

PARAGON PHARMACIES LIMITED**MANAGEMENT DISCUSSION & ANALYSIS
FOR THE THREE AND SIX MONTH PERIODS ENDED FEBRUARY 28, 2009****As at April 28, 2009**

The following is a discussion of the consolidated financial condition and results of operations of Paragon Pharmacies Limited (the “Company”) for the three and six month periods ended February 28, 2009. This discussion and analysis should be read in conjunction with the Company’s interim unaudited consolidated financial statements and accompanying notes for the same period. The presentation in the interim consolidated financial statements for the three and six month periods ended February 28, 2009 conforms with that used for the year ended August 31, 2008. The interim unaudited consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles (“GAAP”). All references to dollars are in Canadian funds unless otherwise indicated.

FORWARD LOOKING STATEMENTS

This discussion of the consolidated financial condition and results of operations of the Company contains forward-looking statements regarding, among other things, the Company’s beliefs, plans, objectives, strategies, estimates, intentions and expectations, including as they relate to its operating and financial results, capital expenditures and the ability to execute on its operating, investing and financing strategies. Consequently, actual results and events may differ materially from those included in, contemplated or implied by such forward looking statements for a variety of reasons. Forward-looking statements are subject to inherent risks and uncertainties including, but not limited to, market and general economic conditions, certain property and casualty risks, the availability to attract and retain pharmacists, the availability and terms of financing, changes in the Company’s relationship with its key suppliers, competitive factors, changes in regulatory environments affecting the Company’s business, and the accuracy in management’s assumptions (see “RISKS AND RISK MANAGEMENT”). This list is not exhaustive of the factors that may affect any of the Company’s forward-looking statements. Investors and others should carefully consider these and other factors and not place undue reliance on these forward-looking statements. In addition, these forward-looking statements relate to the date on which they were made and the Company disclaims and has no intention or obligation to update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

NON-GAAP FINANCIAL MEASURES

The Company reports its financial results in accordance with Canadian GAAP. However, the foregoing contains references to non-GAAP financial measures, such as operating income, gross margin, comparable store revenue, EBITDA (earnings before interest and accretion expense, interest income, depreciation and amortization, stock based compensation, other items including loss from equity investments, and income taxes), EBITDA per common share, cash interest expense, net debt and total capitalization. Non-GAAP financial measures do not have standardized meanings prescribed by GAAP and therefore may not be comparable to similar measures presented by other reporting issuers.

Management's Discussion and Analysis *(continued)*

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

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

OVERVIEW

Paragon is headquartered in Kelowna, British Columbia and currently employs over 450 full and part time staff in its stores and offices. The Company owns and operates 18.5 retail pharmacies, three central fill pharmacies and one home healthcare operation in British Columbia, Alberta and Manitoba.

STRATEGY AND OUTLOOK

As a provider of pharmacy and health services in Western Canada, Paragon's overall strategy is to align its business with the demographic trends of Canada's aging population and the public's desire to lead healthy and more active lifestyles. In this period of global economic slowdown, Paragon has and will continue to focus on its long-term strategy, yet be responsive to the current economic climate.

The actions that Paragon management took in the second quarter supported the Company's restructuring which will enable the Company to be responsive to the effects of a slower economy, create resilience to economic volatility, build a stronger foundation and prepare the organization for growth. Progress was made in each of the key focus areas:

- Managing the bottom line – through both cost containment and revenue growth;
- Inventory management – integrating the Company's buying models and pricing strategies and move to a one company model;
- Organizational restructuring –aligning the Company's resources to improve efficiencies, focus on core business activities and streamline operations;
- Information Technology – analyzing existing systems, enhancing service agreements and contracts to better manage risk as well as integrate operating systems.
- Processes – ongoing standardization and streamlining Paragon's processes to optimize efficiencies. Significant internal work is yet to be completed, particularly in the area of information technology, systems and processes.

While initiatives and efforts in these restructuring and integration activities will continue into the latter half of the fiscal year, the Company will now re-focus more attention on longer term initiatives. These include building on its competitive advantages, enhancing culture, employee and customer experiences to reinforce the Company's strength and positioning in the market place.

A recent review of the Company's brand has resulted in a new look that will be introduced in the Alberta stores in the third and fourth quarters. A fresh look with better merchandising features will in turn provide a more consistent and satisfying customer experience.

