

PET VALUTM

Better Pet Nutrition

PET VALU, INC.

Quarterly Report

Twenty-Six Weeks Ended July 4, 2009

(The financial statements contained herein are prepared in accordance with
Canadian Generally Accepted Accounting Principles)
(in U.S. dollars)

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Pet Valu, Inc.

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Management's Discussion & Analysis

For purposes of this discussion, "Pet Valu" or the "Company" refers to Pet Valu, Inc. and its subsidiaries.

This Management's Discussion and Analysis ("MD&A") contains commentary from the Company's management regarding strategy, operating results, and financial condition.

This MD&A should be read in conjunction with the Consolidated Financial Statements and Notes to the Consolidated Financial Statements for the twenty-six week period ended July 4, 2009. The 2008 fiscal year refers to the 53-week period ended January 3, 2009. Unless otherwise indicated, all amounts are expressed in U.S. dollars. References to Canadian dollars are noted by using the International Monetary symbol for Canadian dollars, namely "C\$".

This MD&A is current as of August 11, 2009. Additional information relating to the Company, including the fiscal 2008 Annual Report of Pet Valu, Inc. and the Annual Information Form of Pet Valu, Inc., is available on-line at www.sedar.com.

Cautionary Statement Regarding Forward-Looking Information

Certain information in this MD&A and in other public announcements by the Company is forward-looking. Forward-looking information includes information concerning the future financial performance, business strategy, plans, goals, objectives, business prospects and opportunities of Pet Valu, Inc. and its affiliates. This information is subject to important risks and uncertainties, which are difficult to predict and assumptions which may prove to be inaccurate. Factors which could cause actual results or events to differ materially from current expectations include, among other things: the ability of the Company to successfully implement its strategic initiatives and whether such strategic initiatives will yield the expected benefits; competitive conditions in the businesses in which the Company participates; changes in consumer spending; the outcome of legal proceedings as they arise; general economic conditions and normal business uncertainty; the availability of suitable store locations; customer preferences towards product offerings; adverse climate changes; the occurrence of a pandemic or other catastrophic event which could create shortages of labour, products or services required to operate the business profitably; fluctuations in foreign currency exchange rates; changes in the Company's relationship with its merchandise and service suppliers; interest rate fluctuations and other changes in borrowing costs; the outcome of a pending acquisition of the Company recommended by the Company's board of directors and which will be submitted to the Company's shareholders for approval on August 25, 2009 and thereafter to the Supreme Court of British Columbia for approval; and changes in laws, rules and regulations applicable to the Company or the markets in which the Company operates. The Company cautions that this is not an exhaustive list of factors that may affect the forward-looking information in the MD&A. Potential investors and readers are urged to give careful consideration to all of these factors in evaluating any forward-looking information and are cautioned not to place undue reliance on such information.

While the Company believes that its forecasts and assumptions are reasonable, results or events predicted in this forward-looking information may differ materially from actual results or events.

Overview

The Company's principal business is that of a specialty retailer and wholesaler of food and supplies for dogs, cats, birds, fish, reptiles, and small animals and a franchisor of pet food and pet-related supply outlets. The Company was founded in 1976 with the opening of its first retail outlet in Ontario, Canada. Canadian operations have grown through "greenfield" store development and through the acquisition of smaller chains. In 1995, the Company entered the U.S. market by opening its first retail outlet in the state of Maryland. At July 4, 2009, there were 295 stores operating in Canada and 61 stores operating in the U.S. Of the 295 Canadian stores, 167 stores were franchised and 128 were company-owned. In the U.S., 60 stores were company-owned and one was franchised. PET VALU stores are located in Ontario, Manitoba, Pennsylvania, New Jersey, Maryland and Virginia. The Company's Paulmac's Pet Food Inc. ("Paulmac's") stores and Your Petschoice Inc. ("Berrys") stores are located in Ontario.

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The Company classifies its operations into two geographical operating segments, Canadian operations and U.S. operations. Canadian stores are operated by Pet Valu Canada Inc., Paulmac's, or Berrys. Canadian stores are also franchised through Pet Valu Canada Inc. or Paulmac's. Berrys does not franchise its stores. U.S. stores are operated by, or franchised through, Pet Valu, Inc.'s U.S. operating subsidiary, Pet Valu International Inc.

Products and Services

PET VALU, PAULMAC'S and BERRYS stores offer a wide range of pet food and pet-related supply products, including national and premium brand products. PET VALU stores also carry a broad selection of private label dog, cat and other pet foods marketed under trademarks owned by Pet Valu Canada Inc. Company-owned and franchise stores also offer customers a large variety of non-food products, such as rawhide products, collars, leashes, flea and tick products, pet cages and carriers, dog and cat toys, cat litter and other pet-related accessories. These products include both brand name and private label brands. Additional pet food and pet-related supply products, not regularly carried by stores, are available by special order from Company warehouses.

In Canada, some PET VALU, some BERRYS and most PAULMAC'S stores sell fish, birds, reptiles, and/or small animals and some PET VALU and PAULMAC'S stores offer grooming services. Stores in Canada and the U.S. carry a range of wild bird products and none sell dogs or cats. Some stores in Canada and the U.S., however, facilitate the adoptions of cats and/or dogs, on behalf of local animal welfare organizations.

The Company has ongoing programs to identify higher quality, differentiated merchandise brands as well as to develop additional private label offerings which take a wellness-focused approach to pet nutrition. Through the introduction of these specialty and private label food offerings as well as unique pet-related supply products the Company seeks to differentiate itself from many of its principal competitors in the sale of pet food and supplies.

Warehousing and Distribution

The Company purchases, warehouses, and distributes pet food and pet-related supplies for and to all stores in Canada and the U.S. There are ten leased and two owned distribution facilities in Canada and two leased distribution facilities in the U.S. Total space in these facilities, inclusive of office space located therein, is approximately 525,000 square feet. Most of these facilities are located regionally to support local small box store delivery logistics.

Distribution services in both countries are provided by a fleet of company-owned and leased vehicles and supplemented by outside carriers.

Franchising

In Canada, Company revenues in relation to franchise operations are generated from fees and gains on the sale of franchises, from ongoing merchandise sales to franchisees, and from royalty and other income from franchise operations. Franchisees purchase the majority of their inventory from the Company. In Canada, PET VALU franchises are sold on a turnkey basis and the price of a franchise includes leasehold improvements where applicable, equipment, merchandise inventory, goodwill where applicable, franchise fees, and a site development fee. PET VALU franchisees pay a royalty as a percentage of gross sales or imputed gross sales and percentage rent equal to the amount by which a fixed percentage of gross sales or imputed gross sales exceeds the base rent payable by the franchisee under the sublease. They also pay distribution fees for the delivery of merchandise to their stores calculated on the basis of a percentage of the retail value of products and they contribute to a promotion fund which is used to defray certain Company expenses in relation to promotional activities. They are also responsible, generally, for the costs of operating the business, including rent, employee wages and benefits, and other costs. Transfer fees are charged on the sale of existing franchises to new franchisees. PAULMAC'S franchisees pay a royalty as a percentage of gross sales and are responsible, generally, for the costs of operating the business, including rent, employee wages and benefits, and other costs. PET VALU franchisees in Canada and PAULMAC'S franchisees sign a franchise agreement and, generally, a lease or sublease. The Company is not currently offering new PAULMAC'S franchises.

The Company has a U.S. franchise system which differs from the Canadian system; however, the Company is not currently offering new PET VALU franchises in the U.S. and, as at July 4, 2009, there was only one U.S. franchise in operation.

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Key Accomplishments

During fiscal 2008 and the first half of fiscal 2009, the Company pursued key priorities intended to improve results from operations, liquidity, capital resources and cash flow.

Store margin improvements

During the second quarter of fiscal 2009, the Company undertook certain actions to increase gross profit margins at corporate and franchise store level. Increases in store gross profit margins improve the overall health of the operations by improving the profits of both the Company and its franchisees. Over the past year, store gross profit margins had weakened as a result of increases in the wholesale cost of products due to increases in commodity prices and, in Canada, an increase in the Canadian dollar cost of imported products. Among the Company's actions to increase store gross profit margins there were retail pricing adjustments across various product lines where competition allowed, as well as adjustments to wholesale prices related to a strengthening of the Canadian dollar.

Reniching

The Company continued to pursue a long-term objective of shifting its product offering to higher-margin, high-quality pet products, which include pet specialty brands and private label products featuring a wellness-focused approach to pet nutrition. Except for changes in foreign currency exchange rates, this reniching program has improved and is expected to continue to improve operating profits and enhance the image of the Company as a specialty retailer.

Inventory Investment

The Company's inventory buying system is designed to take advantage of opportunities, including those in relation to cost inflation. During fiscal 2008, the Company's warehouse inventory levels increased significantly. The Company believes that declines in various commodity prices will slow the rate of any cost increases in fiscal 2009 and will likely result in a reduction of these inventories in fiscal 2009. At July 4, 2009, warehouse inventory levels were C\$2.1 million less than fiscal 2008 year end levels.

Development of Canadian Corporate Store Programs

During fiscal 2008, the Company dedicated an increasing amount of effort to the operation of its Canadian company-owned stores by developing and implementing programs designed to increase sales and operating profitability. These programs included more product and sales training for corporate store staff and an incentive program for corporate store managers. The implementation of these programs has largely been completed. However, they continue to contribute to the increase in comparable store sales of 8.7% for Canadian company-owned stores in the first half of fiscal 2009.

Acquisition

On August 22, 2008, the Company completed the purchase of a 15 store pet food and supply business known as BERRYS or BERRYS...YOUR PETSCHOICE. These stores are all located in eastern Ontario. The purchase price of C\$2.4 million was financed using the Company's existing bank operating line. At the time of acquisition, the Berrys operations and the anticipated operating synergies were expected to incrementally contribute an approximate C\$600,000 to the Company's consolidated income before income taxes during the first 12 months of inclusion. Through the second quarter of fiscal 2009, these stores performed largely as anticipated.

Amendment of Bank Credit Agreement

During the third quarter of fiscal 2008, the Company entered into an agreement with its principal bank to amend its existing credit agreement dated as of July 14, 2006 ("Credit Agreement"). The amendment increased the revolving line of credit in the Credit Agreement from a maximum of C\$15 million to a maximum of C\$20 million. In addition, the amendment created a new C\$5 million term loan that bears interest at prime plus 1% and is repayable in 24 equal monthly installments. The amendment did not materially change any other terms contained in the Credit Agreement.

Repayment of 10% Non-convertible Debentures

In accordance with a debenture holder agreement dated July 24, 2006, the scheduled repayment of principal and accrued interest for the 10% non-convertible debentures created under this agreement was made on July 24, 2008 by cash payments to the debenture holders. The amount of the payments was C\$8,877,836, consisting of principal repayments of C\$8,820,000 and accrued interest of C\$57,836. These payments were financed from the new bank term loan, the Company's bank operating line and funds provided from operations.

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Other Developments

Potential Sale of Pet Valu

As announced in a press release dated July 6, 2009, Pet Valu, Inc. and Pet Valu Canada Inc. have entered into a definitive agreement to be acquired by certain affiliates of Roark Capital Group, an Atlanta based private equity firm. Under the terms of the agreement, shareholders of Pet Valu Canada Inc. (Pet Valu, Inc.'s publicly-traded Canadian operating subsidiary) will receive C\$13.68 in cash for each of their exchangeable shares, representing a total equity value of approximately C\$143.7 million. The transaction is subject to shareholder and court approval and there can be no assurance that it will be completed. The Company's Board of Directors have determined that the transaction is fair to shareholders of the Company and in its best interest and are recommending that shareholders vote in favour of the transaction.

