements designated as hedges.

### Credit risk

The Company's exposure to concentrations of credit risk is limited. The non-collection risk is reduced by the fact that accounts receivable are generated by numerous customers.

## 23. Financial instruments *(continued)*

### Foreign currency risk

Even though the Company’s reporting currency is the US dollar, non-consolidated financial statements of the parent company and its subsidiaries are prepared based on their respective functional currencies, which is the US dollar for US operations and the Canadian dollar for Canadian operations and corporate activities.

Transactions denominated in currencies other than an entity's functional currency are translated according to the temporal method. Under this method, monetary assets and liabilities in foreign currencies are translated at the exchange rate in effect at the balance sheet date, non-monetary assets and liabilities in foreign currencies at their historical rates and statement of earnings items in foreign currencies at the average monthly exchange rates. All exchange gains and losses are current in nature and are included in the consolidated statement of earnings, unless subject to hedge accounting.

For the purpose of minimizing volatility of earnings resulting from the translation of its parent company and subsidiaries monetary items denominated in currencies other than the entity's functional currency, the Company designates, since February 2005, a portion of its US dollar debt as a foreign exchange hedge of its net investment in its US subsidiaries. Accordingly, since the designation date, corresponding unrealized foreign exchange gains and losses are recorded in foreign currency translation adjustments in shareholders' equity.

### Concentration risk

During fiscal 2006, the Company purchased approximately 83% (2005 - 87%) of its branded prescription drugs for its US network from a single supplier, McKesson Corporation, with whom the Company has a long-term supply contract.

*(Tabular amounts are in millions of US dollars, unless otherwise noted)*

## 24. Supplemental cash flow information

### Net changes in non-cash operating asset and liability items

The net changes in non-cash operating asset and liability items are detailed as follows:

| | **2006** | 2005 |
|---|---|---|
| | **$** | $ |
| Accounts receivable, income taxes receivable and prepaid expenses | **(21.0)** | (17.6) |
| Inventories | **(68.2)** | (74.4) |
| Accounts payable, accrued liabilities and income taxes payable | **(48.3)** | 57.4 |
| Other long-term assets | **(0.3)** | (8.0) |
| Other long-term liabilities | **(26.2)** | (4.7) |
| Other items | **-** | (0.3) |
| Net changes in non-cash operating asset and liability items | **(164.0)** | (47.6) |

### Other information

| | | |
|---|---|---|
| Interest paid | **184.7** | 104.1 |
| Income taxes paid | **28.4** | 48.7 |

On November 4, 2005, the Company sold certain real estate assets of its Canadian franchising segment for a total consideration of $94.0 million ($C 111.7 million) in cash and entered into leaseback agreements for the areas used by the Jean Coutu drugstores. The Company realized a pre-tax gain on disposal of $20.9 million ($C 24.8 million). Even though only 41% of the leasable area sold represents the leaseback portion, GAAP requires, under certain criteria, that the entire gain be deferred over the life of the new leases, which have an average duration of approximately 16 years. The deferred gain is presented in the other long-term liabilities.

## 25. Comparative figures

Certain comparative figures have been reclassified to conform with the presentation of the current year.

(Tabular amounts are in millions of US dollars, unless otherwise noted)

## 26. Reconciliation of Canadian GAAP to United States GAAP

These consolidated financial statements are prepared in accordance with Canadian GAAP, which differ, in certain material respects from generally accepted accounting principles in the United States ("US GAAP"). While the information presented below is not a comprehensive summary of all differences between Canadian GAAP and US GAAP, other differences are considered unlikely to have a significant impact on the consolidated net earnings and balance sheets of the Company.