SUMMARY

Key Operating, Investing and Financial Metrics

The following provides a summary of the Company's performance for the three and six month periods ended February 28, 2009 compared to the three and six month periods ended February 29, 2008.

- Second quarter revenue of \$22.204 million (2008: \$21.589 million), an increase of 2.8%. Second quarter pharmacy revenue of \$15.687 million (2008: \$13.723 million) and front store revenue¹ \$6.517 million (2008: \$7.866 million).
 - Six month revenue from operations of \$43.987 million (2008: \$39.267 million), an increase of 12.0%. Six month pharmacy revenue of \$31.133 million (2008: \$24.481 million) and front store revenue of \$12.854 million (2008: \$14.786 million).
- Second quarter comparable store revenue reduction of (2.0%) (excluding tobacco and home health care); comparable pharmacy revenue growth of 2.9%; comparable front store revenue¹ reduction of (13.2%) (excluding tobacco and home health care).
 - Six month comparable store revenue reduction of (1.0%) (excluding tobacco and home health care); comparable pharmacy revenue growth of 2.8%; comparable front store revenue¹ reduction of (9.6%) (excluding tobacco and home health care).
- Second quarter gross margin² as a percentage of revenue of 35.3% (2008: 34.6%), an increase of 0.7%. Second quarter pharmacy gross margin as a percentage of revenue of 40.7% (2008: 35.9%) and front store gross margin as a percentage of revenue of 28.6% (2008: 32.3%).
 - Six month gross margin² as a percentage of revenue of 35.2% (2008: 33.8%), an increase of 1.4%. Six month pharmacy gross margin as a percentage of revenue of 39.9% (2008: 33.8%) and front store gross margin as a percentage of revenue of 27.3% (2008: 31.2%).
- Second quarter operating income³ of \$2.147 million (2008: \$1.927 million), an increase of 11.4%, a result of operating income from the acquisitions completed in the second quarter of 2008.
 - Six month operating income³ of \$3.919 million (2008: \$3.187 million), an increase of 23.0%, primarily a result of operating income from the acquisitions in 2008.

Management's Discussion and Analysis *(continued)*

- Second quarter EBITDA⁴ of \$1.110 million (2008: \$1.118 million), a decrease of 2.5%.
 - Six month EBITDA⁴ of \$1.586 million (2008: \$1.468 million), an increase of 8.1%.

¹ Front store revenue includes all non-pharmacy revenue and excludes home health care stores.

² Gross margin is defined as revenue minus cost of sales

³ Operating income defined as revenue less cost of sales and operating expenses but excluding corporate and other costs, interest and accretion expense, amortization, stock based compensation and other items

⁴ EBITDA defined as earnings before interest expense, income taxes, amortization, stock-based compensation and other items as defined.

Second Quarter

- During the second quarter, the Company initiated the consolidation of its front store purchasing practices through a central buying group based in Calgary. The Company appointed McKesson Corporation as its primary wholesaler for all front store operations. The change which is currently being implemented will allow for a reduction in the front store inventory levels maintained by the Company; increased efficiencies and improved standardization of product offering amongst its locations.
- In light of the economic slowdown, the Company reevaluated current staffing requirements and determined that a reduction in front store staffing levels was necessary. The Company also reevaluated its staffing requirements in various other departments and adjustments were made to better align levels with the needs of the organization. The overall result was an annual saving of approximately \$0.5 million dollars.
- The Company initiated a review of its brand in light of a plan to rebrand its Alberta stores. This review process is now complete and the Company is preparing to roll out the rebrand in Alberta in the third quarter in combination with a marketing program aimed at revenue growth, particularly in front store. The benefit of this initiative will begin in the fourth quarter.
- During the quarter, the Company commenced the redevelopment of its Airdrie, Alberta store. The new location is expected to open in June 2009. The Company is focused on restoring the historical strong results which have been significantly adversely affected over the last twelve months as the mall in which it is located was under redevelopment.
- During the second quarter, the Company secured a new leader for its Alberta front store operations, a Director of Information Technology and a Human Resource Manager. These individuals bring needed expertise to the Company.

