

PET VALU™

Better Pet Nutrition

PET VALU, INC.

FINANCIAL STATEMENTS

(The financial statements contained herein are prepared in accordance with
Accounting Principles Generally Accepted in the United States of America)
(in U.S. dollars)

7300 Warden Ave, Suite 106
Markham, Ontario
L3R 9Z6

Responsibility for Financial Reporting

These consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in the United States. Management is responsible for their integrity, objectivity and reliability and, where necessary, they reflect management's best estimates and judgements. All financial information in the annual report is consistent with the consolidated financial statements. Management is also responsible for the maintenance of financial and operating systems, which include effective controls, to provide reasonable assurance that the Company's assets are safeguarded and that reliable financial information is produced.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board exercises these responsibilities through its Audit Committee. The Audit Committee meets with management and the independent auditors, Grant Thornton, to satisfy itself that management's responsibilities are properly discharged and to review and report to the Board on the consolidated financial statements.

In accordance with Canadian generally accepted auditing standards, the independent auditors conduct an examination each year in order to express an opinion on the consolidated financial statements.



Geoffrey F. A. Holt
President and Chief Executive Officer



Dale Winkworth
Vice-President, Finance and Chief Financial Officer

March 14, 2008

Auditors' Report

To the Shareholders of Pet Valu, Inc.:

We have audited the consolidated balance sheets of Pet Valu, Inc. as at December 29, 2007 and December 30, 2006 and the consolidated statements of operations, shareholders' equity and cash flows for the fiscal years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 29, 2007 and December 30, 2006 and the results of its operations and its cash flows for the fiscal years then ended in accordance with generally accepted accounting principles in the United States of America.



Chartered Accountants
Licensed Public Accountants
Markham, Canada

February 29, 2008, except as to Note 17b which is as of March 5, 2008

Consolidated Balance Sheets

In accordance with accounting principles generally accepted in the United States of America
(In U.S. dollars)

	December 29, 2007	December 30, 2006
Assets		
Current assets		
Cash and short-term investments	\$ 1,635,834	\$ 2,436,834
Accounts receivable	2,041,638	2,445,415
Other receivables (Note 3) (Less allowances of \$5,405, 2006 - \$430,194)	1,273,781	1,303,075
Inventories	32,541,967	25,631,495
Prepaid expenses and other assets	1,701,495	966,135
Deferred income tax assets (Note 13)	787,959	591,090
Total current assets	39,982,674	33,374,044
Notes receivable (Note 4) (Less allowances of \$4,724, 2005 - \$37,755)	24,192	41,541
Deferred charges (Note 1)	1,237,773	1,177,475
Property and equipment, net of accumulated depreciation and amortization (Note 5)	9,259,778	5,542,985
Goodwill (Note 1)	17,132,808	13,883,218
Deferred income taxes (Note 13)	4,273,630	4,236,523
Total assets	\$ 71,910,855	\$ 58,255,786
Liabilities and Shareholders' Equity		
Current liabilities		
Bank overdraft	\$ 2,122,868	\$ 1,066,523
Bank operating loans (Note 6)	3,153,614	3,110,302
Current portion of long-term debt including capital lease obligations (Note 7)	2,625,284	2,610,596
Current portion of deferred gain on warehouse sale (Note 5)	269,080	222,117
Trade accounts payable	6,536,133	6,860,386
Accrued liabilities (Note 8)	4,597,761	3,625,373
Accrued wages and benefits	4,067,541	2,811,695
Income taxes payable (Note 13)	1,534,407	3,215,131
Subordinated debentures (Note 9)	8,995,410	-
Total current liabilities	33,902,098	23,522,123
Deferred franchise revenue (Note 3)	8,182	9,781
Deferred gain on warehouse sale (Note 5)	188,579	385,049
Deferred rent payable	2,629,650	2,155,726
Long-term debt including capital lease obligations, less current maturities (Note 7)	1,072,492	2,842,688
Subordinated debentures (Note 9)	3,773,585	10,743,093
Total liabilities	41,574,586	39,658,460
Commitments and contingencies (Notes 6, 14 & 15)		
Subsequent Events (Note 17)		
Shareholders' Equity		
Capital stock (Notes 10 & 11)	963	963
Additional paid in capital	19,585,169	19,802,745
Accumulated earnings	14,850,532	5,223,320
Accumulated other comprehensive loss	(3,408,410)	(5,737,717)
Treasury stock – exchangeable shares, at cost	(691,985)	(691,985)
Total shareholders' equity	30,336,269	18,597,326
Total liabilities and shareholders' equity	\$ 71,910,855	\$ 58,255,786

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

Signed on behalf of the Board,

 Director

 Director

Consolidated Statements of Operations

In accordance with accounting principles generally accepted in the United States of America
(In U.S. dollars, except number of shares)

	Fiscal Years Ended	
	December 29, 2007	December 30, 2006
Sales and revenue (Note 3)	\$ 162,992,676	\$ 147,036,818
Cost of sales including occupancy costs	111,939,634	103,379,875
Gross profit	51,053,042	43,656,943
Store operating expenses excluding occupancy costs	16,312,508	15,099,524
General and administrative expenses	14,630,454	13,068,571
	20,110,080	15,488,848
Net interest expense (Note 12)	2,080,083	3,509,439
Loss on extinguishment of debt (Note 9)	-	1,137,799
Income before income taxes	18,029,997	10,841,610
Income taxes provision (Note 13)	5,648,436	3,322,244
Net income	\$ 12,381,561	\$ 7,519,366
Basic EPS (Note 2)	\$ 1.42	\$ 0.93
Diluted EPS (Note 2)	1.20	0.79
Weighted average number of common stock and exchangeable shares outstanding:		
Basic (Note 2)	8,733,707	8,080,304
Diluted (Note 2)	10,453,559	9,779,721

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

Consolidated Statements of Shareholders' Equity

In accordance with accounting principles generally accepted in the United States of America
(In U.S. dollars)

	Additional Special Voting Stock	Additional Paid-in Capital	Accumulated Retained Earnings (Deficit)	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Shareholders' Equity (Deficit)	Comprehensive Income (Loss)
Balance – December 31, 2005	\$ 963	\$ 12,453,589	\$ (2,296,046)	\$ (5,383,312)	\$(691,985)	\$ 4,083,209	
Comprehensive Income fiscal 2005							\$ 7,042,427
Stock-based compensation costs	-	139,682	-	-	-	139,682	
Income tax on cancellation of Warrants (Note 11)	-	(66,561)	-	-	-	(66,561)	
Issuance of Exchangeable Shares (Note 11)	-	7,276,035	-	-	-	7,276,035	
Net Income	-	-	7,519,366	-	-	7,519,366	7,519,366
Foreign currency translation Adjustments	-	-	-	(354,405)	-	(354,405)	(354,405)
Balance – December 30, 2006	\$ 963	\$ 19,802,745	\$ 5,223,320	\$ (5,737,717)	\$(691,985)	\$ 18,597,326	-
Comprehensive Income fiscal 2006							\$ 7,164,961
Stock-based compensation costs	-	145,675	-	-	-	145,675	
Repurchase of Exchangeable Shares (Note 10)	-	(617,651)	(2,754,349)	-	-	(3,372,000)	
Issuance of Exchangeable Shares (Note 11)	-	254,400	-	-	-	254,400	
Net Income	-	-	12,381,561	-	-	12,381,561	12,381,561
Foreign currency translation Adjustments	-	-	-	2,329,307	-	2,329,307	2,329,307
Balance – December 29, 2007	\$ 963	\$ 19,585,169	\$ 14,850,532	\$ (3,408,410)	\$(691,985)	\$ 30,336,269	-
Comprehensive Income fiscal 2007							\$ 14,710,868