Special Meeting of Shareholders

Special meetings of the shareholders of Pet Valu, Inc. and Pet Valu Canada Inc. will be held on August 25, 2009 at the Toronto Board of Trade at 10:00 am and 10:30 am EDT, respectively. On July 28, 2009, an information circular was filed on Sedar with respect to these meetings. During the meetings, shareholders will vote on several resolutions required to effect the transaction.

Changes in Economic Conditions

The economic conditions in the markets in which the Company operates have changed significantly during the course of fiscal 2008 and the first half of fiscal 2009. Commodity prices increased throughout fiscal 2008 and many suppliers increased the cost of their products purchased by the Company, which in turn resulted in increased retail prices. However, the Company believes sales have not been materially adversely affected by the changes in these conditions. The Company continues to record gains in same store sales in both Canada and the United States. The Company believes that its various operating strategies including product differentiation and inventory investments will continue to mitigate most of the affect of weaker economic conditions.

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Summary of Quarterly Results

The Company's financial information is prepared using Canadian generally accepted accounting principles ("GAAP"). The reporting currency is U.S. dollars. The functional currency is U.S. dollars for the U.S. operations and Canadian dollars for the Canadian operations. As the Canadian operations comprise the majority of the consolidated operations, the foreign currency exchange rate between the Canadian and U.S. dollars has a material effect on the consolidated U.S. dollar results.

Eight quarter summary

(expressed in thousands of U.S. dollars except for per share amounts)

	Fiscal 2007		Fiscal 2008				Fiscal 2009	
	3 rd Quarter	4 th Quarter	1 st Quarter	2 nd Quarter	3 rd Quarter	4 th Quarter	1 st Quarter	2 nd Quarter
System-wide sales ⁽¹⁾	\$ 52,496	\$ 60,323	\$ 53,270	\$ 54,592	\$ 56,242	\$ 58,108	\$ 49,101	\$ 52,297
Sales and revenue	41,518	46,937	42,800	44,257	46,585	47,369	41,274	43,271
EBITDA ⁽²⁾	5,743	7,852	5,261	6,260	6,613	5,790	4,475	4,383
EBITDA before non-comparable items ⁽³⁾	5,743	8,026	5,261	6,630	7,599	6,783	4,840	5,554
Loss (Gain) on foreign exchange	(437)	(65)	248	(127)	324	2,248	178	(440)
Net income	3,138	4,716	2,835	3,595	3,970	4,339	2,726	2,811
Net income before non-comparable items ⁽³⁾	3,138	4,702	2,835	3,841	4,625	4,127	2,968	3,590
Net income per share – basic	0.36	0.55	0.32	0.38	0.42	0.46	0.29	0.30
Net income per share – diluted	0.31	0.46	0.28	0.35	0.39	0.42	0.27	0.28
Net income per share before non-comparable items ⁽⁴⁾								
basic	0.36	0.55	0.32	0.41	0.49	0.43	0.31	0.38
diluted	0.31	0.46	0.28	0.38	0.45	0.40	0.29	0.35
Non comparable items								
Strategic alternative and sale related costs	-	-	-	-	505	1,048	365	1,171
Shareholder proxy costs	-	-	-	370	480	(54)	-	-
Future tax recovery on NOLs	-	(125)	-	-	-	(874)	-	-
Executive employment related payment	-	640	-	-	-	-	-	-
Promotion fund allowance	-	(466)	-	-	-	-	-	-
Applicable tax on non-comparable items	-	(63)	-	(124)	(330)	(331)	(122)	(392)
Exchange rate at end of quarter	0.9948	0.9805	1.0215	1.0106	1.0328	1.2156	1.2304	1.1617
Average exchange rate	1.0455	0.9810	1.0042	1.0099	1.0397	1.2083	1.2455	1.1623

⁽¹⁾ System-wide sales represent retail sales to customers through company-owned and franchise stores.

⁽²⁾ Earnings before interest, taxes, depreciation and amortization of goodwill is not a recognized measure under GAAP. As this measure does not have a standardized meaning prescribed by GAAP, the Company's method of calculating EBITDA may differ from other companies. Management believes EBITDA is a useful supplemental measure as it provides investors with an indication of cash available prior to debt service, capital expenditures and income taxes.

⁽³⁾ EBITDA before non-comparable items and net income before non-comparable items are not recognized measures under GAAP. As these measures do not have standardized meanings prescribed by GAAP, the Company's method of calculating EBITDA before non-comparable items and net income before non-comparable items may differ from other companies. Management believes EBITDA before non-comparable items and net income before non-comparable items are useful supplemental measures as they provide investors with measures that can be used to compare year over year net income and EBITDA without the effects of non-recurring or non-operational activities.

⁽⁴⁾ Net income per share before non-comparable items is not a recognized measure under GAAP. As this measure does not have a standardized meaning prescribed by GAAP, the Company's method of calculating net income per share before non-comparable items may differ from other companies. Management believes net income per share before non-comparable items is a useful supplemental measure as it provides investors with a measure that can be used to compare year-over-year net income without the effects of non-recurring or non-operational activities.

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Non-comparable items

Non-comparable items are non-recurring and/or non-operational items incurred by the Company during the applicable period.

The Company incurred expenses of \$1,552,782 in fiscal 2008 and \$1,171,203 in the second quarter of fiscal 2009 for a year to date fiscal 2009 total of \$1,536,324 related to actions taken in assessing strategic alternatives which have culminated in the definitive agreement to sell the Company to affiliates of Roark Capital Group described earlier herein (see "Other Developments – Potential Sale of Pet Valu").

In connection with a May 2008 proxy contest, costs of \$350,530 were incurred directly by the Company. In addition, expenses of \$445,155 incurred by the party who initiated the contest, Goodwood Inc., were reimbursed by the Company.

The Company reduced the valuation allowance relating to the net operating loss ("NOL") carryforwards for tax purposes of the U.S. operations in fiscal 2008 and 2007. The result of the reduction in the valuation allowance is a future tax recovery of \$874,000 in fiscal 2008 and \$125,000 in fiscal 2007.

A one-time expense of approximately \$640,000 in relation to an employment contract between the Chief Executive Officer of the Company ("CEO") and the Company was incurred in fiscal 2007. The contract expired as of December 31, 2007 and a new contract was executed with the CEO effective January 1, 2008.

The Company and its franchisees make contributions to the Canadian promotion fund, which is used for marketing and advertising activities. The Company determined that the deficit balance of the promotion fund at the end of fiscal 2007 was likely to be recovered in fiscal 2008 having regard to the magnitude of the promotion fund deficit and the Company's assessment of its future promotional plans. Therefore, the allowance of \$466,000 from fiscal 2006 was reversed in full in fiscal 2007. The fund was in a surplus position at the end of fiscal 2008 and, therefore, there was no allowance required in fiscal 2008. At the end of the second quarter of fiscal 2009 the fund was in a deficit position of approximately \$144,000. No allowance has been provided.

For a more in depth discussion of non-comparable items, please refer to the section of this MD&A entitled "Results of Operations".

Effect of Translating C\$ Functional Currency for the Canadian Operations into US\$ Reporting Currency

The Company is comprised of various Canadian and U.S. subsidiaries. Generally, the country in which the subsidiary operates will determine the functional currency. The reporting currency for the consolidated financial statements is U.S. dollars. Therefore, for each subsidiary whose functional currency is not U.S. dollars, the statement of operations and the balance sheet are converted to U.S. dollars at the end of the period using the average foreign currency exchange rate for the period and the end of period foreign currency exchange rate, respectively. For the second quarter of fiscal 2009 the Canadian dollar was 13.1% weaker than the comparable period of the prior year. At July 4, 2009, the Canadian dollar was 4.4% stronger than at January 3, 2009. These effects were somewhat offset when the results of operations and balance sheets of subsidiaries which use the U.S. dollar as their functional currency were consolidated with the results of operations and balance sheets of the Canadian subsidiaries.

Summary of effects of translating Canadian operations into US dollar reporting currency
(All amounts in millions of US dollars)

	Q2 2008 Reported	Q2 2009 Reported	Foreign Exchange (1)	YTD 2008 Reported	YTD 2009 Reported	Foreign Exchange (1)
System-wide sales	\$ 54.6	\$ 52.3	\$ (6.4)	\$ 107.9	\$ 101.4	\$ (15.9)
Sales and revenue	44.3	43.3	(5.2)	87.1	84.5	(12.9)
EBITDA	6.2	4.4	(0.5)	11.5	8.9	(1.4)
EBITDA before non-comparable items	6.6	5.6	(0.7)	11.8	10.4	(1.7)
Net income	3.6	2.8	(0.3)	6.4	5.5	(0.8)
Net income before non-comparable items	3.8	3.6	(0.4)	6.7	6.6	(1.0)

(1) Foreign exchange represents the impact of the change in currency exchange rates used in translating the Canadian operations from the functional currency of Canadian dollars into the reporting currency of US dollars

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Comparison of Second Quarter Fiscal 2009 to Second Quarter Fiscal 2008

Store Operations

During the second quarter of fiscal 2009, the Company closed one U.S. store. There were no store openings during the quarter. Store operations are evaluated on an on-going basis with openings and closings resulting from shifts in demographics, quality of locations, population growth and competition.

In the second quarter of fiscal 2009, the average number of stores in operation was 356.3, sixteen stores more than the average for the second quarter of the prior year. The increase is entirely in Canada as the average number of stores in operation in the US decreased by one to 61 in the second quarter of the current year as compared to 62 in the second quarter of the prior year.

System-wide sales

(\$52.3 million – Q2 2009, \$54.6 million – Q2 2008)

During the second quarter of fiscal 2009, system-wide sales decreased by \$2.3 million or 4.2% from the prior year. The change in foreign currency exchange rates resulted in a decrease in system-wide sales from the comparable period of the prior year of \$6.4 million. Before the effects of the change in foreign currency exchange rates, the system-wide sales in the Canadian operations increased by \$3.9 million or 8.6%. The system-wide sales in the U.S. operations increased by \$0.2 million or 2.4%. Of the increase in Canada, the BERRYS' stores, which were acquired in the third quarter of fiscal 2008, contributed \$1.0 million to sales during the second quarter of fiscal 2009. For the year to date period, system-wide sales decreased by \$6.5 million or 6.0%. The change in foreign currency exchange rates resulted in a decrease in system-wide sales of \$15.9 million. Before the effects of the change in foreign currency exchange rates, the system-wide sales in the Canadian operations increased by \$8.4 million or 9.4%. System-wide sales in the U.S. operations increased by \$1.0 million or 5.6% for the year to date period. Of the increase in Canada, the BERRYS' stores contributed \$1.9 million to sales during the year to date period.

Comparable store sales represent a year-over-year comparison of the same group of stores that were open during both years of comparison. A store becomes comparable one year after its first full month of operation. Comparable store sales for the second quarter increased by 6.0% in Canada and by 2.8% in the U.S. For the year to date period, comparable store sales increased by 6.9% in Canada and 5.8% in the U.S. Factors contributing to the increase in Canada include product differentiation strategies, store image strategies, in-store inventory positions, and retail price inflation. As a result of differentiation strategies, higher margin product sales have continued to show growth. Store image strategies and improved in-store inventory positions have contributed to more positive shopping experiences for customers, resulting in higher sales levels. Similar factors existed in the U.S.