Management's Discussion and Analysis *(continued)*

RESULTS OF OPERATIONS

The following table presents a summary of certain selected operating data and consolidated financial information for the Company:

Thousands except per share amounts	3 Months Ended		6 Months Ended	
	February 28, 2009	February 29, 2008	February 28, 2009	February 29, 2008
Revenue	22,204	21,589	43,987	39,267
Gross Margin	7,846	7,463	15,490	13,287
Operating Expenses ¹	5,699	5,536	11,571	10,100
Operating Income	2,147	1,927	3,919	3,187
Corporate Expenses	1,037	809	2,333	1,719
EBITDA ²	1,110	1,118	1,586	1,468
Stock-based compensation	29	13	46	47
Amortization	1,065	838	2,153	1,401
Interest and accretion expense ³	307	1,965	6,041	3,552
Other Items ⁴	120	99	149	158
Net Income (loss)	(411)	(1,797)	(6,803)	(3,690)
EBITDA per common share				
- Basic net earnings EBITDA	\$0.01	\$0.03	\$0.02	\$0.04
- Diluted net earnings EBITDA	\$0.01	\$0.02	\$0.02	\$0.03
Earnings per common share				
- Basic net loss	(\$0.01)	(\$0.04)	(\$0.07)	(\$0.03)
- Diluted net loss	(\$0.01)	(\$0.04)	(\$0.07)	(\$0.03)

¹ Operating expenses include store level selling, general and administration expenses (excludes corporate expenses, amortization, interest expense, and stock-based compensation).

² EBITDA defined as earnings before interest expense, income taxes, amortization, stock-based compensation and other items as defined.

³ Interest expense includes bank charges and interest Q2-2009: \$14,342 (Q2-2008: \$37,612), YTD-2009: \$73,094 (YTD-2008: \$77,468; interest on long term debt Q2-2009: \$209,115 (Q2-2008: \$195,461), YTD-2009: \$457,784, (YTD-2008: \$347,607); and interest income of Q2-2009: \$43,889 (Q2-2008: \$162,438), YTD-2009: \$142,698 (YTD-2008: \$389,921).

The financing costs on the convertible debenture are a non-cash item and include interest and accretion on the debenture.

⁴ Other items include loss on equity investments of Q2-2009: \$119,605 (2008: \$99,306), YTD-2009: \$142,698 (YTD-2008: \$158,260).

Management's Discussion and Analysis *(continued)*

The following table provides a quantitative reconciliation of net loss to EBITDA:

Thousands	3 Months Ended		6 Months Ended	
	February 28, 2009	February 29, 2008	February 28, 2009	February 29, 2008
Net loss	(411)	(1,797)	(6,803)	(3,690)
Add the following:				
Interest and accretion expense	307	1,965	6,041	3,552
Amortization	1,065	838	2,153	1,401
Stock based compensation	29	17	46	47
Other items	120	99	149	158
EBITDA	1,110	1,118	1,586	1,468

Revenue

Revenue is comprised of sales to customers of the Company's retail pharmacies, home health care store and central fill pharmacies. Revenue was \$22.204 million in the second quarter compared to \$21.589 million in the same period last year, an increase of \$0.615 million or 2.8%. Increases were a result of growth in same store pharmacy revenue of 2.9%, revenue from the acquisitions of Alentex and Central Fill in 2008 offset by a reduction in same store front store revenues of 17.0%.

The significant decline in front store revenue was in part due to the impact of provincial legislation that restricts the display of tobacco products in BC and prohibits the sale of tobacco products in Alberta as of January 1, 2009. These restrictions directly account for a 3.8% drop in revenue for the quarter plus the resulting decline in traffic directly affected other front store sales. In addition, the Airdrie location which is under redevelopment resulted in an additional 2.3% drop. The balance is attributable to overall economic conditions and operational factors that management has identified and is working to resolve.

Revenue for the six month period was \$43.987 million compared to \$39.267 million for the same period last year, an increase of \$4.72 million or 12.0%. Rx revenue increases were primarily a result of growth from acquisitions. Front store revenues excluding tobacco declined year over year by 9.6% due to the Airdrie redevelopment, overall poor economic conditions and reduced traffic resulting from restrictions on the sale of tobacco products.