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

Consolidated Statements of Cash Flows

In accordance with accounting principles generally accepted in the United States of America
(In U.S. dollars)

	Fiscal Years Ended	
	December 29, 2007	December 30, 2006
Operating activities		
Net income	\$ 12,381,561	\$ 7,519,366
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,808,018	1,880,723
Deferred income taxes	(67,792)	(20,185)
Loss on disposal of property and equipment	47,242	6,772
Amortization of debenture discount	-	166,473
Loss on extinguishment of debt	-	1,139,407
Stock based compensation costs	143,981	139,797
Deferred charges	244,775	31,356
Amortization of deferred gain on warehouse sale	(240,751)	(228,248)
Write off of goodwill on store closures	7,934	105,600
Changes in other operating assets and liabilities:		
Decrease (increase) in receivables	968,377	(618,257)
Increase in inventories	(2,688,850)	(1,914,920)
Increase in prepaid expenses	(552,684)	(39,242)
(Decrease) increase in trade accounts payable	(1,279,228)	1,704,257
Increase in accrued liabilities	1,241,167	281,965
(Decrease) increase in income taxes payable	(2,089,320)	635,145
Net cash provided by operating activities	9,924,430	10,790,009
Investing activities		
Purchases of property and equipment	(4,135,537)	(2,227,125)
Proceeds on disposal of property and equipment	17,080	25,184
Purchase of store goodwill	(642,352)	(427,322)
Notes and other receivables	19,824	14,885
Net cash used in investing activities	(4,740,985)	(2,614,378)
Financing activities		
(Repayment) borrowing of short-term financing	(495,375)	1,286,265
Increase (decrease) in bank overdraft	779,898	(503,202)
Repayment of capital lease obligation	(365,592)	(369,856)
Issuance of Exchangeable Shares	266,648	7,276,037
Repayment of note payable	(120,281)	(121,581)
(Repayment) borrowing of term loan financing	(2,360,970)	3,943,827
Repurchase of Exchangeable Shares	(3,372,000)	-
Tax on cancellation of warrants	-	(66,561)
Repayment of debentures	-	(26,794,712)
Issuance of 10% non convertible debentures	-	7,792,208
Net cash used in financing activities	(5,667,672)	(7,557,575)
Effect of exchange rate changes on cash	(316,773)	145,070
Net (decrease) increase in cash	(801,000)	763,126
Cash and short-term investments – Beginning of fiscal year	2,436,834	1,673,708
Cash and short-term investments – End of fiscal year	\$ 1,635,834	\$ 2,436,834

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

Notes to Consolidated Financial Statements

For the fiscal years ended December 29, 2007 and December 30, 2006

In accordance with accounting principles generally accepted in the United States of America

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

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

1. Significant Accounting Policies

Background Pet Valu, Inc. was incorporated in Delaware, U.S.A. on February 28, 1996 and is a specialty retailer and wholesaler of pet food and pet-related supplies and a franchiser of pet food and pet-related supply products. The operations now carried on through Pet Valu, Inc. and its subsidiaries began in 1976 in Ontario, Canada and in 1995 in the U.S. As of December 29, 2007, Pet Valu, Inc. and its subsidiaries had 189 franchised and 92 company-owned stores in Ontario and Manitoba (Canada) and 2 franchised and 60 company-owned stores in Maryland, Virginia, Pennsylvania and New Jersey (U.S.). These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP").

Principles of Consolidation The consolidated financial statements include the accounts of Pet Valu, Inc., its subsidiaries, Pet Valu Canada Inc., Pet Valu International Inc. and Realty Management Systems Inc., and subsidiaries of Pet Valu Canada Inc., including Paulmac's Pet Food Inc., All Pet Enterprises Limited, and Peton Distributors Inc. (collectively, the "Company"). All significant intercompany transactions and balances are eliminated on consolidation.

Fiscal Year-end The Company operates under a 52-week fiscal year ending on the Saturday nearest December 31. The consolidated financial statements for the years ended December 29, 2007 (fiscal 2007) and December 30, 2006 (fiscal 2006) each consisted of 52 weeks.

Fair Value of Financial Instruments The Company's estimate of the fair value of cash and short-term investments, trade accounts, 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, term loan and other notes payable approximated 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.

Business and Credit Risk Concentration Financial instruments which potentially subject the Company to concentrations of credit risk are cash and short-term investments and notes receivable. The Company's deposits are with various high quality financial institutions. The Company is dependent on key suppliers to provide sufficient quantities of inventory at competitive prices. The Company does not currently have any key suppliers who provide greater than 10% of the Company's inventory requirements.

To the extent that the assets securing bank overdrafts and bank operating loans and other activities are not denominated in the same currency, changes in foreign currency exchange rates can expose the Company to foreign currency risk.

The bank operating loans and certain other loans and notes are subject to variable interest rates. The Company does not engage in hedging and, therefore, is subject to interest rate risk.

Use of Estimates The presentation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the dates of the financial statements, as well as the reported amounts of revenues and expenses during the reported periods. Actual results could differ from those estimates.

Cash and Short-term Investments Cash and short-term investments included cash on hand, cash balances with banks and short-term investments in overnight deposit instruments with the Company's lender. Interest rates pertaining to the short-term investments range from 3.5% to 5.2%.

1. Significant Accounting Policies (Continued)

Inventories and Cost of Sales Merchandise inventories are valued at the lower of cost or net realizable value. Cost is determined utilizing the retail inventory method of accounting under the first in first out cost flow assumption and includes certain distribution and buying costs relating to the processing of merchandise. Cost of sales includes the cost of merchandise, plus store occupancy costs and certain foreign currency transaction gains/losses. Foreign currency gains included in cost of sales were \$779,498 and \$2,628 in fiscal 2007 and 2006, respectively.

The Company accounts for vendor rebates and allowances using EITF No. 02-16, "Accounting by a Reseller for Cash Consideration Received from a Vendor by a Customer (Including a Reseller of the Vendor's Products)". EITF 02-16 provides guidance on how the cash consideration received by a customer from a vendor should be classified in the customer's statement of income. The Company includes vendor rebates in the cost of sale or inventory as appropriate when the purchases occur.

Property and Equipment Property and equipment are stated at cost. Additions and improvements are capitalized, while repairs and maintenance are charged to expense as incurred. The straight-line method of depreciation is used for financial reporting purposes. Estimated useful lives (or remaining lease life) are as follows:

Buildings	25 years
Furniture and fixtures	3 to 10 years
Automotive equipment	5 to 10 years
Leasehold improvements	Over the shorter of the useful life or the remaining term of the lease (not exceeding 11 years)
Internally-developed software	5 years

The Company accounts for internally-developed software according to Statement of Financial Position ("SOP") 98-1 "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." All capitalized software costs meet the characteristics of SOP 98-1. In particular, the software was internally developed or modified with the sole purpose of meeting the Company's internal requirements and neither at the time of development nor currently are there substantive plans to market the software externally.