Sales and revenue

(\$43.3 million – Q2 2009, \$44.3 million – Q2 2008)

Sales and revenue represent retail sales through company-owned stores in Canada and the U.S., retail sales through franchise stores in the U.S., merchandise sales to franchisees in Canada, initial and continuing franchise fees in both countries, and wholesale sales to third parties. The Company's sales and revenue decreased by \$1.0 million or 2.2% in the second quarter of fiscal 2009 as compared to the second quarter of fiscal 2008. The change in foreign currency exchange rates resulted in a decrease in sales and revenue of \$5.2 million. Before the effects of the change in foreign currency exchange rates, the sales and revenue in the Canadian operations increased by \$4.0 million or 11.5%. The sales and revenue from the U.S. operations increased by \$0.2 million or 2.3%. Increases in comparable store sales and the purchase of franchises contributed to the increase in sales and revenue in Canada and the U.S. Of the increase in Canada, the acquired BERRYS' stores contributed \$1.0 million to sales during the second quarter of fiscal 2009. For the year to date, the Company's sales and revenue decreased by \$2.5 million. The change in foreign currency exchange rates resulted in a decrease in sales and revenue of \$12.9 million. Before the effects of the change in foreign currency exchange rates, the sales and revenue in the Canadian operations increased by \$9.4 million or 13.6%. Sales and revenue from the U.S. operations increased by \$1.0 million or 5.5% for the year to date period. Of the increase in Canada, the acquired BERRYS' stores contributed \$1.9 million to sales during the year to date period.

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In the second quarter of fiscal 2009, total merchandise sales through company-owned stores increased by \$2.6 million to \$23.4 million, accounting for an increase of 5.8% in consolidated sales and revenue. The change in foreign currency exchange rates resulted in a decrease in merchandise sales through company-owned stores of \$2.3 million. Before the effects of the change in foreign currency exchange rates, the merchandise sales through company-owned stores in the Canadian operations increased by \$4.6 million or 38%. Increases in Canada were due to both the increase in the number of company-owned stores in operation, including the acquisition of the BERRYS' stores, and the increase in comparable store sales. In the U.S. operations, merchandise sales through company-owned stores increased by \$0.2 million or 2.6%. For the year to date, total merchandise sales through company-owned stores increased by \$4.8 million, accounting for an increase of 5.5% in consolidated sales and revenue. The change in foreign currency exchange rates resulted in a decrease in merchandise sales through company-owned stores of \$5.3 million. Before the effects of the change in foreign currency exchange rates, the merchandise sales through company-owned stores in the Canadian operations increased by \$9.1 million or 39%. In the U.S. operations, merchandise sale through company-owned stores for the year to date period increased by \$1.0 million or 5.7%

Merchandise revenue from franchisees includes (1) merchandise sales at U.S. franchise stores; and (2) merchandise sold to Canadian franchisees together with related franchise distribution charges, royalty revenue and percentage rent revenue. Total merchandise revenue from franchise stores decreased by \$3.2 million to \$19.5 million, accounting for a 7.3% decrease in consolidated sales and revenue. The change in foreign currency exchange rates resulted in a decrease in revenue from franchisees of \$2.9 million. Before the effects of the change in foreign currency exchange rates, the merchandise revenue from franchise stores in the Canadian operations decreased by \$0.3 million or 1.4%. In the U.S. operations, merchandise revenue from franchise stores was consistent with the prior year. In the Canadian operations, increases in comparable store sales were partially offset by a 7.9% decrease in the average number of franchise stores in operation. For the year to date, total merchandise revenue from franchise stores decreased by \$6.9 million, accounting for an 8.0% decrease in consolidated sales and revenue. The change in foreign currency exchange rates resulted in a decrease in revenue from franchisees of \$7.4 million. Before the effects of the change in foreign currency exchange rates, the merchandise revenue from franchise stores in the Canadian operations increased by \$0.4 million.

Gross profit

(\$13.3 million – Q2 2009, \$14.8 million – Q2 2008)

Gross profit on sales and revenue decreased by \$1.5 million or 9.7% in the second quarter of fiscal 2009 as compared to the second quarter of fiscal 2008. The change in foreign currency exchange rates resulted in a decrease in gross profit of \$1.6 million. Before the effects of the change in foreign currency exchange rates, gross profit in the Canadian operations decreased by \$0.1 million as compared to the comparable period of the prior year. In the U.S. operations, gross profit increased by \$0.2 million or 10.0%. Blended gross profit margins decreased to 30.8% in the second quarter of fiscal 2009, as compared to 33.4% in the second quarter of the prior year. For the year to date, gross profit on sales and revenue decreased by \$2.1 million or 7.4%. The change in foreign currency exchange rates resulted in a decrease in gross profit of \$4.0 million. Before the effects of the change in foreign currency exchange rates, gross profit in the Canadian operations increased by \$1.2 million or 5.3%. In the U.S. operations, gross profit for the year to date increased by \$0.7 million or 13.6%

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Store operating expenses

(\$4.9 million – Q2 2009, \$4.6 million – Q2 2008)

Store operating expenses increased by \$0.3 million or 7.2% in the second quarter of fiscal 2009 as compared to the second quarter of fiscal 2008. The change in foreign currency exchange rates resulted in a decrease of \$0.5 million in store operating expenses. Before the effects of the change in foreign currency exchange rates, store operating expenses in the Canadian operations increased by \$0.8 million or 31.2%. In the U.S. operations, store operating expenses were consistent with the comparable period of the prior year. A 33.2% increase in the number of Canadian company-owned stores and increases in wages and bank charges contributed to the increase in store operating expenses. For the year to date period, store operating expenses increased by \$0.7 million. The change in foreign currency exchange rates resulted in a decrease of \$1.1 million in store operating expenses. Before the effects of the change in foreign currency exchange rates, store operating expenses in the Canadian operations increased by \$1.8 million. Store operating expenses in the U.S. operations for the year to date period were consistent with the prior year.

General and administrative expenses

(\$4.9 million – Q2 2009, \$4.5 million – Q2 2008)

General and administrative expenses increased by \$0.4 million or 9.2% in the second quarter of fiscal 2009 as compared to the second quarter of fiscal 2008. The change in foreign currency exchange rates resulted in a decrease of \$0.8 million in general and administrative expenses. Before the effects of the change in foreign currency exchange rates, general and administrative expenses in the Canadian operations increased by \$1.2 million or 27.2%. In the U.S. operations, general and administrative expenses were consistent with the prior year. Included in general and administrative expenses in the second quarter of fiscal 2009 were non-comparable items totaling \$1.2 million from the Company's actions related to the assessment of strategic alternatives and the sale of the Company. For the year to date period, general and administrative expenses increased by \$0.3 million. The change in foreign currency exchange rates resulted in a decrease of \$1.7 million in general and administrative expenses. Before the effects of the change in foreign currency exchange rates, general and administrative expenses in the Canadian operations increased by \$2.0 million. General and administrative expenses in the U.S. operations, for the year to date period, were consistent with the prior year. Non-comparable items related to the assessment of strategic alternatives and the sale of the Company for the year to date totaled \$1.5 million.

Foreign exchange gains / losses

(\$0.4 million gain – Q2 2009, \$0.1 million gain – Q2 2008)

Foreign currency exchange gains in the second quarter of fiscal 2009 were \$0.3 million greater than the comparable period of the prior year. Gains of approximately \$0.4 million were incurred in relation to a US dollar denominated loan to the Canadian operations from the US operations. These gains are non-cash gains and will not be realized until the loan is repaid. There were also foreign exchange gains of less than \$0.1 million in relation to US dollar denominated bank operating loans and accounts payable in the Canadian operations. The Company has adopted a policy to limit the amount of US dollar denominated borrowings under its operating loans to \$1 million to minimize foreign exchange gains or losses of this nature. For the year to date period, foreign currency exchange gains were \$0.3 million as compared to losses of \$0.1 million for the comparable period of the prior year.

Net interest expense

(\$0.2 million – Q2 2009, \$0.5 million – Q2 2008)

Net interest expense decreased by \$0.3 million or 58.5% in the second quarter of fiscal 2009 as compared to the second quarter of fiscal 2008. The change in foreign currency exchange rates resulted in a decrease of \$0.1 million in net interest expense. Before the effects of the change in foreign currency exchange rates, net interest expense in the Canadian operations decreased by \$0.2 million. In the U.S. operations, net interest expense was consistent with the comparable period of the prior year. Repayment of debentures in fiscal 2008 and reductions in bank borrowings contributed to the reduction in interest expense. For the year to date period, net interest expense was \$0.4 million as compared to \$1.0 million for the comparable period of the prior year.

Pet Valu, Inc.

Income taxes

(\$0.9 million – Q2 2009, \$1.7 million – Q2 2008)

The provision for income taxes for the second quarter of fiscal 2009 was \$0.8 million less than the comparable period of the prior year. The effective tax rate for the second quarter of fiscal 2009 was 23.9% as compared to 32.1% in the second quarter of fiscal 2008. A higher percentage of the consolidated pre-tax income was generated by the U.S. operations in the second quarter of fiscal 2009 than the second quarter of fiscal 2008, which attracts no income tax provision due to the availability of NOL carryforwards to offset taxable income.

The Company reviews the likelihood of a realization of the NOL carryforwards of the U.S. operations on a regular basis. The Company believes it is more likely than not that a portion of the NOL carryforwards will be realized based on the current and projected taxable income of the U.S. operations. There is no adjustment to the valuation allowance relating to NOL carryforwards during interim periods.

Net income

(\$2.8 million – Q2 2009, \$3.6 million – Q2 2008)

Net income for the second quarter of fiscal 2009 decreased by \$0.8 million from the comparable period of the prior year. Net income before non-comparable items for the second quarter of fiscal 2009 was \$3.6 million as compared to \$3.8 million in the second quarter of fiscal 2008. Canadian operations net income before non-comparable items in the second quarter of fiscal 2009, excluding the effects of the change in the foreign currency exchange rates, decreased by \$0.1 million as compared to the comparable period of the prior year. The change in foreign currency exchange rates resulted in a decrease of \$0.4 million in Canadian operations net income before non-comparable items. US operations net income increased by \$0.3 million. There were no non-comparable items in the US operations. Sales increases and improvements in blended gross profit margins in the US operations were partially offset by increases in operating expenses. For the year to date period, net income before non-comparable items was \$6.6 million as compared to \$6.7 million in the comparable period of the prior year.

Liquidity and Financial Position

At July 4, 2009, the Company had cash and short term investments of \$3.7 million as compared to \$2.4 million at the end of fiscal 2008.

The Company had non-cash working capital of \$15.3 million at the end of the second quarter of fiscal 2009, which was \$2.5 million more than the non-cash working capital of \$12.8 million at the end of fiscal 2008, partially due to an increase in inventory. There are no requirements to increase working capital in fiscal 2009; however, as store locations are added in the future or the breadth of product lines are expanded, inventory requirements may increase.

Merchandise accounts payable leveraging (trade payables over inventory) was 18.3% as of July 4, 2009 as compared to 16.0% as of January 3, 2009. The Company maintains a relatively low level of leveraging due to efforts to realize increased vendor discounts and allowances.

Total assets increased by approximately \$5.5 million to \$78.8 million at July 4, 2009, as compared to \$73.3 million at the end of fiscal 2008. The change in foreign currency exchange rates resulted in an increase of \$2.8 million in total assets. Before the effects of the change in foreign currency exchange rates, total assets in the Canadian operations increased by \$1.8 million or 2.9%. In the U.S. operations, total assets increased by \$0.9 million. Higher levels of cash, property and equipment, goodwill and income taxes recoverable contributed to the increase in assets.

Cash provided by operating activities in the second quarter of fiscal 2009 was \$5.8 million as compared to cash provided by operating activities of \$3.4 million in the comparable period of the prior year. In addition to net income, reductions in receivables and inventory contributed to the cash provided by operating activities.

Net cash used in investing activities for the second quarter of fiscal 2009 was \$1.2 million as compared to \$0.8 million in the second quarter of fiscal 2008. In addition to the normal replacement of existing assets, the Company acquired various franchises. During the second quarter of fiscal 2009, the Company repurchased five franchise stores (2008 – three) for \$568,877 (2008 - \$199,304). Cash flow from operations was used to support the cost of repurchasing franchise store assets.

Pet Valu, Inc.