All material differences between Canadian GAAP and US GAAP and the effect on net earnings and shareholders' equity are presented in the following tables with an explanation of the adjustments.

| | **2006** | 2005 |
|---|---|---|
| | **$** | $ |
| ***Reconciliation of net earnings*** | | |
| Net earnings - Canadian GAAP | **103.8** | 104.4 |
| Adjustment in respect of amortization (a) | **-** | 0.3 |
| Adjustment in respect of sale-leaseback (b) | **(1.7)** | - |
| Adjustment in respect of sale of capital assets (c) | **0.9** | - |
| Tax effect of above adjustments | **0.4** | (0.1) |
| Net earnings - US GAAP | **103.4** | 104.6 |
| | | |
| Net earnings per share - US GAAP (in dollars) | | |
| Basic | **0.40** | 0.41 |
| Diluted | **0.39** | 0.41 |
| | | |
| ***Other comprehensive income items*** | | |
| Cumulative translation adjustments, net of tax (e) | **74.8** | 46.5 |
| Cumulative translation adjustments on amortization, on sale-leaseback and on sale of capital assets, net of tax (a, b, c and e) | **(1.3)** | (0.8) |
| Changes in fair value of derivatives, net of tax (d) | **7.2** | (1.1) |
| Reclassification of realized gain on derivatives to the earnings (d) | **0.3** | 2.7 |
| Other comprehensive income items | **81.0** | 47.3 |

*(Tabular amounts are in millions of US dollars, unless otherwise noted)*

## 26. Reconciliation of Canadian GAAP to United States GAAP *(continued)*

| | **As at May 27, 2006** | As at May 28, 2005 |
|---|---|---|
| | **$** | $ |
| ***Statement of accumulated other comprehensive income items*** | | |
| Accumulated other comprehensive income items: | | |
| Cumulative translation adjustments, net of tax (e) | **121.0** | 46.2 |
| Cumulative translation adjustments on amortization, on sale-leaseback and sale of capital assets, net of tax (a, b, c and e) | **(2.7)** | (1.4) |
| Cumulative changes in fair value of derivatives net of reclassification of realized gain (loss) to the earnings and net of tax (d) | **6.7** | (0.8) |
| Accumulated other comprehensive income items | **125.0** | 44.0 |

| | **As at May 27, 2006** | As at May 28, 2005 |
|---|---|---|
| ***Reconciliation of shareholders' equity*** | | |
| Shareholders' equity - Canadian GAAP | **1,565.7** | 1,412.1 |
| Adjustments in respect of: | | |
| Amortization (a) | **(13.0)** | (13.0) |
| Sale-leaseback (b) | **(1.7)** | - |
| Sale of capital assets (c) | **0.9** | - |
| Tax effect of above adjustments | **4.9** | 4.5 |
| Cumulative translation adjustments, net of tax (e) | **(121.0)** | (46.2) |
| Accumulated other comprehensive income items | **125.0** | 44.0 |
| Shareholders' equity - US GAAP | **1,560.8** | 1,401.4 |

*(Tabular amounts are in millions of US dollars, unless otherwise noted)*

## 26. Reconciliation of Canadian GAAP to United States GAAP *(continued)*

The impact of differences between Canadian GAAP and US GAAP on consolidated balance sheet items is as follows:

| | As at May 27, 2006 | | As at May 28, 2005 | |
|---|---|---|---|---|
| | **Canadian GAAP** | **US GAAP** | Canadian GAAP | US GAAP |
| | **$** | **$** | $ | $ |
| ***Consolidated balance sheets items*** | | | | |
| **Assets** | | | | |
| Capital assets (a) and (b) | **1,385.8** | **1,436.9** | 1,492.5 | 1,477.3 |
| Other long-term assets (a), (b) and (d) | **113.6** | **127.1** | 106.0 | 111.6 |
| **Liabilities** | | | | |
| Other long-term liabilities (b) | **407.1** | **476.6** | 480.8 | 482.0 |
| **Shareholders' equity** | **1,565.7** | **1,560.8** | 1,412.1 | 1,401.4 |

### *a) Amortization*

Under Canadian GAAP, the Company has used the compounded interest method to depreciate its buildings held for leasing until May 31, 2004 (Note 2e). This method was not acceptable under US GAAP. The Company records depreciation under US GAAP for its buildings held for leasing using the straight-line method at a rate of 2.5%.