During the year there were additions of \$392,464 to leasehold improvements that were not amortized as the assets were not available for service as of December 29, 2007.

Long-Lived Assets The Company accounts for long-lived assets using Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for Impairment and Disposal of Long-lived Assets." SFAS No. 144 requires that long-lived assets and certain identifiable intangibles to be held and used by the Company be reviewed for possible impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If changes in circumstances indicate that the carrying amount of an asset that an entity expects to hold and use may not be recoverable, future cash flows expected to result from the use of the asset and its disposition must be estimated. If the undiscounted value of the future cash flows is less than the carrying amount of the asset, impairment is recognized. Management has reviewed its property and equipment for impairment and believes that there has been no impairment of the Company's long-lived assets.

Goodwill The Company accounts for goodwill using SFAS No. 141 "Business Combination", and SFAS No. 142 "Goodwill and Intangible Assets". SFAS No. 141 requires the use of the purchase method of accounting for business combinations and prohibits the use of the pooling of interests method. SFAS No. 141 also refines the definition of intangible assets acquired in a purchase business combination.

Goodwill represents the excess purchase price of acquired businesses over the fair value of the net assets acquired. Goodwill as shown on the consolidated balance sheets of the Company relates to the leveraged buyout of the Company in 1990, a business acquired in fiscal 1998 and the repurchase of franchises. In 2007, additions to goodwill amounted to \$642,352 (2006-\$427,322) in relation to the acquisition of franchises. It is the Company's policy to write-off goodwill related to reacquired stores when the store ceases operation. In 2007, a loss of \$7,934 was recorded on the disposal of goodwill (2006-\$105,600). When a store is refranchised, any goodwill recorded at the time the store was previously reacquired is included in the cost of assets sold.

1. Significant Accounting Policies (Continued)

Impairment tests were performed as of December 29, 2007 and December 30, 2006. Fair value was determined on a discounted cash flow calculation. Based on the results of these tests, the Company determined that its goodwill was not impaired. Goodwill is not subject to amortization.

Deferred Charges Debt issuance costs relating to the debentures referred to in Note 9 are recorded as deferred charges and are amortized over the term of the debentures on a straight-line basis. As of December 29, 2007 and December 30, 2006, the unamortized balance was \$40,919 and \$95,631 respectively.

Deferred financing costs relating to the senior line of credit referred to in Note 6 are recorded as deferred charges and are amortized over the term of the credit agreement. As of December 29, 2007 and December 30, 2006 the unamortized balance was \$108,383 and \$116,934, respectively.

The Company has various lease agreements which include scheduled rent increases over the non-cancelable lease term. Rent expense for such leases is recognized on a straight-line basis over the related lease term. The excess of rent expense over the actual cash paid is recorded as deferred rent payable. The Company has entered into sublease arrangements with its Canadian franchisees and has recognized revenues on a straight-line basis resulting in deferred rents receivable, which are also included in deferred charges.

Revenue Recognition The Company recognizes revenue from retail sales through company-owned stores, wholesale sales to other retailers, and revenues from its franchise operations. All revenues are recorded net of sales and use taxes.

Retail sales through company-owned stores are recognized at the time of sale. Wholesale sales to other retailers are recognized at the time of delivery.

The Company has individual franchise agreements which grant the individual franchisees the exclusive right to operate a franchise store. Initial site development fees, established business fees and franchise fees are collected in advance and recorded as income when the store commences operations as a franchise location. All initial fees are earned on the date of the store opening. On the sale of an existing company-owned store to a franchisee, costs relating to the sale of the store are charged to expense as incurred and proceeds (excluding fees) in excess of the net book value of store assets sold to the franchisee are recorded as a gain on the date of sale.

Ongoing revenue from Canadian franchise operations is comprised of royalties, percentage rents, franchise fees, fees for services, and wholesale merchandise sales. Royalties and percentage rents are based on the gross sales or imputed gross sales of the franchise and are recorded in income as earned. Franchise fees are non-refundable. Accordingly, revenue is recognized when the fees are collected. Fees for service are recognized when the service has been performed by the Company. Canadian franchisees purchase the majority of their inventory from the Company. Accordingly, the Company recognizes revenue from the wholesale sale of merchandise to these franchisees at the time of delivery.

Under the U.S. franchising system, the Company retains ownership of all inventories and recognizes revenue and records related expenses upon the sale of merchandise at the retail level. U.S. franchisees purchase the store equipment and are responsible for store operating costs, including labour for which they receive an allowance from the Company. In addition, U.S. franchisees are paid a royalty based on merchandise sales and compliance with operational standards. Royalties and store operating cost allowances paid by the Company to U.S. franchisees are recorded as store operating expenses.

Stock-based Compensation Plans The Company has stock-based compensation plans which are described in Note 11. The Company accounts for stock-based compensation using SFAS No. 123(R) "Stock Based Compensation". Under SFAS No. 123(R), the Company is required to use a fair value method for estimating the value of the stock options and to record compensation costs for any stock option outstanding for which the requisite service period has not yet been completed. Any consideration paid upon exercise of options and the issue of shares is credited to share capital.

1. Significant Accounting Policies (Continued)

Income Taxes The Company accounts for income taxes using SFAS No. 109, "Accounting for Income Taxes". SFAS No. 109 uses an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the Company's financial statements or tax returns as well as tax credit carryforwards and loss carryforwards. These deferred taxes are measured by applying substantively enacted tax rates. Future tax benefits, such as loss carryforwards, are recognized to the extent that such benefits are more likely than not to be realized during the carryforward period.

The Company adopted FASB Interpretation 48, "Accounting for Uncertainty in Income Taxes" (FIN 48), on December 31, 2006. FIN 48 is an interpretation of SFAS No. 109, "Accounting for Income Taxes". Beginning fiscal 2007, the Company records the financial statement effects of an income tax position when it is more likely than not, based on the technical merits, that it will be sustained upon examination. A tax position that meets the more-likely-than-not recognition threshold is measured and recorded as the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with a taxing authority. Previously recognized tax positions are derecognized in the first period in which it is no longer more likely than not that the tax position will be sustained. The benefit associated with previously unrecognized tax positions are generally recognized in the first period in which the more-likely-than-not threshold is met at the reporting date, the tax matter is ultimately settled through negotiation or litigation or when the related statute of limitations for the relevant taxing authority to examine and challenge the tax position has expired. The recognition, derecognition, and measurement of tax positions are based on management's best judgment given the facts, circumstances and information available at the reporting date.

Differences between a tax position taken or expected to be taken in the Company's tax returns and the amount of benefit recognized and measured in the financial statements result in unrecognized tax benefits, which are recorded in the balance sheet as either a liability for unrecognized tax benefits or reductions to recorded tax assets, as applicable. Interest and penalties are accrued with respect to unrecognized tax benefits in accordance with the legislation of the respective taxing jurisdictions, which are recognized as a component of interest expense. As of December 29, 2007, there was no interest or penalties related to unrecognized tax benefits recorded in interest expense.

The adoption of FIN 48 did not have an impact in the Company's statements of operations and financial position and did not result in a cumulative adjustment in retained earnings at adoption.

During the year ended December 29, 2007, the Company recognized expenses related to interest and penalties totaling \$234,917 (2006 - \$167,892). The Company had no accrual for interest and penalties as of December 29, 2007 and December 30, 2006.