Replacements of certain property and equipment were funded through vendor leasing programs.

Net cash used in financing activities in the second quarter of fiscal 2009 was \$4.1 million as compared to \$2.6 million in the comparable period of the prior year. During the second quarter of fiscal 2009, the Company repaid part of its bank operating line and made scheduled principal repayments on long term debt. In the second quarter of fiscal 2008, in addition to the repayment of part of its bank operating line and the scheduled principal repayments of long term debt, the Company received \$0.6 million from the exercise of options and used \$0.7 million to acquire exchangeable shares of Pet Valu Canada Inc. under a normal course issuer bid.

The Company anticipates that cash flow from current operations will be sufficient to meet debt servicing obligations for fiscal 2009. Future expansion will be funded through operating cash flow. The Company anticipates that it will continue to generate positive cash flow for the foreseeable future.

The Company has certain debt obligations that will mature in fiscal 2009. The Company has adequate financial resources to meet these maturities as they come due.

Capital Resources

The Company's Credit Agreement provides the Company with a C\$20 million revolving line of credit for a term of five years and a C\$5 million term loan to be repaid over twenty-four months. The Credit Agreement contains a financial covenant in relation to debt service and certain limitations regarding indebtedness, liens, leases, dividends and capital expenditures. The Company is in compliance with the covenants contained in the Credit Agreement as of the date hereof.

At July 4, 2009, the Company had utilized C\$6.1 million of the revolving line of credit as compared to C\$6.2 million at January 3, 2009.

During the third quarter of fiscal 2008, a new term loan for C\$5 million was drawn.

On March 5, 2008, 785,411 warrants to purchase exchangeable shares of Pet Valu Canada Inc. at C\$2.00 per share and 66,533 warrants to purchase exchangeable shares of Pet Valu Canada Inc. at C\$5.50 per share were exercised for proceeds of C\$1,936,754.

The Company does not have any commitments with respect to future capital expenditures. Replacement of existing capital assets will occur as required. Additions of furniture and fixtures are normally financed through internal cash flow. Additions of tractors, trailers, warehouse material handling equipment, and some computer and office equipment may be financed through vendor leasing programs.

Financial Instruments

The Company's consolidated financial statements include various financial instruments, namely, cash and short term investments, accounts receivable, other receivables, notes receivable, bank overdraft, bank operating loans, accounts payable and accrued liabilities, long term debt and subordinated debentures.

Cash and short term investments

The Company's excess cash is invested in overnight deposits with high quality financial institutions to generate a return on these funds. The Company assesses the credit and interest rate risks on these investments as minimal.

Accounts Receivable and Other Receivables

The Company's accounts receivable and other receivables are from its suppliers and the Company's franchise operators. The Company assesses the credit risk on its receivables from franchises to be minimal due to the short settlement terms on these receivables and the distributed nature of the balance between a large number of franchise operators. The Company assesses the credit risk on its receivables from its suppliers to be minimal due to its ability to offset any monies owed by the supplier against amounts owed to the supplier for goods purchased.

Pet Valu, Inc.

Long term debt

The Company's long term debt consists of a term loan with its bank, capital leases and a supplier note payable. The term loan, which comprises the majority of the long term debt, and the supplier note payable have floating rates of interest based on Canadian and U.S. bank prime. The Company believes that debt subject to variable interest rates is at an acceptable level and that any current obligations affected by minor fluctuations in rates can be met by current operations.

Foreign currency exchange risk on financial instruments

The Company is exposed to risks arising from fluctuations in currency exchange rates between Canadian dollars and United States dollars. Generally, this risk is minimal as the majority of the financial instruments are short term in nature and held in the local currency of the respective operating company. The Canadian subsidiaries borrow US dollars through their bank operating line and from the US subsidiaries to facilitate merchandise purchases from US suppliers. While the amount borrowed in foreign currencies at any given time varies, borrowing levels at the end of the second quarter of fiscal 2009 would result in gains or losses of approximately \$365,000 for each 5% change in the Canadian / US currency exchange rate, with gains occurring as the Canadian dollar strengthens and losses occurring as the Canadian dollar weakens. The Company has adopted a policy to limit the amount of US dollar denominated borrowings under its operating loans to \$1 million to minimize the foreign exchange gains or losses.

Off-Balance Sheet Arrangements

There are no off-balance sheet arrangements as of July 4, 2009 or January 3, 2009.

Contingent Liabilities

There are various claims outstanding against the Company including the matters referred to in the litigation paragraphs of the "Risks and Uncertainties" section of this MD&A.

Risks and Uncertainties

The Company is exposed to a number of risks in the normal course of its business that have the potential to affect operating performance. Exposure to certain risks is an integral part of carrying on business.

Competition

The Company's stores compete with four main types of competitors: (i) grocery product retailers; (ii) pet specialty stores; (iii) pet product superstores; and (iv) pet shops. Grocery product retailers include grocery stores, mass merchandisers, warehouse clubs, and convenience retailers such as some convenience stores, discount stores, drug stores, and hardware general merchandise stores.

The Company's stores compete with these groups by seeking to offer products at competitive prices as well as higher margin, high-quality products including private label and natural and wellness focused products, and by seeking to provide a convenient, friendly, service-oriented shopping environment in which customers may discuss their pets and obtain product information and advice about the care of their pets from knowledgeable staff.

The Company expects continued increases in competition and plans to address this challenge by employing strategies focused on its key competitive strengths. These include customer service, convenience, and the introduction of new specialty and wellness focused products.

Dependence on Key Personnel

The success of the Company is dependent to a significant degree upon the expertise and experience of its senior management, most of whom have been with the Company for many years. The Company's continued success could depend on its ability to retain current management or hire comparable replacement personnel.

Pet Valu, Inc.

Reliance on Suppliers, Product Lines and Current Distribution Arrangements

The Company purchases significant amounts of its merchandise from certain key suppliers. A termination or interruption in the flow of merchandise from any of these vendors or any other significant suppliers of pet food or pet-related supplies offered by the Company could have an adverse impact on the Company.

Economic Conditions and Resulting Product Cost Inflation

Economic conditions including escalating costs in energy, agricultural products, and livestock used either in the production of food products or as ingredients in food products sold by the Company may result in inflation in the cost of many products sold by the Company. In periods of cost inflation, the Company believes retail prices could increase among all retailers. The Company's inventory investment strategy is expected to provide a competitive advantage in this regard. In the event that weaker economic conditions persist and consumers begin to change their purchasing patterns, the Company's convenient locations and strong private label programs are expected to provide it with an advantage.

Foreign Exchange Risks Associated with Merchandise Purchased in Foreign Currencies

The Company purchases certain of its goods for resale from foreign suppliers in foreign currencies. The foreign currency exchange rate at the time of purchase is included in the calculation of the cost of the product. There are, therefore, the usual risks associated with exchange rate fluctuations. Currently, the Company's Canadian subsidiaries purchase approximately 25% of its products in US dollars. The Company does not currently hedge against changes in the US / Canadian currency exchange rates.

Risks Associated with Importing Merchandise

The Company imports merchandise into Canada from the US and other countries and into the US from Canada and other countries. This merchandise includes products that are subject to various laws and rules, including those administered by the Food and Drug Administration in the U.S. and the Canadian Food Inspection Agency in Canada. These agencies are empowered to act to prevent the importing of goods for various reasons within their mandate. Broad import restrictions could negatively impact the ability of the Company to source products demanded by its customers. For example, import and export controls on animal protein ingredients of pet products pursuant to events such as the discovery of bovine spongiform encephalopathy in cattle or the avian flu virus in poultry could disrupt the supply of products available for the Company to sell, or affect the price of brand name products or the raw material ingredients for its private label products.

Leases

The Company leases space for most of the company-owned and franchise stores, as well as the majority of warehouse and office facilities. The terms of the leases vary by location. In the event of unreasonable rent increases upon renewal of store leases or an inability to secure renewals, relocation costs should not, in general, be material. However, there is the usual risk associated with the loss of a profitable retail location and the inability to find a substitute location of equal profitability. The Company does not anticipate at the present time any material impact on profitability in relation to potential losses of desirable store locations. With respect to warehouse and office facilities, the Company expects that it will be in a position to find adequate facilities in the event that it is unable to reach satisfactory extensions of lease terms at current locations.

Environmental Matters

As an owner, occupier, and lessor of property, the Company is subject to various laws relating to environmental matters. Under such laws an owner, occupier, or lessor could be liable for the costs of removal and remediation of certain contaminants with respect to the properties it owns, occupies, or leases. These risks are believed to be limited.

Litigation

Paulmac's is currently defending a motor vehicle claim where the amount claimed for damages totals C\$3.6 million and the limit of insurance coverage is C\$2.0 million. Moreover, the plaintiffs made a claim for punitive damages and there is no insurance coverage for punitive damages. While the outcome of this litigation is not certain, the Company believes that there are substantive defences to this claim.

Pet Valu, Inc. and its affiliates (other than Paulmac's) have, both before and after this claim, and Paulmac's has, since its acquisition by Pet Valu Canada Inc., maintained automobile insurance coverage limits which have been, and are, well in excess of the above limit and which have been, and are, adequate in the view of management to cover future risks similar to the above.

Pet Valu, Inc.

In fiscal 2007 Pet Valu, Inc. and Pet Valu Canada Inc. (the "Pet Valu Companies") were joined, or targeted to be joined, as defendants, along with manufacturers and pet food retailers in five potential class action lawsuits concerning the manufacture and sale of pet food products alleged to contain melamine. The actions in which the Pet Valu Companies were joined were commenced in Saskatchewan, British Columbia and Newfoundland and Labrador. Actions in which they were targeted to be joined were commenced in Ontario and Manitoba.

In the first half of fiscal 2008, a settlement agreement was reached involving all five above actions as well as approximately 100 other actions commenced in the U.S. and Canada which do not involve the Pet Valu Companies. The settlement agreement received final approval of the U.S. and Canadian courts in the latter half of 2008 but two appeals have since been filed in the U.S. contesting the final approval by the U.S. Court. No appeals have been filed in Canada and the time for filing an appeal has passed; however, the appeals in the U.S. will postpone the payment of any claims pursuant to the settlement and it is uncertain how long these appeals will take to resolve. The settlement agreement is binding on all members of the settlement class except for 114 individuals who validly opted out of the settlement, 25 of which were in Canada. The settlement agreement creates a settlement fund of US\$24 million to be administered by a neutral claims administrator that will allow a potential recovery of up to 100% of all economic damages incurred by pet owners subject to certain limitations. The Pet Valu Companies expect that the settlement will have no financial impact on them.

From time to time, the Company is named as a defendant in other legal proceedings arising from its normal business activities. Although the amount of any liability that could arise with respect to currently pending actions cannot be estimated, in the opinion of the Company, any such liability is not likely to have a material adverse effect on its financial position, operating results or liquidity.

Seasonality

The Company does not have a significant exposure to seasonal fluctuations among its product lines. Historically, fourth quarter earnings tend to be stronger due to higher store sales and increased margins.

Inflation

The results of operations and financial condition are presented based upon historical cost. While it is difficult to accurately measure the impact of inflation, the Company believes that in areas other than retail pricing and product costs, which are discussed above, the effects of inflation on its operations have been immaterial over the last three years.

Market risks

The Company does not engage in financial transactions for trading or speculative purposes.

Expansion Plans

Expansion by the Company either through greenfield development or synergistic acquisition depends on several factors such as its ability to obtain favourable store sites and / or identify synergistic competitors, and to compete in existing or new markets.