Gross Margin

Gross margin is calculated as revenue less cost of sales. Cost of sales is comprised of the cost of goods sold through the Company's retail pharmacies, home health care store and central fill pharmacies. Gross margin was \$7.846 million in the second quarter compared to \$7.463 million in the same period last year, an increase of \$0.383 million or 5.1%. This was primarily a result of the acquisition of the Alentex and Central Fill locations in the prior year. Gross margin as a percentage of revenue increased to 35.3% from 34.6% in 2008 due to higher margin pharmacy revenues.

Management's Discussion and Analysis *(continued)*

Gross margin was \$15.490 million for the six month period compared to \$13.287 million for the same period last year, an increase of \$2.203 million or 16.6%. This was primarily a result of an increase in gross margin as a percentage of sales and gross margin from acquisitions. Gross margin as a percentage of sales increased to 35.2% from 33.8% in the same period last year.

Operating Expenses

Operating expenses include all store level selling, general and administration expenses (which include wages and benefits), store occupancy costs, marketing and administration/other costs and excludes all corporate costs, interest and accretion expense, amortization, stock based compensation and other items as defined.

Operating expenses were \$5.699 million in the second quarter compared to \$5.536 million in the same period last year, an increase of \$0.163 million or 2.9%. Same store operating expenses declined by 1.8% over the comparable period. Operating expenses as a percentage of revenue were 25.7% compared to 25.6% for 2008. Operating expenses for the quarter were down 2.9% from the first quarter. This reduction resulted from front store staffing adjustments implemented in the quarter along with various other expense reductions.

Operating Income

Operating income is income generated from store level operations before corporate costs, amortization, interest and accretion expense, stock-based compensation and other items as defined.

Operating income was \$2.147 million in the second quarter compared to \$1.927 million in the same period last year, an increase of \$0.220 million or 11.4%.

Operating income was \$3.919 million for the six month period compared to \$3.187 million for the same period last year, an increase of \$0.732 million or 23.0%.

Corporate and Other Costs

Corporate and other costs include all costs related to the corporate and administration offices including wages, benefits, occupancy, marketing, administration, and public company costs but excluding stock based compensation. Corporate and other costs were \$1.037 million in the second quarter compared to \$0.787 million in the same period last year, an increase of \$0.250 million or 31.8%. Corporate costs decreased by \$0.257 million from the first quarter.

Corporate expenses for the six month period were \$2.333 million compared to \$1.719 million for the same period last year, an increase of \$0.614 million or 35.7%.

EBITDA

EBITDA was \$1.110 million in the second quarter compared to \$1.118 million in the same period last year, a decrease of \$0.030 million or 2.6%. The decrease in EBITDA was primarily a result of the improved store operating income contributed by the stores acquired in the prior year offset by the increase in corporate costs.

EBITDA was \$1.586 million for the six month period compared to \$1.468 million for the same period last year, an increase of \$0.118 million or 8.0%. The increase in EBITDA was a result of decreased operating and corporate costs as summarized above.

Interest and accretion expense

Interest and accretion expense includes financing costs on the convertible debenture, bank charges and interest, interest on long-term debt and capital leases and is reported net of interest income. Financing costs on the convertible debenture consist of accretion, accrued interest, and amortization of financing costs. As the debenture was converted in the first quarter there were no related financing costs in the second quarter.

Bank charges and interest were \$0.014 million in the second quarter (2008 - \$0.038 million); interest and amortization of related financing costs on long-term debt was \$0.337 million (2008 - \$0.195 million) due to bank financing relating to the acquisitions in the prior year; and interest income was \$0.044 million (2008 - \$0.162 million). Interest income declined due to lower investable assets and falling interest rates.

Bank charges and interest were \$0.066 million for the six month period (2008: \$0.077 million); interest and amortization of related financing costs on long-term debt was \$0.689 million (2008: \$0.348 million); and interest income of \$0.127 million (2008: \$0.390 million).

Amortization

Amortization of capital and intangible assets were \$1.065 million in the second quarter compared to \$0.838 million in the same period last year, an increase of \$0.227 million or 27.1%. This increase is primarily a result of the amortization of capital and intangible assets acquired in the Alentex and Central Fill acquisitions in the prior year.

Amortization of capital and intangible assets were \$2.153 million for the six month period compared to \$1.401 million for the same period last year, an increase of \$0.752 million or 53.7%. This increase is primarily a result of amortization resulting from the acquisitions.