### b) Sale-leaseback

On November 4, 2005, the Company sold certain real estate assets of its Canadian franchising segment and entered into leaseback agreements. Under Canadian GAAP, the sale-leaseback transaction was accounted for using sale-leaseback accounting which resulted in the Company recording a sale, removing all properties and related liabilities from its balance sheet and recognizing a deferred gain from the sale. The leases are accounted for as operating leases.

## 26. Reconciliation of Canadian GAAP to United States GAAP *(continued)*

### b) Sale-leaseback *(continued)*

Under US GAAP, this transaction was accounted for in accordance with Statement Financial Accounting Standards No. 98 ("SFAS 98"), “Accounting for Leases”. SFAS 98 prohibits sale recognition on a sale-leaseback transaction when the sublease is not considered to be minor. The Company accounted for the transaction as a financing transaction which requires sale proceeds to be recorded as a liability on which an interest expense will subsequently be calculated during the term of the amortization period. In addition, since the sale of assets is not recorded, the carrying value of the assets is not adjusted for and will be depreciated over the liability amortization period. Aggregate lease payments received by the purchaser are recorded as revenues by the Company and applied in reduction of the liability.

### c) Sale of capital assets

As part of the transaction referred to in Note 24, the Company sold certain real estate assets of its Canadian franchising segment which were not subject to a leaseback agreement. Accordingly, the Company recorded a $900,000 gain per US GAAP, compared with a $18,000 gain per Canadian GAAP, reflecting the lesser net book value of the assets sold under US GAAP.80

### *d) Derivative financial instruments and hedging*

Under US GAAP, the Company records derivatives on the balance sheet as assets or liabilities measured at their fair value. Gains and losses resulting from changes in the values of those derivatives are accounted for depending on the use of the derivative and whether it qualifies for hedge accounting.

The Company has interest rate swaps in order to fix the interest rate on a portion of its variable interest debt. These interest rate swaps are designated as cash flow hedges with changes in the fair value of those contracts recorded as a component of other comprehensive income items and subsequently recognized as interest on long-term debt in the period in which the hedged exposure takes place. Under Canadian GAAP, changes in fair value of those contracts are not recognized (Note 2f).

### *e) Foreign currency translation adjustments*

Under Canadian GAAP, the Company's gains and losses arising from the translation of the financial statements are deferred in foreign currency translation adjustments in shareholders’ equity. Under US GAAP, foreign currency translation adjustments are presented as a component of other comprehensive income items under shareholders’ equity.

## 26. Reconciliation of Canadian GAAP to United States GAAP *(continued)*

***f) Changes to US accounting policies***

### 2006

*Share-Based Payment*

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (Revised in 2004), Share-Based Payment (SFAS 123R), that addresses the accounting for share-based payments. SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. The Company adopted SFAS 123R on September 1, 2005. The adoption of SFAS 123R had no material impact on the Company's consolidated financial statements.

*Rental Costs Incurred during a Construction Period*

In October 2005, the FASB issued the FASB Staff Positions (FSP) No. 13-1, "Accounting for Rental Costs Incurred during a Construction Period". The FSP No. 13-1 addresses the accounting for rental costs associated with operating leases that are incurred during a construction period and requires those costs to be recognized as rental expense. Under Canadian GAAP, the Company capitalizes those rental costs. The provisions of the FSP No. 13-1 were prospectively applied to the reporting period beginning on February 27, 2006. The adoption of the FSP No. 13-1 had no material impact on the Company's consolidated financial statements.

### 2005

*Consolidation of Variable Interest Entities*

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities - an Interpretation of ARB No. 51." The Interpretation addresses consolidation of variable interest entities (VIEs) to which the usual condition for consolidation does not apply because the VIEs have no voting interests or otherwise are not subject to control through ownership of voting interests. It requires existing unconsolidated VIEs to be consolidated by their primary beneficiaries if the entities do not effectively disperse risks among parties involved. In December 2003, the FASB revised FIN 46 (FIN 46R), which delayed the required implementation date for periods ending after March 15, 2004. The Company was required to apply the provisions of FIN 46R effective June 1, 2004. The adoption of this interpretation had no material impact on the Company’s consolidated financial statements.