The Company and its subsidiaries file income tax returns in the United States and Canada. All taxation years after 1995 are subject to examination.

Foreign Currency Translation Pursuant to SFAS No. 52, "Foreign Currency Translation", the functional currency of the Canadian operations is Canadian dollars, the functional currency of the U.S. operations is U.S. dollars, and the reporting currency for the consolidated operations is U.S. dollars. Accordingly, the assets and liabilities of the Company's Canadian operating subsidiary, Pet Valu Canada Inc., are recorded in the functional currency of Canadian dollars and are translated into the reporting currency at the rate of exchange as of the balance sheet date. Revenues and expenses are translated at the average rates of exchange for the period of operation. Gains and losses arising from the translation are deferred and classified as a foreign currency translation adjustment within accumulated other comprehensive income.

Store Pre-opening Costs All costs associated with the opening of new stores are charged to expense as incurred.

Advertising Costs Advertising costs are charged to expense as incurred. Advertising expense was \$701,329 and \$845,587 in fiscal 2007 and 2006, respectively. In 2007, the entire remaining balance of the allowance for promotion fund deficit in the amount of \$466,283 was reversed and included as a reduction in advertising expense. In 2006, a partial reversal of the allowance for promotion fund deficit in the amount of \$179,371 was included as a reduction to advertising expense.

1. Significant Accounting Policies (Continued)

Recently Issued Accounting Standards

In September 2006, FASB issued SFAS No. 157, "Fair Value Measurement." SFAS 157 defines fair value and establishes a framework for measuring fair value. It also expands the disclosures required for fair value measurement. SFAS 157 applies to other accounting pronouncements that require fair value measurement; however it does not require any new fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. The adoption of SFAS 157 will not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

In February, 2007, FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities- Including an Amendment of FASB Statement No. 115." SFAS 159 permits an entity to have the option to measure selected financial instruments and certain other items at fair value at specified election dates. A business entity would report unrealized gains and losses on which the fair value option has been elected in earnings at each subsequent reporting date. The fair value option may be applied on an instrument by instrument basis, is irrevocable and must be applied to an entire instrument. Most of the provisions of SFAS 159 are elective; however the amendment of SFAS No. 155, "Accounting for Certain Investments in Debt and Equity Securities", must be applied to all entities with available-for-sale and trading securities. SFAS 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The adoption of SFAS 159 will not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

In December 2007, FASB issued SFAS No. 160, "Noncontrolling Interest in Consolidated Financial Statements – An Amendment of ARB No. 51". SFAS 160 establishes new accounting and reporting standards for noncontrolling interests in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 requires that noncontrolling interests be reported as a component of equity within the consolidated financial statements, that changes in a parent company's ownership interest where the parent retains controlling interest be recorded as equity transactions and that upon deconsolidation the parent recognize a gain or loss in net income. The resulting gain or loss is to be measured using the fair value of the noncontrolling equity investment on the deconsolidation date. SFAS 160 is effective for fiscal years and interim periods beginning on or after December 15, 2008. The adoption of SFAS 160 will not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

In December 2007, FASB issued SFAS No. 141(R), "Business Combinations". SFAS 141(R) replaces SFAS No. 141, "Business Combinations". SFAS 141(R) establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any noncontrolling interest. SFAS 141(R) requires that an acquirer record the assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree at fair value. It also provides guidance for recognizing and measuring goodwill obtained during a business combination. In addition, guidance is provided on disclosure requirements to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS 141(R) is effective prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The adoption of SFAS 141(R) will not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

Newly Adopted Accounting Standards

In June 2006, FASB issued FASB Interpretation No. ("FIN") 48, "Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109." FIN 48 clarifies the accounting for uncertainty in income taxes recognized in financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosures and transitions. FIN 48 was effective for fiscal years beginning after December 15, 2006. The adoption of FIN 48 has not had a material effect on the Company's consolidated financial position, results of operations or cash flows.

1. Significant Accounting Policies (Continued)

In June 2006, FASB ratified the consensus of the Emerging Issues Task Force (EITF) Issue No. 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should be Presented in the Income Statement (That Is Gross versus Net Presentation)". Issue No. 06-3 states that the presentation of taxes assessed by a governmental authority that are directly imposed on a revenue-producing transaction between a seller and a customer including sales, use, value added and some excise taxes are an accounting policy decision. The Company excludes such taxes from the presentation of sales. The adoption of Issue 06-03 has not had a material effect on the Company's consolidated financial position, results of operations or cash flows.

In September 2006, FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - An amendment of FASB statements No. 87,88,106 and 132(R)." SFAS 158 requires that employers recognize the funded status of defined benefit pension and other postretirement benefit plans as a net asset or liability on the balance sheet and recognize as a component of other comprehensive income, net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognized as a component of net periodic benefit cost. SFAS 158 requires that the funded status of the plan and the required disclosure requirements are effective for the fiscal year ending after December 15, 2006. The requirement to measure plan assets and benefit obligations was effective for fiscal years ending after December 15, 2008. The Company maintains a defined contribution 401(K) and profit sharing plan; consequently the adoption of SFAS 158 has not had a material effect on its consolidated financial position, results of operations or cash flows.

Supplemental Cash Flow Information

	Fiscal Years Ended	
	December 29, 2007	December 30, 2006
Interest paid	\$ 2,029,607	\$ 3,193,845
Income taxes paid	\$ 8,316,128	\$ 3,110,702
Income taxes refunded	\$ 503,869	\$ 342,889

Non-cash investing and financing activities:

Capital lease obligations of \$382,568 and \$346,359 were entered into during fiscal 2007 and 2006, respectively.

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 preferred stock, 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 (see Note 10).

In fiscal 2007 and fiscal 2006, 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 1,331,894 Exchangeable Shares and/or Common Stock were outstanding on December 29, 2007 (December 30, 2006 – 1,454,394)(see Note 11). 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.

2. Net Earnings per Share (Continued)

Net income applicable to holders of Common Stock and Exchangeable Shares:
(In U.S. dollars, except for number of shares) Fiscal Years Ended

	December 29, 2007	December 30, 2006
Net income for the year	\$ 12,381,561	\$ 7,519,366
Net income applicable to holders of Common Stock and Exchangeable Shares		
Basic	\$ 12,381,561	\$ 7,519,366
Interest on 8.5% debenture	188,851	175,761
Diluted	\$ 12,570,412	\$ 7,695,127
Basic EPS	\$ 1.42	\$ 0.93
Diluted EPS	\$ 1.20	\$ 0.79
Weighted average number of Common Stock and Exchangeable Shares outstanding:		
Basic	8,733,707	8,080,304
Effect of dilutive stock options outstanding	370,294	392,476
Effect of dilutive warrants outstanding	676,831	634,214
Effect of conversion of 8.5% debenture	672,727	672,727
Diluted	10,453,559	9,779,721

3. Franchise Operations

Included in other receivables were net amounts due from franchisees of \$1,182,609 and \$1,036,541 as of December 29, 2007 and December 30, 2006, respectively.