Other Risks

Additional risks include: the ability of the Company to successfully implement its strategic initiatives and whether such strategic initiatives will yield the expected benefits; changes in consumer spending; customer preferences toward product offerings; adverse climate changes; the occurrence of a pandemic or other catastrophic event which could create shortages of labour, products or services required to operate the business profitably; the outcome of a pending acquisition of the Company which will be submitted to the Company's shareholders for approval on August 25, 2009 and thereafter to the Supreme Court of British Columbia for approval; and changes in the laws, rules and regulations applicable to the Company or the markets in which the Company operates.

Pet Valu, Inc.

Transactions with related parties

There were no transactions with related parties in the first half of fiscal 2009. The Company had the following transactions with related parties in the first half of fiscal 2008:

- a) Interest payments were made on debentures held by certain officers and former directors of C\$206,863 in the second quarter of fiscal 2008 and C\$416,573 in the first half of fiscal 2008. The principal amounts of these debentures and all outstanding interest was repaid on the maturity date of July 24, 2008.
- b) Payments of C\$30,826 for the second quarter of fiscal 2008 and C\$34,680 for the first half of fiscal 2008 were made to a former director of the Company for consulting services provided regarding various matters.

Critical accounting estimates

There were no new critical accounting estimates in the first half of fiscal 2009. Please see the discussion of critical accounting estimates in the MD&A for the year ended January 3, 2009.

Changes in Accounting Policies including Initial Adoption

In December 2006, the CICA issued Handbook Section 1535. This section establishes standards for disclosing information about an entity's capital and how it is managed. An entity must disclose information to enable the users of the financial statements to evaluate the entity's objectives, policies and processes for managing capital. The section applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. The effect of adopting Section 1535 is that the Company explicitly discloses its objectives, policies and processes for managing capital.

In December 2006, the CICA issued Handbook Section 3862 and Section 3863. Entities are required to provide disclosures and presentations in the financial statements to enable the users of those statements to evaluate the significance of the financial instruments for the entity's financial position and performance. The additional disclosures and presentations will also enable the users to evaluate the extent of risks arising from financial instruments and how well the entity manages those risks. The sections apply to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. An entity may choose to early adopt the requirements in conjunction with Handbook Section 3855. The effect of adopting Sections 3862 and 3863 is that the Company has placed more emphasis on disclosure of the nature and extent of risks arising from financial instruments to which the Company is exposed and how those risks are managed.

In June 2007, the CICA issued Handbook Section 3031. This section replaced the existing Handbook Section 3030 Inventories. The section establishes standards for the measurement and disclosure of inventories. The section states that inventories shall be measured at the lower of cost and net realizable value. Cost is defined as all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location. An entity may use the standard cost method or the retail method if it is determined that the results approximate cost. It is applicable to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008. The adoption of Handbook Section 3031 has not had a material effect on the Company's financial position, results of operations, or cash flows.

In February 2008, the CICA issued Handbook Section 3064. This new handbook section replaces Section 3062 Goodwill and Intangibles and Section 3450 Research and Development Costs. The section establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The section outlines the criteria to be used to recognize an intangible asset. It gives further guidance on capitalizing intangible assets during the research and development stages. This section applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2008. The adoption of Handbook Section 3064 did not have a material effect on the Company's financial position, results of operations, or cash flows.

Pet Valu, Inc.

Outstanding Share Data

The following table contains the number of outstanding voting or equity securities. Please refer to notes 6 and 8 of the July 4, 2009 financial statements for additional information.

	<u>Aug 11, 2009</u>	<u>July 4, 2009</u>	<u>Jan. 3, 2009</u>
Common Stock of Pet Valu, Inc.	100	100	100
Special Voting Stock of Pet Valu, Inc.	-	-	-
Additional Special Voting Stock of Pet Valu, Inc.	9,626,274	9,626,274	9,626,274
Exchangeable Shares of Pet Valu Canada Inc.	9,499,740	9,499,020	9,495,020
Common Shares of Pet Valu Canada Inc. (held by Pet Valu, Inc.)	1	1	1
Non-voting securities convertible into Exchangeable Shares of Pet Valu Canada Inc.:			
8.5% debentures of Pet Valu Canada Inc. (face value C\$3.7 million)	672,727	672,727	672,727

Outlook

The Company continues to pursue strategic initiatives to improve earnings during 2009 as outlined in the Outlook section of the fiscal 2008 Annual Report.

Strategies Addressing Current Economic Conditions

The Company has implemented specific programs to address recession-based impacts. These include specific initiatives with respect to reductions in occupancy and other costs where reductions might be possible as a result of the current economic conditions. Cost reductions on some warehouse leases are expected as those leases are renewed during the third quarter of fiscal 2009 or replaced with leases for new facilities.

To the extent that customer buying patterns have changed as a result of the current economic conditions, the Company's financial performance has not been materially impacted. The Company will continue to monitor activity in all the markets in which the Company operates and respond accordingly.

Pursuit of Organic Growth

Organic growth has resulted primarily from the Company's reniching programs, including the additions of new differentiated products and the continued development of private label products. These reniching programs are ongoing and include further product differentiation, staff training, facilities upgrades and customer service initiatives. The Company will continue to focus on these programs for the foreseeable future with the goal of increasing sales, maintaining strong margins and improving the customer experience and product selection.

Initiatives to Sustain Growth in Earnings

Improvements to the efficiency of the operation of the business are being sought through expanded automation in relation to both routine decision-making and inventory management. Improvements to productivity are being pursued through the development of performance management measures at all levels of staffing.

Pet Valu, Inc.

Disclosure Controls and Procedures and Internal Controls over Financial Reporting

The Company has designed disclosure controls and procedures to provide reasonable assurance that material information related to the Company is included in the annual and quarterly filings. In addition, the Company evaluated the effectiveness of the disclosure controls and procedures as of the end of the annual filing period of January 3, 2009 and concluded that these controls were effective.

The Company has designed internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. The Company evaluated the effectiveness of the internal controls over financial reporting as of the end of the annual filing period of January 3, 2009 and concluded that these controls were effective.

There have been no changes in the Company's internal controls over financial reporting during the second quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Pet Valu, Inc.

August 11, 2009

To the Shareholders of Pet Valu, Inc.:

An auditor has not reviewed the consolidated balance sheet or the consolidated statement of shareholders' equity of Pet Valu, Inc. as at July 4, 2009, nor the consolidated statements of operations, comprehensive income, shareholders' equity and cash flows for the twenty-six week period then ended.

Pet Valu, Inc.

Consolidated Balance Sheets

In accordance with Canadian generally accepted accounting principles

(Unaudited)

(In U.S. dollars)

	July 4, 2009	January 3, 2009
Assets		
Current assets		
Cash and short-term investments	\$ 3,743,284	\$ 2,425,424
Accounts receivable	1,772,573	1,605,128
Income taxes recoverable	1,202,617	-
Other receivables	948,612	962,771
Inventories	34,875,850	34,237,470
Prepaid expenses and other assets	2,918,400	3,071,558
Future income taxes (Note 10)	954,657	960,893
Total current assets	46,415,993	43,263,244
Notes receivable	10,988	15,730
Deferred rent receivable and other assets	1,016,275	983,261
Property and equipment, net of accumulated depreciation and amortization	9,602,322	8,515,195
Goodwill	16,911,103	15,703,335
Future income taxes (Note 10)	4,852,897	4,837,327
Total assets	\$ 78,809,578	\$ 73,318,092
Liabilities and Shareholders' Equity		
Current liabilities		
Bank overdraft	\$ 1,121,920	\$ 1,457,101
Bank operating loans (Note 4)	5,234,052	5,132,159
Current portion of long-term debt, including capital lease obligations (Note 5)	2,549,893	2,486,299
Deferred gain on warehouse sale	47,752	152,108
Trade accounts payable	6,380,803	5,468,561
Accrued liabilities	4,604,499	5,774,612
Accrued wages and benefits	4,321,600	3,988,362
Income taxes payable	-	620,101
Subordinated debentures (Note 6)	3,134,477	2,947,258
Total current liabilities	27,394,996	28,026,561
Deferred franchise revenue	5,167	5,492
Deferred rent payable	2,618,069	2,431,255
Long-term debt including capital lease obligations, less current maturities (Note 5)	1,341,726	2,237,030
Total liabilities	31,359,958	32,700,338
Contingencies (Note 11)		
Shareholders' Equity		
Accumulated earnings	29,781,682	24,245,113
Accumulated other comprehensive loss	(5,742,706)	(6,987,180)
	24,038,976	17,257,933
Capital stock (Notes 8 and 9)	963	963
Contributed surplus	24,101,666	24,050,843
Treasury stock – exchangeable shares, at cost	(691,985)	(691,985)
Total shareholders' equity	47,449,620	40,617,754
Total liabilities and shareholders' equity	\$ 78,809,578	\$ 73,318,092

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

Pet Valu, Inc.

Consolidated Statements of Operations

In accordance with Canadian generally accepted accounting principles

(Unaudited)

(In U.S. dollars)

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	July 4, 2009	June 28, 2008	July 4, 2009	June 28, 2008
Sales and revenue	\$ 43,270,951	\$ 44,256,770	\$ 84,545,324	\$ 87,056,973
Cost of sales including occupancy costs	29,938,546	29,486,692	58,368,907	58,802,581
Gross profit	13,332,405	14,770,078	26,176,417	28,254,392
Store operating expenses excluding occupancy costs	4,948,639	4,614,435	9,527,380	8,834,172
General and administrative expenses	4,937,781	4,520,343	9,021,219	8,756,562
	3,445,985	5,635,300	7,627,818	10,663,658
Net interest expense	194,436	468,741	397,313	958,651
(Gain) loss on foreign exchange	(439,879)	(127,270)	(262,359)	121,021
Income before income taxes	3,691,428	5,293,829	7,492,864	9,583,986
Income taxes provision	880,439	1,698,640	1,956,295	3,153,965
Net income	\$ 2,810,989	\$ 3,595,189	\$ 5,536,569	\$ 6,430,021
Basic EPS (Note 2)	\$ 0.30	\$ 0.38	\$ 0.58	\$ 0.71
Diluted EPS (Note 2)	\$ 0.28	\$ 0.35	\$ 0.54	\$ 0.63
Weighted average number of common stock and exchangeable shares outstanding:				
Basic (Note 2)	9,497,757	9,404,679	9,496,461	9,084,150
Diluted (Note 2)	10,364,344	10,334,805	10,353,176	10,328,469

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

Pet Valu, Inc.

Consolidated Statements of Comprehensive Income

In accordance with Canadian generally accepted accounting principles

(Unaudited)

(In U.S. dollars)

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	July 4, 2009	June 28, 2008	July 4, 2009	June 28, 2008
Net Income	\$ 2,810,989	\$ 3,595,189	\$ 5,536,569	\$ 6,430,021
Other comprehensive income				
Unrealized foreign currency translation gains and losses	1,507,962	196,401	1,244,474	(529,383)
Comprehensive Income	\$ 4,318,951	\$ 3,791,590	\$ 6,781,043	\$ 5,900,638

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

Pet Valu, Inc.

Consolidated Statements of Shareholders' Equity

In accordance with Canadian generally accepted accounting principles

(Unaudited)

(In U.S. dollars)

	Additional Special Voting Stock	Contributed Surplus	Accumulated Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Shareholders' Equity (Deficit)
Balance – December 29, 2007	\$ 963	\$ 21,805,645	\$ 11,070,145	\$ (2,269,085)	\$ (691,985)	\$ 29,915,683
Stock-based compensation costs	–	53,997	–	–	–	53,997
Repurchase of Exchangeable Shares (Note 8)	–	(350,578)	(1,563,605)	–	–	(1,914,183)
Issuance of Exchangeable Shares (Note 9)	–	2,541,779	–	–	–	2,541,779
Net Income	–	–	14,738,573	–	–	14,738,573
Foreign currency translation Adjustments	–	–	–	(4,718,095)	–	(4,718,095)
Balance – January 3, 2009	\$ 963	\$ 24,050,843	\$ 24,245,113	\$ (6,987,180)	\$ (691,985)	\$ 40,617,754
Stock-based compensation costs	–	38,879	–	–	–	38,879
Issuance of Exchangeable Shares (Note 9)	–	11,944	–	–	–	11,944
Net Income	–	–	5,536,569	–	–	5,536,569
Foreign currency translation Adjustments	–	–	–	1,244,474	–	1,244,474
Balance – July 4, 2009	\$ 963	\$ 24,101,666	\$ 29,781,682	\$ (5,742,706)	\$ (691,985)	\$ 47,449,620

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

Pet Valu, Inc.