Included in sales and revenue were the following amounts with respect to Canadian franchise operations:

	Fiscal Years Ended	
	December 29, 2007	December 30, 2006
Merchandise sales to franchisees	\$ 69,120,000	\$ 64,688,000
Distribution charges	6,072,000	5,589,000
Initial franchise fees	317,000	259,000
Gain on sale of company-owned stores	8,000	10,000
Franchise royalties and other revenues	12,700,000	11,418,000
	\$ 88,217,000	\$ 81,964,000

In fiscal 2007 and 2006, the Company earned initial franchise fees and gains on the sale of company-owned stores of \$1,307 and \$11,031 respectively, through its U.S. franchise operations. Retail sales of merchandise through U.S. franchise stores were \$1,348,048 and \$1,686,152 in fiscal 2007 and 2006, respectively, and were included in sales and revenue. Royalties and other fees paid to U.S. franchisees in the amount of \$264,199 for fiscal 2007 and \$395,156 for fiscal 2006 were included in store operating expenses excluding occupancy costs.

Promotion Fund

The Company's Canadian franchisees contribute a percentage of their weekly merchandise purchases to a promotion fund. This fund is used to offset marketing and advertising activities performed by the Company. Collections for this fund are made in accordance with the terms of applicable agreements made with each franchisee. The percentage of franchise merchandise purchases designated for the promotion fund is determined at the discretion of the Company, subject to certain restrictions contained in the franchise agreements.

3. Franchise Operations (Continued)

A deficit balance in the promotion fund may occur when the cumulative cost of marketing and advertising activities exceed the cumulative franchise funding. These differences can be short-term in nature, caused by timing of marketing and advertising activities in a given year as compared to franchise funding for that year, or long-term as part of strategic uses of the fund. The promotion fund had a deficit balance of \$112,854 and \$430,194 at the end of fiscal 2007 and 2006, respectively. During fiscal 2007 and 2006, the Company reduced marketing and advertising activities; as a result of the reduced activities, a recovery in the promotion fund deficit was obtained in the amount of \$466,283 (2006-\$179,371). The Company has reviewed the marketing and advertising activities, and the expected funding for the near term and concluded that due to the planned strategic uses of the fund, the deficit balance at the end of fiscal 2007 is expected to reverse in the near term. Accordingly, the Company has reversed the entire allowance for the promotion fund deficit in the amount of \$466,283. At the end of fiscal 2006, the Company maintained an allowance of \$430,194.

Bank Comfort Letters

On many occasions when requested by a lending institution, Pet Valu Canada Inc. has provided a comfort letter for the purpose of assisting franchisees in securing financing. In the comfort letter, Pet Valu Canada Inc. states that it will agree to purchase certain inventory and equipment necessary for the operation of the store at book value less 15% in the case where the lending institution is forced to realize on its security.

4. Notes Receivable

Notes receivable included loans in the amount of \$28,916 and \$77,933 as of December 29, 2007 and December 30, 2006, respectively. The loans bore interest at a rate of prime plus 3% for Canadian franchisees (9.00% at December 29, 2007 and December 30, 2006). These notes were provided to various franchisees in connection with the purchase of their franchises and to provide working capital. The loans are for various terms not exceeding seven years.

5. Property and Equipment

	December 29, 2007	December 30, 2006
Land	\$ 2,078,174	\$ 80,404
Buildings	1,202,482	994,537
Furniture and fixtures	13,480,169	11,990,843
Automotive equipment	3,376,400	2,938,705
Leasehold improvements	4,578,705	3,153,506
Internally-developed software	1,569,450	1,328,805
	26,285,380	20,486,800
Less: Accumulated depreciation and amortization	17,025,602	14,943,815
	\$ 9,259,778	\$ 5,542,985

During fiscal 2007 and 2006, the Company recorded depreciation and amortization expense related to property and equipment of \$1,808,018 and \$1,880,723 respectively.

In 1999, the Company sold and leased back five of its Canadian warehouses. The sale resulted in gross proceeds of \$6,972,010 and a deferred pre-tax gain of \$1,759,075. The deferred gain is being amortized into income over the term of the various leases.

During the year there were additions of \$392,464 to leasehold improvements that were not amortized, as the assets were not placed in service as of December 29, 2007.

6. Bank Operating Loans

In July 2006, the Company entered into an amended and restated credit agreement with Bank of Montreal and Harris, N.A. The credit agreement provides the Company with a C\$15,000,000 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 of C\$15 million and a borrowing base calculation related to inventories and franchise receivables. On December 29, 2007 the borrowings outstanding under the credit facility, the borrowing base and the resulting availability were \$3,153,614 (2006-\$3,110,302), C\$15,000,000 (2006-C\$15,000,000), and C\$11,907,880 (2006- C\$11,375,254), respectively. Interest on the revolving line of credit is calculated using the bank's prime rate plus 0.25% per annum. The interest rates at December 29, 2007 were 6.25% for Canadian dollar borrowings and 8.0% for U.S. dollar borrowings. In addition, a fee of 0.25% is charged on the unused portion of the credit facility. (2006-0.25%)

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

Pursuant to the above 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 December 29, 2007.

7. Long-term Debt

	December 29, 2007			December 30, 2006		
	Long-term	Current	Total	Long-term	Current	Total
Bank term loan	\$ -	\$2,124,766	\$ 2,124,766	\$ 1,787,655	\$2,145,186	\$ 3,932,841
Term loan	-	-	-	-	5,148	5,148
Supplier notes payable	236,989	118,494	355,483	331,212	110,404	441,616
Other notes payable	1,839	22,962	24,801	28,030	32,803	60,833
Capitalized lease obligations	833,664	359,062	1,192,726	695,791	317,055	1,012,846
Total	\$ 1,072,492	\$2,625,284	\$ 3,697,776	\$ 2,842,688	\$2,610,596	\$ 5,453,284

Bank Term Loan

The bank term loan is part of the amended and restated credit agreement (see Note 6). The loan bears interest at prime plus 1% (7% at December 29, 2007) and matures September 30, 2008. The loan is repayable in 24 equal monthly installments.

Term Loan

The term loan bore interest at 8%. The loan matured in 2007 and was secured by a mortgage on a certain property.

Supplier Notes Payable

During fiscal 2000, the Company entered into loan agreements with a supplier. These loans are payable in annual principal installments of C\$50,000 and US\$67,500, respectively and mature in 2010. The loans bear interest, payable monthly, at Canadian bank prime (6% at December 29, 2007) and U.S. prime for U.S. dollar borrowings within the United States (7.25% at December 29, 2007), respectively. 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.

Other Notes Payable

Other notes payable bear interest at annual rates ranging between 6.00% and 8.25%, have various maturity dates from 2008 to 2009, and are unsecured.

7. Long-term Debt (Continued)**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 \$2,014,021 and \$1,928,660 as at December 29, 2007 and December 30, 2006, respectively. Accumulated depreciation relating to these assets was \$872,489 and \$938,798 as at December 29, 2007 and December 30, 2006, respectively.

Future repayments are as follows:

	Bank Term Loans	Supplier Notes Payable	Other Notes Payable	Capitalized Lease Obligations	Total
2008	\$ 2,124,766	\$ 118,494	\$ 22,962	\$ 438,230	\$ 2,704,452
2009	-	118,494	1,839	321,361	441,694
2010	-	118,495	-	216,339	334,834
2011	-	-	-	166,065	166,065
2012	-	-	-	146,610	146,610
2013	-	-	-	102,809	102,809
2014	-	-	-	495	495
	\$ 2,124,766	\$ 355,483	\$ 24,801	\$ 1,391,909	\$ 3,896,959
Less: Interest	-	-	-	199,183	199,183
Current Maturities	2,124,766	118,494	22,962	359,062	2,625,284
Total	\$ -	\$ 236,989	\$ 1,839	\$ 833,664	\$ 1,072,492

8. Accrued Liabilities

	December 29, 2007	December 30, 2006
Accrued interest	\$ 357,989	\$ 264,146
Accrued rent, common area maintenance and realty taxes	866,631	869,516
Sales and use taxes	1,001,695	732,311
Supplies and services	2,371,446	1,759,400
	\$ 4,597,761	\$ 3,625,373

9. Subordinated Debentures

	December 29, 2007			December 30, 2006		
	Face Value (Converted from C\$)	Unamortized Discount	Net	Face Value (Converted from C\$)	Unamortized Discount	Net
8.5% subordinated (non-convertible)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
12.5% subordinated (non-convertible)	-	-	-	-	-	-
8.5% subordinate (convertible)	3,773,585	-	3,773,585	3,174,876	-	3,174,876
10% subordinate (non-convertible)	8,995,410	-	8,995,410	7,568,217	-	7,568,217
	\$12,768,995	\$ -	\$12,768,995	\$10,743,093	\$ -	\$10,743,093
Balance Sheet Classification						
Current	8,995,410	-	8,995,410	-	-	-
Non-Current	3,773,585	-	3,773,585	10,743,093	-	10,743,093
	\$12,768,995	\$ -	\$12,768,995	\$10,743,093	\$ -	\$10,743,093

(a) 8.5% Non-Convertible

In fiscal 1996, Pet Valu Canada Inc. raised C\$15,054,788 through the sale of units to its subscribing Common and Exchangeable Shareholders (see Note 10). Each unit consisted of one C\$7.50 principal amount 8.5% non-convertible subordinated unsecured debenture of Pet Valu Canada Inc. due July 24, 2006 and one Exchangeable Share purchase warrant (see Note 11) of Pet Valu Canada Inc. The fair value of these warrants was allocated to shareholders' equity, resulting in a debenture discount of \$700,831 (C\$963,506), which was amortized over the remaining term of the debentures. Amortization of \$49,322 (C\$55,936) was included in net interest expense for fiscal 2006. Repayment to the debenture trustee and in certain cases to debenture holders directly was made on July 24, 2006 with proceeds from a private placement of 10% non-convertible unsecured subordinated debentures (see Note 9(d)) and availability from the bank revolving line of credit.

(b) 12.5% Non-Convertible

In fiscal 2004, Pet Valu Canada Inc. issued to Penfund Mezzanine Limited Partnership II ("Penfund") a C\$15,000,000 secured subordinated debenture and share purchase warrants entitling Penfund to purchase up to 924,200 Exchangeable Shares. The fair value of these warrants at the time of issue was \$624,767 (C\$793,829), which was allocated to shareholders' equity, and deducted as a debenture discount, which was being amortized over the five year term of the debenture. Amortization of \$116,917 (C\$132,595) was included in net interest expense for fiscal 2006. As a result of the repayment of C\$2,627,934 of the debentures referred to in Note 9(c), 47,256 of the warrants issued to Penfund referred to above were cancelled on March 31, 2005. On October 31, 2006, the Company prepaid the entire principal amount of the 12.5% non-convertible subordinated debenture held by Penfund which was otherwise due on September 30, 2009. On the date of repayment, the unamortized discount was C\$462,776. In addition to the principal, a prepayment premium of C\$150,000 was also paid. The Company was also required to write off the deferred charges of C\$677,602 related to the arrangement of the debt financing. As a result of the prepayment, the Company recognized a loss on extinguishment of debt of \$1,137,799 (C\$1,290,378).

9. Subordinated Debentures (Continued)

(c) 8.5% Convertible

In fiscal 1999, an agreement was completed creating new 8.5% convertible subordinated unsecured debentures of Pet Valu Canada Inc. in the amount of C\$6,327,934. These debentures replaced certain existing 7% convertible debentures and one non-convertible unsecured debenture together with a corresponding exchangeable share purchase warrant (see Note 11).

These debentures are convertible, at any time, into Exchangeable Shares at a conversion price of C\$5.50 per share and are repayable by Pet Valu Canada Inc. on the terms specified in the applicable debenture holder agreement. Debentures totaling C\$2,627,934, along with accrued interest thereon, were repaid in fiscal 2005. The balance of C\$3,700,000 is due in 2009. Interest on this debenture is paid quarterly.

(d) 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. The proceeds from the private placement and availability from the bank revolving line of credit were used to make repayment to the debenture trustee and, in certain cases, the debenture holders directly of C\$15,054,788 of the 8.5% debentures which matured on July 24, 2006. Interest on the 10% debentures is paid quarterly. The initial term of these debentures is two years. The holders have an option to extend for an additional two years and the issuer has an option to prepay the debt after the completion of the first year of the extended period upon payment of a premium equal to 1% of the principal amount being repaid.

The investors in the private placement included, among others, certain directors and/or officers of Pet Valu, Inc. and Pet Valu Canada, directly or indirectly. In particular, Geoffrey Holt, who is a director and officer of both companies, invested C\$5,000,000 through Holtcorp, a personal holding company; Douglas Lunau, who is a director of both companies, invested C\$3,000,000 through the Lunau Family Trust; Breena Holt, who is a director of both companies and a consultant to Pet Valu Canada, invested C\$150,000; Darryl Squires, who is a director of both companies, invested C\$20,000; and John Turner, who is an officer and part-time employee of Pet Valu Canada, invested C\$150,000. Interest paid to the related parties in fiscal 2007 was C\$832,000 (2006-C\$157,282). 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 is now C\$4,500,000 and that of Lunau Family Trust is now C\$3,500,000.

10. 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

	December 29, 2007		December 30, 2006	
	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	-
Additional paid-in capital		19,585,169		19,802,745
		19,586,132		19,803,708

10. Capital Stock (Continued)

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

				December 29, 2007	December 30, 2006
	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	8,920,116	8,566,416	8,566,416	8,743,516
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 December 29, 2007 and December 30, 2006, which has been eliminated in consolidation.

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 December 29, 2007 and December 30, 2006, in treasury at cost.

Pet Valu Canada Inc. repurchased and cancelled 299,600 Exchangeable Shares during fiscal 2007 under a normal course issuer bid for cash in the amount of \$3,372,000 (C\$3,762,460). No shares were repurchased in fiscal 2006.

11. 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 877,610 Exchangeable Shares of Pet Valu Canada Inc. for issuance pursuant to its Plans of which 397,660 are available for grant.

11. Stock Options and Warrants (Continued)

There were no Common Stock and Exchangeable Share options granted in fiscal 2007. The weighted average fair value of the Common Stock and Exchangeable Share options granted in fiscal 2006 was \$1.52 per share. 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 years ended	
	December 29, 2007	December 30, 2006
Expected dividend rate	-	0%
Expected volatility	-	40%
Weighted average risk-free interest rate	-	4.0%
Expected lives (years)	-	4 to 8

Pursuant to the terms of the Board Stock Option Plan, new board members receive 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 December 29, 2007, there were 15,000 Board options vested and exercisable and 422,950 Executive options vested and exercisable with weighted average exercise prices of C\$3.06 and C\$2.97, respectively.