Consolidated Statements of Cash Flows

In accordance with Canadian generally accepted accounting principles

(Unaudited)

(In U.S. dollars)

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	July 4, 2009	June 28, 2008	July 4, 2009	June 28, 2008
Operating activities				
Net income	\$ 2,810,989	\$ 3,595,189	\$ 5,536,569	\$ 6,430,021
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	497,129	498,144	967,777	979,099
Future income taxes	16,033	18,812	30,967	37,633
Loss (gain) on disposal of property and equipment	7,819	9,835	15,979	(298)
Amortization of debenture discount	25,141	29,027	48,679	58,221
(Gain) loss on foreign exchange	(439,879)	(127,270)	(262,359)	121,021
Stock based compensation costs	50,065	6,121	38,879	10,520
Deferred charges	13,713	94,701	94,085	214,091
Amortization of deferred gain on warehouse sale	(55,496)	(64,073)	(107,454)	(128,516)
Changes in other operating assets and liabilities:				
Decrease (increase) in receivables	152,747	(230,567)	(57,703)	463,792
Decrease (increase) in inventories	2,291,232	(700,628)	1,373,886	(1,759,232)
Decrease in prepaid expenses	99,648	99,972	253,108	301,441
Increase in trade accounts payable	177,420	753,633	695,802	643,664
(Decrease) increase in accrued liabilities	957,863	(603,035)	(1,154,484)	(1,016,300)
(Decrease) increase in income taxes	(749,796)	15,828	(1,786,425)	(1,041,326)
Net cash provided by operating activities	5,854,628	3,395,689	5,687,306	5,314,641
Investing activities				
Purchases of property and equipment	(651,000)	(651,122)	(1,284,687)	(1,130,208)
Proceeds on disposal of property and equipment	109	11,915	3,321	22,488
Business Acquisitions (Note 3)	(568,877)	(199,304)	(1,263,905)	(751,587)
Notes and other receivables	2,200	4,023	4,718	8,070
Net cash used in investing activities	(1,217,568)	(834,488)	(2,540,553)	(1,851,237)
Financing activities				
Repayment of short-term financing	(3,210,142)	(1,128,075)	(131,386)	(303,429)
Decrease in bank overdraft	(183,798)	(600,039)	(388,475)	(1,234,937)
Repayment of capital lease obligation	(90,183)	(101,225)	(179,825)	(193,993)
Issuance of Exchangeable Shares	11,944	570,561	11,944	2,504,692
Repayment of term loan financing	(535,968)	(624,061)	(1,037,775)	(1,253,441)
Repayment of note payable	(83,022)	(49,648)	(83,022)	(49,648)
Repurchase of Exchangeable Shares	-	(651,317)	-	(1,914,183)
Net cash used in financing activities	(4,091,169)	(2,583,804)	(1,808,539)	(2,444,939)
Effect of exchange rate changes on cash	51,952	101,036	(20,354)	11,260
Net increase in cash	597,843	78,433	1,317,860	1,029,725
Cash and short-term investments – Beginning of fiscal period	3,145,441	2,587,126	2,425,424	1,635,834
Cash and short-term investments – End of fiscal period	\$ 3,743,284	\$ 2,665,559	\$ 3,743,284	\$ 2,665,559

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

Pet Valu, Inc.

Notes to Consolidated Financial Statements

For the twenty-six week periods ended July 4, 2009 and June 28, 2008

In accordance with Canadian generally accepted accounting principles
(Unaudited)

(All amounts are expressed in U.S. dollars, unless otherwise indicated.)

(Canadian dollar reporting shall be cited as C\$)

1. Significant Accounting Policies

The unaudited interim consolidated financial statements (the "financial statements") have been prepared by management in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") and include the accounts of Pet Valu, Inc. and its subsidiaries. These financial statements do not contain all disclosures required by Canadian GAAP for annual financial statements, and accordingly, the financial statements should be read in conjunction with the most recently prepared annual financial statements for the 53 week period ended January 3, 2009.

These financial statements follow the same accounting policies and their methods of application as described in the most recent annual financial statements for the 53 week period ended January 3, 2009, except as noted below.

Reclassifications

Certain reclassifications have been made to the prior year's financial statements to conform to current year's presentation.

Newly Adopted Accounting Standards

In December 2006, the CICA issued Handbook Section 1535. This section establishes standards for disclosing information about an entity's capital and how it is managed. An entity must disclose information to enable the users of the financial statements to evaluate the entity's objectives, policies and processes for managing capital. The section applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. The effect of adopting Section 1535 is that the Company explicitly discloses its objectives, policies and processes for managing capital (Note 7).

In December 2006, the CICA issued Handbook Section 3862 and Section 3863. Entities are required to provide disclosures and presentations in the financial statements to enable the users of those statements to evaluate the significance of the financial instruments for the entity's financial position and performance. The additional disclosures and presentations will also enable the users to evaluate the extent of risks arising from financial instruments and how well the entity manages those risks. The sections apply to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. An entity may choose to early adopt the requirements in conjunction with Handbook Section 3855. The effect of adopting Sections 3862 and 3863 is that the Company has placed more emphasis on disclosure of the nature and extent of risks arising from financial instruments to which the Company is exposed and how those risks are managed (Note 13).

In June 2007, the CICA issued Handbook Section 3031. This section replaced the existing Handbook Section 3030 Inventories. The section establishes standards for the measurement and disclosure of inventories. The section states that inventories shall be measured at the lower of cost and net realizable value. Cost is defined as all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location. An entity may use the standard cost method or the retail method if it is determined that the results approximate cost. It is applicable to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008. The adoption of Handbook Section 3031 has not had a material effect on the Company's financial position, results of operations, or cash flows.

In February 2008, the CICA issued Handbook Section 3064. This new handbook section replaces Section 3062 Goodwill and Intangibles and Section 3450 Research and Development Costs. The section establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The section outlines the criteria to be used to recognize an intangible asset. It gives further guidance on capitalizing intangible assets during the research and development stages. This section applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2008. The adoption of Handbook Section 3064 did not have a material effect on the Company's financial position, results of operations, or cash flows.

Pet Valu, Inc.

2. Net Earnings per Share

Basic earnings per share ("EPS") exclude potentially dilutive securities and are computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted EPS is computed assuming the conversion or exercise of all dilutive securities such as convertible debentures, options and warrants.

In order to reflect the economic substance of the Company's capital structure, the computation of basic EPS is based on the aggregate number of shares of common stock of Pet Valu, Inc. ("Common Stock") and exchangeable shares of its subsidiary, Pet Valu Canada Inc. ("Exchangeable Shares"), excluding treasury stock. Diluted EPS is based on the diluted effect of equity and debt instruments convertible into either Common Stock or Exchangeable Shares (Note 9).

In the second quarters of fiscal 2009 and fiscal 2008, the calculation of diluted EPS included certain stock options, warrants and convertible debt outstanding during the relevant period. The debt was convertible into 672,727 Exchangeable Shares. Stock options and warrants to purchase 329,390 Exchangeable Shares and/or Common Stock were outstanding on July 4, 2009 (June 28, 2008 – 338,830) (Note 9). The Company uses the treasury method to determine the number of Exchangeable Shares to be added to the denominator due to dilutive warrants and options.

Net income applicable to holders of Common Stock and Exchangeable Shares:
(In U.S. dollars)

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	July 4, 2009	June 28, 2008	July 4, 2009	June 28, 2008
Net income for the period	\$ 2,810,989	\$ 3,595,189	\$ 5,536,569	\$ 6,430,021
Net income applicable to holders of Common Stock and Exchangeable Shares				
Basic	\$ 2,810,989	\$ 3,595,189	\$ 5,536,569	\$ 6,430,021
Interest on 8.5% debenture	44,838	51,767	86,817	103,834
Diluted	\$ 2,855,827	\$ 3,646,956	\$ 5,623,386	\$ 6,533,855
Basic EPS	\$ 0.30	\$ 0.38	\$ 0.58	\$ 0.71
Diluted EPS	\$ 0.28	\$ 0.35	\$ 0.54	\$ 0.63
Weighted average number of Common Stock and Exchangeable Shares outstanding:				
Basic	9,497,757	9,404,679	9,495,461	9,084,150
Effect of dilutive stock options outstanding	193,860	257,399	184,988	319,979
Effect of dilutive warrants outstanding	-	-	-	251,613
Effect of conversion of 8.5% debenture	672,727	672,727	672,727	672,727
Diluted	10,364,344	10,334,805	10,353,176	10,328,469

Pet Valu, Inc.

3. Business Acquisitions

	Thirteen Weeks Ended		Twenty-six Weeks Ended	
	July 4, 2009	June 28, 2008	July 4, 2009	June 28, 2008
Franchise Repurchases (see a below)	\$ 568,877	\$ 199,304	\$ 1,263,905	\$ 751,587
Other Business Acquisition (see b below)	-	-	-	-
Net Cash Consideration Paid	\$ 568,877	\$ 199,304	\$ 1,263,905	\$ 751,587

a) Franchise Repurchases

Included in the consolidated financial results of the Company are repurchases of franchise stores. The repurchases have been accounted for through the purchase method.

	Thirteen Weeks Ended		Twenty-Six Weeks Ended	
	July 4, 2009	June 28, 2008	July 4, 2009	June 28, 2008
Number of Stores Repurchased	5	3	12	5
Inventory	\$ 250,878	\$ 163,016	\$ 667,544	\$ 334,623
Property and equipment	50,487	32,088	118,990	61,126
Goodwill	267,512	4,200	477,371	355,838
Cash consideration	\$ 568,877	\$ 199,304	\$ 1,263,905	\$ 751,587

b) Other Business Acquisition

On August 22, 2008, the Company's Canadian operating subsidiary, Pet Valu Canada Inc., acquired 100% of the issued and outstanding shares of four corporations: Pets Choice Distributors Ltd, 1517256 Ontario Inc., 1202772 Ontario Ltd. and 869317 Ontario Ltd. Together, these four companies operate a chain of 15 pet food and supply retail stores operating under the "Berrys...Your PetsChoice" banner in eastern Ontario. The primary reasons for the acquisition were to increase sales and gross margins and to expand the Company's presence in Ontario.

The aggregate purchase price was \$2,270,645 and was paid in cash from the Company's bank operating line of credit. The cash consideration paid, net of cash acquired of \$39,904, was \$2,230,741.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition.

	August 22, 2008
Current assets	\$ 842,005
Property and equipment	31,801
Goodwill	1,722,246
Total assets acquired	\$ 2,596,052
Current liabilities assumed	365,311
Net assets acquired	\$ 2,230,741

The \$1,722,246 of goodwill was assigned to the Canadian segment for purposes of segmented reporting. None of the goodwill is expected to be deductible for tax purposes.

Pet Valu, Inc.

3. Business Acquisitions (Continued)

The following table shows the consolidated financial results of the Company as if the acquisition had been completed at the beginning of the 2008 fiscal year.