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 31, 2005	675,600	1.16 – 3.28	2.78
Granted	10,000	4.99	4.99
Exercised	(79,150)	1.16 – 3.28	2.60
Cancelled	(4,000)	1.16 – 2.75	1.96
Outstanding December 30, 2006	602,450	\$ 1.16 – 4.99	\$ 2.84
Granted	-	-	-
Exercised	(122,500)	1.16 – 3.28	2.34
Cancelled	-	-	-
Outstanding December 29, 2007	479,950	\$ 1.30 – 4.99	\$ 2.97

The weighted average remaining term of options outstanding at December 29, 2007 was 2.52 years.

The following table summarizes information about stock options outstanding at December 29, 2007:

Range of exercise price	Options Outstanding	Weighted Average Remaining Contractual Life(yrs)	Options outstanding		Options exercisable	
			Average Exercise Price	Weighted Price	Options Exercisable	Weighted Average Exercise Price
\$ 1.30 – 1.46	5,720	3.05	\$ 1.44		3,720	\$1.43
2.06	50,000	6.89	2.06		30,000	2.06
2.75	2,000	0.04	2.75		2,000	2.75
2.80	195,730	1.98	2.80		195,730	2.80
3.26	20,000	3.37	3.26		8,000	3.26
3.28	196,500	1.79	3.28		196,500	3.28
4.99	10,000	4.07	4.99		2,000	4.99
	479,950				437,950	

11. Stock Options and Warrants (Continued)

Warrants

In fiscal 2004, Pet Valu Canada Inc. issued share purchase warrants as part of a private placement financing entitling the holder to purchase up to 924,200 Exchangeable Shares of Pet Valu Canada Inc. The share purchase warrants were issued in three tranches, as follows: (1) 810,411 warrants exercisable at C\$2.00 ("Tranche A Warrants"), at the option of the holder; (2) 66,533 warrants exercisable at C\$5.50 ("Tranche B Warrants"), at the option of the holder; and (3) 47,256 warrants exercisable at C\$5.50 ("Tranche C Warrants"). Each warrant entitles the holder to purchase one Exchangeable Share. All warrants expire on September 30, 2009. The Tranche C Warrants were not automatically exercisable, but rather only became exercisable in certain circumstances, and were subject to cancellation if certain conversion rights held by unrelated third party investors were cancelled. The cancellation of said conversion rights was completed in fiscal 2005 and the Tranche C warrants were cancelled.

In fiscal 2006, 25,000 of the Tranche A Warrants were exercised. On December 29, 2007 and December 30, 2006, 785,411 Tranche A Warrants and 66,533 Tranche B Warrants remained outstanding (see Note 17 b).

During fiscal 1996, Pet Valu Canada Inc. issued 2,007,305 warrants in connection with the 8.5% non-convertible subordinated unsecured debentures (see Note 9a). Each warrant entitled the holder to purchase one Exchangeable Share at a price equal to the greater of (i) C\$7.00; or (ii) the then current market price of an Exchangeable Share on the Toronto Stock Exchange less C\$7.00, at any time on or before July 24, 2006, subject to adjustment under certain events, as defined. In fiscal 2006, there were 1,138,208 warrants exercised for total proceeds of C\$7,967,456. The remaining 869,097 warrants expired unexercised.

12. Net Interest Expense

Net interest expense is comprised of:

	Fiscal years ended	
	December 29, 2007	December 30, 2006
Interest on bank indebtedness	\$ 471,798	\$ 249,918
Interest and penalties on taxes	234,917	167,892
Amortization of financing costs	94,245	228,470
Interest on notes payable and bank term loan	243,364	117,730
Interest on debentures	1,109,767	2,638,154
Amortization of debenture discount	-	166,239
Interest income	(74,008)	(58,964)
Interest expense, net	\$ 2,080,083	\$ 3,509,439

13. Income Taxes

Provisions for federal, state and foreign income taxes in the consolidated statements of operations consist of the following components:

	Fiscal years ended					
	December 29, 2007			December 30, 2006		
	Current	Deferred	Total	Current	Deferred	Total
U.S. federal taxes	\$ 27,541	\$ 288,300	\$ 315,841	\$ 21,951	\$ 634,971	\$ 656,922
U.S. state taxes	9,203	730,624	739,827	8,375	153,077	161,452
Non-U.S. taxes	5,665,752	70,626	5,736,378	3,312,356	133,791	3,446,147
Provision for income taxes before valuation allowance	5,702,496	1,089,550	6,792,046	3,342,682	921,839	4,264,521
Decrease in valuation allowance	-	(1,143,610)	(1,143,610)	-	(942,277)	(942,277)
Provision for income taxes	\$ 5,702,496	\$ (54,060)	\$ 5,648,436	\$ 3,342,682	\$ (20,438)	\$ 3,322,244

13. Income Taxes (continued)

In assessing the Company's ability to realize deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. The Company believes that there is sufficient positive evidence including the taxable income recorded in fiscal 2007 and 2006 and projected future taxable income to conclude that it is more likely than not that it will realize a portion of its deferred tax assets.

The Company's net deferred tax balance before valuation allowance was \$10,671,948. The deferred tax balance decreased by \$890,613 because the Company utilized net operating losses to reduce current year taxes. In addition, the deferred tax balance decreased by \$252,997 due to the expiration of state net operating losses and other adjustments.

The balance of the increase in the deferred tax assets relates to the Canadian operations.

The provision for income tax differs from the amount computed by applying the U.S. federal income tax rate of 34% as a result of the following:

	Fiscal years ended			
	December 29, 2007		December 30, 2006	
	Dollars	Percent	Dollars	Percent
Computed expected income tax expense	\$ 6,130,199	34.0%	\$ 3,686,147	34.0%
Permanent differences:				
Foreign exchange	(276,960)	(1.5)%	2,385	(0.0)%
Debt discount amortization	-	0.0%	103,718	1.0%
State income taxes net of federal benefit	488,286	2.7%	106,558	1.0%
Foreign tax rate differential	334,111	1.9%	187,713	1.7%
Other, net	116,410	0.6%	178,000	1.6%
Valuation allowance	(1,143,610)	(6.3)%	(942,277)	(8.7)%
Provision (benefit) for income taxes	\$ 5,648,436	31.4%	\$ 3,322,244	30.6%

The tax effects of temporary timing differences that give rise to significant portions of the deferred income tax assets and liabilities are as follows:

	December 29, 2007	December 30, 2006
Deferred tax assets:		
Loss carryforwards	\$ 9,166,243	\$ 10,205,790
Other items	2,066,070	1,760,529
Deferred tax assets before valuation allowance	11,232,313	11,966,319
Valuation allowance	(5,610,359)	(6,753,969)
Total deferred tax assets	5,621,954	5,212,350
Deferred tax liabilities:		
Intangible assets, net	(560,365)	(384,737)
Total deferred tax liabilities	(560,365)	(384,737)
Net deferred tax asset	\$ 5,061,589	\$ 4,827,613

Balance Sheet Classification	December 29, 2007	December 30, 2006
Current	\$ 787,959	\$ 591,090
Non-current	4,273,630	4,236,523
	\$ 5,061,589	\$ 4,827,613

13. Income Taxes (continued)

At December 29, 2007, the Company has available Canadian and U.S. federal and state net operating loss carryforwards of \$24,495,518 which can be carried forward through the years 2011-2026 and have been tax effected as per above.