	13 Weeks Ended June 28, 2008	26 Weeks Ended June 28, 2008
Proforma revenue	\$ 45,567,492	\$ 89,392,392
Proforma net income	\$ 3,717,367	\$ 6,650,337
Proforma earnings per share		
Basic	\$ 0.40	\$ 0.73
Diluted	\$ 0.36	\$ 0.65
Weighted average number of Common Stock and Exchangeable Shares outstanding:		
Basic	9,404,679	9,084,150
Diluted	10,334,805	10,328,469

4. Bank Operating Loans

In July 2006, the Company entered into an amended and restated credit agreement with Bank of Montreal and Harris, N.A. ("Credit Agreement"). The Credit Agreement provides the Company with a revolving line of credit for a term of five years and a C\$5,000,000 term loan to be repaid over twenty-four months. Borrowings under the revolving line of credit are limited to the lesser of the loan ceiling (C\$20 million as at July 4, 2009 and January 3, 2009) and a borrowing base calculation related to inventories and franchise receivables.

On July 23, 2008, the Company entered into an amending agreement with its bank that increased the ceiling on the revolving line of credit from a maximum of C\$15 million to a maximum of C\$20 million. In addition, the amendment created a new C\$5 million term loan that bears interest at prime plus 1% and is repayable in 24 equal monthly installments. Concurrently with the execution of the amending agreement, the balance of the term loan on that date, plus all accrued interest, totaling C\$627,160, was repaid. All other terms in the Credit Agreement remained substantially the same. On July 4, 2009, the borrowings outstanding under the credit facility were \$5,234,052 (January 3, 2009 - \$5,132,159). The borrowing base calculation exceeded the loan ceiling; therefore borrowings were limited to C\$20,000,000 at July 4, 2009 and January 3, 2009. The resulting availability at July 4, 2009 was C\$13,919,602 (January 3, 2009 - C\$13,761,348). Interest on the revolving line of credit is calculated using the bank's prime rate plus 0.25% per annum. The interest rates at July 4, 2009 were 2.50% for Canadian dollar borrowings and 4.00% for U.S. dollar borrowings. In addition, a fee of 0.25% is charged on the unused portion of the credit facility.

The facility is collateralized by liens against all assets of the Company, subject to certain permitted encumbrances.

Pursuant to the Credit Agreement, in addition to its borrowing base restrictions, the Company must comply with certain general covenants which include, among others, a minimum consolidated debt service ratio. The Company was in compliance with the covenants at July 4, 2009.

Pet Valu, Inc.

5. Long-term Debt

	July 4, 2009			January 3, 2009		
	Long-term	Current	Total	Long-term	Current	Total
Bank term loan	\$ 179,335	\$ 2,152,019	\$ 2,331,354	\$ 1,199,682	\$ 2,056,598	\$ 3,256,280
Supplier notes payable	67,500	67,500	135,000	108,632	108,632	217,264
Capitalized lease obligations	1,094,891	330,374	1,425,265	928,716	321,069	1,249,785
Total	\$ 1,341,726	\$ 2,549,893	\$ 3,891,619	\$ 2,237,030	\$ 2,486,299	\$ 4,723,329

Bank Term Loan

The bank term loan is part of the Credit Agreement (Note 4). The loan bears interest at prime plus 1% (3.25% at July 4, 2009) and matures July 23, 2010. The loan is repayable in 24 equal monthly installments.

Supplier Notes Payable

During fiscal 2000, the Company entered into loan agreements with a supplier which provided for annual principal installments of C\$50,000 and US\$67,500, respectively, interest, payable monthly, at Canadian bank prime (2.25% at July 4, 2009) and U.S. prime for U.S. dollar borrowings within the United States (3.25% at July 4, 2009), respectively, and maturity in 2010. Pursuant to the loan agreements, the Company must meet certain merchandise purchase targets. If the targets are not met, the principal repayments are accelerated based on a formula. During the second quarter of 2009, the remaining balance of the C\$ loan in the amount of C\$100,000 was repaid.

Capital Lease Obligations

The Company financed certain automotive equipment and computer and office equipment under capital leases with a capitalized cost included in property and equipment of \$2,356,263 and \$2,283,502 as at July 4, 2009 and January 3, 2009, respectively. Accumulated depreciation relating to these assets was \$984,507 and \$1,082,075 as at July 4, 2009 and January 3, 2009, respectively.

Future repayments are as follows:

	Bank Term Loans	Supplier Notes Payable	Capitalized Lease Obligations	Total
2009	\$ 1,076,009	\$ 67,500	\$ 233,084	\$ 1,376,593
2010	1,255,345	67,500	391,001	1,713,846
2011	-	-	320,777	320,277
2012	-	-	274,962	274,962
2013	-	-	233,857	233,857
2014	-	-	147,187	147,187
2015	-	-	109,748	109,748
2016	-	-	54,804	54,804
2017	-	-	10,040	10,040
	\$ 2,331,354	\$ 135,000	\$ 1,775,460	\$ 4,241,314
Less: Interest	-	-	350,195	350,195
Current Maturities	2,152,019	67,500	330,374	2,549,893
Total	\$ 179,335	\$ 67,500	\$ 1,094,891	\$ 1,341,226

Pet Valu, Inc.

6. Subordinated Debentures

	July 4, 2009			January 3, 2009		
	Face Value (Converted from C\$)	Unamortized Discount	Net	Face Value (Converted from C\$)	Unamortized Discount	Net
8.5% subordinate (convertible)	\$ 3,184,988	\$ 50,511	\$ 3,134,477	\$ 3,043,764	\$ 96,506	\$ 2,947,258
10% subordinate (non-convertible)	-	-	-	-	-	-
	\$ 3,184,988	\$ 50,511	\$ 3,134,477	\$ 3,043,764	\$ 96,506	\$ 2,947,258
Balance Sheet Classification						
Current	3,184,988	50,511	3,134,477	3,043,764	96,506	2,947,258
Non-Current	-	-	-	-	-	-
	\$ 3,184,988	\$ 50,511	\$ 3,134,477	\$ 3,043,764	\$ 96,506	\$ 2,947,258

(a) 8.5% Convertible

Pet Valu Canada Inc. has an outstanding 8.5% convertible subordinated unsecured debenture in the amount of C\$3,700,000. This debenture is convertible, at any time, into Exchangeable Shares at a conversion price of C\$5.50 per share and is repayable by Pet Valu Canada Inc. on the terms specified in the applicable debenture holder agreement. The debenture is due in December of 2009. Interest on this debenture is paid quarterly.

(b) 10% Non-convertible

A private placement of 10% non-convertible unsecured subordinated debentures of Pet Valu Canada Inc. and guaranteed by Pet Valu, Inc. in the principal amount of C\$8,820,000 was completed on July 24, 2006. Interest on the 10% debentures was paid quarterly. In accordance with the debenture agreement, the scheduled repayment of principal and accrued interest for the 10% non convertible debentures was made on July 24, 2008 by cash payments to the debenture holders. The amount of the payments was C\$8,877,836, made up of principal repayments of C\$8,820,000 and accrued interest of C\$57,836. These payments were financed from the new bank term loan (Notes 4 and 5), the Company's bank operating line (Note 4) and funds provided from operations.

The investors in the private placement included, among others, certain then directors and/or officers of Pet Valu, Inc. and Pet Valu Canada Inc., directly or indirectly. In particular, Geoffrey Holt, who was a director (until May of 2008) and continues to be an officer of both companies, invested C\$5,000,000 through Holtcorp Inc., a personal holding company; Douglas Lunau, who was a director of both companies (until May of 2008), invested C\$3,000,000 through the Lunau Family Trust; Breena Holt, who was a director of both companies (until May of 2008) and a consultant to Pet Valu Canada Inc., invested C\$150,000; Darryl Squires, who was a director of both companies (until May of 2008), invested C\$20,000; and John Turner, who is an officer and part-time employee of Pet Valu Canada Inc., invested C\$150,000. As a result of a sale of certain of these debentures by Holtcorp Inc. to the Lunau Family Trust, completed on July 1, 2007, the principal amount of Holtcorp Inc.'s investment became C\$4,500,000 and that of Lunau Family Trust became C\$3,500,000.

Pet Valu, Inc.

7. Capital Disclosures

The Company considers its capital to include shareholders' equity and its subordinated debentures. As at July 4, 2009, the Company's capital was \$50,584,097 (January 3, 2009 - \$43,565,012).

The Company's objective when managing its capital is to seek continuous improvement in the return to its shareholders while maintaining a low to moderate tolerance level for risk. The objective is achieved by prudently managing the capital generated through internal growth and profitability, through the use of lower cost capital, including capital leases and bank debt, and raising share capital or debt when required to fund opportunities as they arise. The Company may also return capital to shareholders through the repurchase of shares or reduce debt where it determines either of these to be an effective method of achieving the above objective. The Company does not use ratios in the management of its capital.

The Company is not subject to any externally imposed capital requirements, although the Company's credit agreement with its bank contains certain restrictions on the issuance of debt, prepayment of debt, and dividends or distributions to shareholders.

8. Capital Stock

Authorized

9,626,274	Additional Special Voting Stock with a par value of \$0.0001 per share, possessing as a class a total number of votes equal to the number of outstanding Exchangeable Shares from time to time not owned by Pet Valu, Inc. or any of its subsidiaries.
100,000,000	Preferred Stock with 8% cumulative dividends, a par value of \$0.0624 per share, redeemable at the option of both the Company and the holder based on terms as defined.
20,000,000	Common Stock with a par value of \$0.0001 per share, possessing one vote per share.

Issued and Outstanding

	July 4, 2009		January 3, 2009	
	Shares Issued and Outstanding	Amount	Shares Issued and Outstanding	Amount
Additional Special Voting Stock	9,626,274	\$ 963	9,626,274	\$ 963
Common Stock	100	-	100	-
Contributed Surplus		24,101,666		24,050,843
		\$ 24,102,629		\$ 24,051,806

In fiscal 2000, the Company reacquired the 100,000,000 shares of Preferred Stock and 1,000,000 warrants as part of a private placement. The Preferred Stock is now held by one of Pet Valu Canada Inc.'s subsidiaries, PVUS Holdings Inc. and is eliminated on consolidation. The warrants were cancelled.

Pet Valu Canada Inc. Shares

	July 4, 2009			January 3, 2009	
	Authorized	Issued	Outstanding	Pet Valu, Inc. Common Equivalents	Pet Valu, Inc. Common Equivalents
Common Shares, no par value	Unlimited	1	1	-	-
Exchangeable Shares, no par value	Unlimited	9,852,720	9,499,020	9,499,020	9,495,020
Class A Preferred Shares, no par value	7,000,000	-	-	-	-
Class B Preferred Shares, no par value	176,845	-	-	-	-
Class C Preferred Shares, no par value	1	-	-	-	-

Pet Valu Canada Inc. had one common share issued to Pet Valu, Inc. as of July 4, 2009 and January 3, 2009 which has been eliminated in consolidation.

Pet Valu, Inc.

8. Capital Stock (Continued)

Exchangeable Shares

The Exchangeable Shares have the right to dividends and can vote on an equivalent basis with the Common Stock and have exercise privileges which could result in the exchange of the Exchangeable Shares for Common Stock. The Exchangeable Shares vote in Pet Valu, Inc. through the Additional Special Voting Stock, which is held by CIBC Mellon Trust Company as trustee.

In order to reflect the economic substance of the Company's capital structure, the value of the Exchangeable Shares and equity instruments of Pet Valu Canada Inc. convertible into Exchangeable Shares have been included in shareholders' equity in the consolidated financial statements.

Pet Valu, Inc. held 353,700 Exchangeable Shares at July 4, 2009 and January 3, 2009 in treasury at cost.

During fiscal 2008, Pet Valu Canada Inc. repurchased and cancelled 131,400 Exchangeable Shares under a normal course issuer bid for cash in the amount of \$1,914,183. There have been no repurchases in the first two quarters of fiscal 2009.

9. Stock Options and Warrants

The Company's Executive Stock Option Plan and Board Stock Option Plan (collectively, the "Plans") provide for the granting of options to purchase Exchangeable Shares to certain full-time employees and to members of the Company's Board of Directors. Required disclosure information with respect to these Plans has been combined due to the similarities of the Plans.

The Company has reserved 665,550 Exchangeable Shares of Pet Valu Canada Inc. for issuance pursuant to its Plans of which 336,160 are available for grant.

The weighted average fair value of the Common Stock and Exchangeable Share options granted in fiscal 2008 was \$3.06 per share. There were no Common Stock and Exchangeable Share options granted in the first two quarters of fiscal 2009. The fair value of the Common Stock and Exchangeable Share options granted is estimated at the grant date using the Black-Scholes option-pricing model with the following assumptions:

	Fiscal periods ended	
	July 4, 2009	January 3, 2009
Expected dividend rate	-	0%
Expected volatility	-	33%
Weighted average risk-free interest rate	-	3.0%
Expected lives (years)	-	3

Pursuant to the terms of the Board Stock Option Plan, new board members are entitled to receive 10,000 options that vest and become exercisable at a rate of 2,000 per year of service on the Board. Such options expire three years after vesting. The Board Plan permits the board to grant additional options to existing directors as well.

Pursuant to the terms of the Executive Stock Option Plan, certain full time employees are eligible to receive options that may be granted from time to time by the Company. The option exercise period shall not exceed ten years.

As of July 4, 2009, there were 5,000 Board options vested and exercisable and 287,890 Executive options vested and exercisable with weighted average exercise prices of C\$1.46 and C\$4.49, respectively.

Pet Valu, Inc.

9. Stock Options and Warrants (Continued)

Information with respect to all options outstanding is as follows:
(all amounts in Canadian dollars)

	Shares	Range of Exercise Prices	Weighted Average Exercise Price
Outstanding December 29, 2007	479,950	\$ 1.30 – 4.99	\$ 2.97
Granted	79,500	11.74	11.74
Exercised	(208,060)	2.06 – 4.99	3.09
Cancelled	(18,000)	3.26 – 4.99	3.84
Outstanding January 3, 2009	333,390	\$ 1.30 – 11.74	\$ 4.94
Granted	-	-	-
Exercised	4,000	3.26	3.26
Cancelled	-	-	-
Outstanding July 4, 2009	329,390	\$ 1.30 – 11.74	\$ 4.96

The weighted average remaining term of options outstanding at July 4, 2009 was 0.85 years.

The following table summarizes information about stock options outstanding at July 4, 2009:

Range of exercise price	Options Outstanding	Options outstanding		Options exercisable	
		Weighted Average Remaining Contractual Life(yrs)	Weighted Average Exercise Price	Options Exercisable	Weighted Average Exercise Price
\$ 1.30 – 1.46	5,720	1.53	\$ 1.44	5,720	\$ 1.44
2.06	35,000	5.38	2.06	25,000	2.06
2.80	139,670	0.47	2.80	139,670	2.80
3.28	69,500	0.28	3.28	69,500	3.28
11.74	79,500	4.50	11.74	53,000	11.74
	329,390			292,890	

Warrants

On March 5, 2008, 785,411 warrants exercisable at C\$2.00 and 66,533 warrants exercisable at C\$5.50 were exercised for proceeds of C\$1,936,754.

No warrants were outstanding as of July 4, 2009 or January 3, 2009.

Issuance of Exchangeable Shares

	26 Weeks Ended			
	July 4, 2009		June 28, 2008	
	Shares Issued	Proceeds	Shares Issued	Proceeds
Exercise of Stock Options	4,000	\$ 11,945	195,620	\$ 608,704
Exercise of Warrants	-	-	851,944	1,895,990
	4,000	\$ 11,945	1,047,564	\$ 2,504,694

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10. Income Taxes

The Company's future tax assets are comprised of timing differences related to depreciable assets, intangible assets and net operating loss carryforwards. The Company reduces the future tax assets by a valuation allowance for the portion of the net operating loss carryforward that management determined does not meet the more likely than not criteria for recognition. An estimate of future taxable income is used in this determination. This estimate is revised once a year in the fourth quarter unless there has been a significant change in the results of operations. Therefore, unless otherwise stated there is no adjustment to the valuation allowance during the interim periods.

11. Contingencies

From time to time, the Company is named as a defendant in legal actions arising from its normal business activities. Although the amount of any liability that could arise with respect to currently pending actions cannot be estimated, in the opinion of the Company, any such liability is unlikely to have a material adverse effect on its financial position, operating results or liquidity.

12. Related Party Transactions

The Company had the following transactions with related parties:

- a) Interest payments were made on debentures held by certain officers and former directors of C\$206,863 in the second quarter of fiscal 2008 and C\$416,573 in the first half of fiscal 2008. The principal amounts of these debentures and all outstanding interest was repaid on the maturity date of July 24, 2008 (Note 6).
- b) Payments of C\$30,826 for the second quarter of fiscal 2008 and C\$34,680 for the first half of fiscal 2008 were made to a former director of the Company for consulting services provided regarding various matters. No payments were made in the first half of the current fiscal year.

The related party transactions noted above were measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

13. Financial Instruments

The Company has classified its assets and liabilities as follows:

Asset/Liability	Classification	Measurement
Cash and short-term investments	Held for trading	Fair value
Accounts receivable	Loans and receivables	Amortized cost
Notes receivable	Loans and receivables	Amortized cost
Bank indebtedness and bank operating loans	Other liabilities	Amortized cost
Accounts payable and accruals	Other liabilities	Amortized cost
Capital lease obligations and other long-term debt	Other liabilities	Amortized cost
Subordinated debentures	Other liabilities	Amortized cost

The Company's estimate of the fair value of cash and short-term investments, trade accounts receivable, notes receivable and other receivables, trade accounts payable, accrued liabilities, accrued wages and benefits and income taxes payable approximates their carrying value due to the short-term nature of these instruments. The estimated fair value of supplier notes payable, bank overdrafts, bank operating loans, a term loan and other notes payable approximates the carrying value because of their variable interest rates. The carrying value of capital lease obligations approximates their fair value as their interest rates approximate current market interest rates. The subordinated debentures are not listed for trading on a stock exchange and are not actively traded. Accordingly, as fair value of these debentures is not readily determinable, the debentures are recorded at amortized cost.

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13. Financial Instruments (Continued)

The Company, through its financial assets and liabilities, is exposed to various risks. The following is an analysis of those risks at July 4, 2009.

Credit Risk

Financial instruments which potentially subject the Company to concentrations of credit risk are cash and short-term investments and accounts and notes receivable. The Company's maximum exposure to credit risk was \$6,475,457 at July 4, 2009 (\$5,009,053 at January 3, 2009). The Company mitigates the risk on cash and short-term investments by the fact that its deposits are with various high quality financial institutions. The Company has receivables from its suppliers and from the Company's franchise operators. The credit risk on its receivables from suppliers is managed by the Company's ability to offset any monies owed by the supplier against amounts owed to the suppliers. The management of credit risk on its franchisee accounts receivable is maintained by having short settlement terms on these receivables and by the distributed nature of the balance between a large number of franchise operators.

Liquidity Risk

The Company manages its liquidity risk by maintaining various financing sources, including bank debt, subordinated debentures and capital leases. The Company maintains adequate availability on its operating loan to minimize this risk (Note 4). The Company also prepares financial projections to ensure that it has sufficient funds to meet its contractual debt obligations.

Foreign Currency Exchange Rate Risk

The Company is exposed to currency risks associated with its Canadian subsidiaries which have net liabilities, for bank loans and intercompany accounts, denominated in US dollars. At July 4, 2009, if the Canadian dollar had weakened 5 percent against the US dollar with all other variables held constant, after tax net income for the trailing four quarters would have been \$365,000 lower (Fiscal Year Ended January 3, 2009 - \$550,000). Conversely, if the Canadian dollar had strengthened 5% against the US dollar with all other variables held constant, after tax net income would have been \$365,000 higher (Fiscal Year Ended January 3, 2009 - \$550,000). The lower foreign currency exchange rate sensitivity in net income at July 4, 2009 compared with January 3, 2009 is due to a decrease in US dollar bank borrowings within the Company's Canadian subsidiaries.

Interest Rate Risk

Notes receivable, the bank operating loan (Note 4), bank term loan (Note 5) and supplier notes payable (Note 5) are all at variable interest rates. At July 4, 2009, if interest rates at that date had been 100 basis points lower, with all other variables held constant, after tax net income for the trailing four quarters would have been \$50,000 higher (Fiscal Year Ended January 3, 2009 - \$60,000) due to lower interest expense on variable rate borrowings. Conversely, if interest rates had been 100 basis points higher, with all other variables held constant, net income after taxes would have been \$50,000 lower (Fiscal Year Ended January 3, 2009 - \$60,000).

14. Subsequent Events

On July 5, 2009 Pet Valu, Inc. and Pet Valu Canada Inc. entered into a definitive agreement to be acquired by certain affiliates of Roark Capital Group, an Atlanta based private equity firm. Under the terms of the agreement, shareholders of Pet Valu Canada Inc. (Pet Valu, Inc.'s publicly-traded Canadian operating subsidiary) will receive C\$13.68 in cash for each exchangeable share held. The transaction has been approved by the Boards of Directors of Pet Valu, Inc. and Pet Valu Canada Inc.. The agreement is still subject to shareholder and final court approval. The meeting of shareholders will take place on August 25, 2009.

Subsequent events have been reviewed through to August 11, 2009, the date of issuance of these financial statements.

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15. Segmented Financial Information

The Company operates exclusively in the pet product retail industry. The Company's reportable segments are based on geographic area. All intercompany revenues and expenses are eliminated in computing revenues and operating income. The accounting policies of the segments are the same as those described in Note 1 - Significant Accounting Policies.

Operating results and other financial data by segment were as follows:
(in thousands of U.S. dollars)

	Thirteen Weeks Ended July 4, 2009		Twenty-Six Weeks Ended July 4, 2009	
		June 28, 2008		June 28, 2008
Sales and revenue to external customers				
Canada	\$ 33,931	\$ 35,129	\$ 65,745	\$ 69,236
U.S.	9,340	9,128	18,800	17,821
Total sales and revenue	\$ 43,271	\$ 44,257	\$ 84,545	\$ 87,057
Net interest expense				
Canada	\$ 191	\$ 465	\$ 391	\$ 951
U.S.	3	4	6	8
Total net interest expense	\$ 194	\$ 469	\$ 397	\$ 959
Net Income				
Canada	\$ 1,938	\$ 3,171	\$ 3,841	\$ 5,817
U.S.	873	403	1,696	559
Intersegment elimination	-	21	-	54
Total net income	\$ 2,811	\$ 3,595	\$ 5,537	\$ 6,430
Depreciation and amortization				
Canada	\$ 413	\$ 417	\$ 798	\$ 814
U.S.	84	81	170	165
Total depreciation and amortization	\$ 497	\$ 498	\$ 968	\$ 979
Purchases of property and equipment				
Canada	\$ 606	\$ 578	\$ 1,208	\$ 979
U.S.	45	73	77	151
Total purchases of property and equipment	\$ 651	\$ 651	\$ 1,285	\$ 1,130

Total assets and other financial data by segment were as follows:
(in thousands of U.S. dollars)

	July 4, 2009	January 3, 2009
Total assets		
Canada	\$ 110,069	\$ 107,887
U.S.	22,775	21,614
Intersegment elimination	(54,034)	(56,183)
Total assets	\$ 78,810	\$ 73,318
Capital assets and goodwill		
Canada	\$ 25,142	\$ 22,744
U.S.	1,371	1,475
Total capital assets and goodwill	\$ 26,513	\$ 24,219