14. Commitments

Leases

The Company had rental obligations, excluding certain realty tax, maintenance and other expenses on its office, warehouse and store premises, of the following annual amounts as of December 29, 2007:

	Assumed by Franchisees	Property Leases	Equipment Operating Leases	Total
2008	\$ 7,194,000	\$ 8,467,000	\$ 119,594	\$ 15,780,594
2009	5,902,000	7,277,000	69,157	13,248,157
2010	4,722,000	6,082,000	43,630	10,847,630
2011	3,936,000	5,008,000	43,630	8,987,630
2012	2,902,000	4,030,000	36,614	6,968,614
2013 and thereafter	4,741,000	13,441,000	30,495	18,212,495
	\$ 29,397,000	\$ 44,305,000	\$ 343,120	\$ 74,045,120

Rental expense for fiscal 2007 and 2006 was \$8,406,385 and \$7,567,285, respectively. This included contingent rents of \$29,154 in 2006. This is net of rent recoveries related to sublease arrangements with franchisees. In addition, total rent recovered from franchisees in fiscal 2007 and 2006 was \$6,865,911 and \$6,531,113, respectively. The Company is responsible for any lease obligations of the Company not met by franchisees. Store leases typically have an initial term of five years, with two five-year renewal options.

15. 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.

16. Employee Savings Plan

The Company maintains a defined contribution 401(K) and profit sharing plan which permits eligible employees who have completed one year of service and attained the age of 21 to make contributions by salary reduction of up to 60% of compensation. Under the plan, the Company makes mandatory matching contributions and discretionary profit sharing contributions. Matching contributions equal 50% of the first 6% of compensation that is contributed by each participating employee. Matching contributions vest at a rate of 20% per year, over the first 5 years of service. In connection with the required matching, the Company portion was \$77,793 and \$75,553 during fiscal 2007 and 2006, respectively. There have been no discretionary profit sharing contributions since the inception of the plan.

17. Subsequent Events

- a. Subsequent to year end, Pet Valu Canada Inc. repurchased and cancelled 75,200 Exchangeable Shares under a normal course issuer bid at a cost of C\$970,240.
- b. On March 5, 2008, 785,411 Tranche A Warrants and 66,533 Tranche B Warrants were exercised for proceeds of C\$1,936,754 (see Note 11).

18. 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 for fiscal 2007 and 2006 were as follows:
(in thousands of U.S. dollars)

	Fiscal years ended	
	December 29, 2007	December 30, 2006
Sales and revenue to external customers		
Canada	\$ 127,078	\$ 111,801
U.S.	35,915	35,236
Total sales and revenue	\$ 162,993	\$ 147,037
Net interest expense		
Canada	\$ 2,101	\$ 3,555
U.S.	(21)	(46)
Total net interest expense	\$ 2,080	\$ 3,509
Net Income		
Canada	\$ 10,481	\$ 5,880
U.S.	2,346	2,111
Intersegment elimination	(445)	(472)
Total net income	\$ 12,382	\$ 7,519
Depreciation and amortization		
Canada	\$ 1,396	\$ 1,481
U.S.	412	400
Total depreciation and amortization	\$ 1,808	\$ 1,881
Purchases of property and equipment		
Canada	\$ 3,793	\$ 1,725
U.S.	343	502
Total purchases of property and equipment	\$ 4,136	\$ 2,227

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

	December 29, 2007	December 30, 2006
Total assets		
Canada	\$ 118,401	\$ 95,165
U.S.	17,007	15,498
Intersegment elimination	(63,497)	(52,407)
Total assets	\$ 71,911	\$ 58,256
Capital assets and goodwill		
Canada	\$ 24,881	\$ 17,818
U.S.	1,512	1,608
Total capital assets and goodwill	\$ 26,393	\$ 19,426

Corporate Directory

Board Members*

C. Ian Ross²
Chairman^{3,4,5}
Director,
Ontario Power Generation Inc.

Geoffrey F. A. Holt
Board Member^{3,4,5}
Chief Executive Officer^{3,4,5}
President^{3,5}

Gary Goertz¹
Board Member^{3,4,5}
Retired Executive
Director,
World Heart Corporation

Breana L. Holt
Board Member^{3,4,5}

Tony Iordanis¹
Board Member^{3,4,5}
Executive Vice-President,
Picture Homes Millennium Inc.

Douglas Lunau²
Board Member^{3,4,5}
Retired Executive
Director,
Menu Foods Gen Par Limited

Darryl Squires^{1,2}
Board Member^{3,4,5}
President,
The Lake Partnership Inc.

Officers

Ed Casey
President and Chief Operating Officer⁴

David Stauble
President and Chief Operating Officer,
Peton Distributors Inc.
Senior Vice-President, Merchandising⁴

Angelo Intorre
Executive Vice-President⁵

John Turner
Senior Vice-President,
Business Development^{4,5}

Michael Fitzgerald
Secretary^{3,4,5}
Vice-President, Senior Counsel⁴

Dale Winkworth
Vice-President, Finance and Chief Financial Officer^{3,4}
Vice-President⁵

Wayne Balsinger
Vice-President, Accounting³
Vice-President, Finance and Chief Financial Officer⁵

Jack Handa
Vice-President, Information Technology and
Systems and Chief Information Officer⁴

Carole Holt
Treasurer^{3,4,5}

John Fleming
Vice-President,
Business Development^{4,5}

Christine A. Martin-Bevilacqua
Vice-President, Human Resources⁴

Brian McKeown
Vice-President, Corporate Security
and Loss Prevention^{4,5}

Denis McLaughlin
Vice-President, Merchandising Pet
Nutrition⁴

Phil Policelli
Vice-President,
Warehousing and Distribution⁴

Steve Rifle
Vice-President, Real Estate⁴

Deborah Barook
Assistant Vice-President,
Senior Associate Counsel⁴

John Watson
Assistant Vice-President,
Marketing and Sales Planning⁴

Jim Young
Assistant Vice-President,
Store Operations⁴

Alexandra Moulard
Assistant Vice-President,
Senior Associate Counsel⁴

* Term of office of all directors expires on the date of the annual meeting of stockholders of Pet Valu, Inc., namely, May 8, 2008. For information as to nominees for election on that date, please refer to Pet Valu, Inc.'s management information circular with respect to that meeting of stockholders.

1. Member of Audit Committee
2. Member of Corporate Governance and Compensation Committee
3. Pet Valu, Inc.
4. Pet Valu Canada Inc.
5. Pet Valu International Inc.

Executive Offices

7300 Warden Ave., Suite 106
Markham, Ontario
L3R 9Z6
905-946-1200
Fax: 905-946-0658

U.S. Corporate Office

489 Devon Park Drive, Suite 320
Wayne, PA 19087
610-225-0800
Fax: 610-225-0822

Annual Meeting

Pet Valu, Inc.
The Toronto Board of Trade
77 Adelaide Street West
First Canadian Place
Toronto, Ontario
May 8, 2008 – 2:30 pm

Stock Exchange Listing

Toronto

Stock Trading Symbol

PVC

Auditors

Grant Thornton LLP
15 Allstate Parkway, Suite 200
Markham, Ontario
L3R 5B4

Fiscal Year End

Saturday closest to
December 31

Transfer Agent and Registrar

CIBC Mellon Trust Company
Toronto, Ontario