Other items

Other items for the quarter consist of a \$0.120 million equity loss on the investment in 1036985 Alberta Ltd. (Cochrane Super Drug Mart) compared to \$0.990 million equity loss for the same period in 2008. For the six month period, the equity loss was \$0.143 million compared to a loss of \$0.158 million for the six month period ended February 29, 2008.

Net loss

The net loss was \$0.410 million in the second quarter compared to a net loss of \$1.797 million in the same period last year, a decreased loss of \$1.387 million. The decrease is principally due to decreased interest and accretion expense as a result of the conversion of the debenture.

The net loss for the six month period was \$6.802 million compared to a loss of \$3.690 million for the same period last year, an increase of \$3.122 million. The increase is principally as a result of costs and expenses relating to the conversion of the debenture.

FINANCIAL POSITION

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

	February 28, 2009	August 31, 2008
Cash and cash in escrow	(11,446)	(14,269)
Bank indebtedness	-	921
Current portion of long-term liabilities	9,191	2,459
Convertible debenture	-	17,233
Long-term liabilities ¹	6,004	13,899
Net debt ²	3,749	20,243
Shareholders' equity ³	34,004	18,313
Total capitalization	37,753	38,556
Net debt: Shareholders' equity	0.11:1	1.11:1
Net debt: Total capitalization	0.10:1	0.52:1
EBITDA: Cash interest expense ⁴	3.93:1	3.97:1

¹ Excludes the equity portion of the convertible debenture at August 31, 2008 of \$7,524.

² Net debt is defined as total bank indebtedness, long term debt (including current portion), capital leases (including current portion), convertible debenture, equity portion of convertible debenture and is net of cash and restricted cash.

³ Includes the equity portion of the convertible debenture at August 31, 2008 of \$7,524.

⁴ Cash interest expense excludes financing costs on the convertible debenture and amortization of other financing costs and is net of interest income

OUTSTANDING SHARE DATA

The Company had outstanding 97.6 million common shares and 1.0 million options and 1.875 million warrants to acquire its common shares at February 28, 2009. Further details are available in Note 13 of the unaudited interim consolidated financial statements as at February 28, 2009.

LIQUIDITY AND CAPITAL RESOURCES

The Company currently has an operating line of credit facility of a maximum of \$3 million, bearing interest at prime plus 1.25% per annum. The operating line is secured by a general security agreement representing a first charge on all the assets and undertakings of the Company and its subsidiaries, unlimited guarantees of advances by the Company and its subsidiaries, subordination/priority agreements with a certain supplier and an assignment of fire insurance over assets of the Company and its subsidiaries. At February 28, 2009, the Company had issued letters of credit aggregating \$0.5 million leaving \$2.5 million of the \$3 million facility available. The Company was in compliance with bank covenants for the second quarter ended February 28, 2009.

Management's Discussion and Analysis *(continued)*

The Company's principal capital requirements are to fund working capital needs and renovate existing stores. These capital requirements have generally been satisfied by a combination of cash flow from operations and borrowings under its term and operating line of credit facility and the issuance of common shares. Capital required to fund acquisitions of pharmacies have been obtained through a combination of debt financing and the issuance of common shares.

In May, 2007 the Company issued a \$20.0 million convertible debenture, the proceeds of which were restricted for future acquisitions and which required matching senior debt. In fiscal 2008, the Company secured a \$7.5 million loan facility to be used for acquisitions to be matched with the convertible debenture funds on a dollar for dollar basis. Advances under this facility totaled \$7.060 million.

On November 14, 2008, the Company announced that it had concluded with the debenture holder a note conversion and share subscription agreement. The agreement provided the Company with approximately \$13.8 million of cash proceeds and eliminated the Company's \$20 million debenture. Shares issued under the agreement had a combined average issuance price of approximately \$0.40 per share. As a result of the agreement, the debenture holder increased its ownership in Paragon from 25.6% (undiluted) to approximately 70% (undiluted) of the outstanding common shares. Further details of this transaction are set out in Note 11 to the unaudited interim financial statements for the period ended February 28, 2009.

In conjunction with the aforementioned transaction the Company also renegotiated certain terms of its credit facilities included revised financial covenants and, in certain circumstances, accelerated repayments based on the EBITDA of the Company. The amendments also altered the pricing on the Company's bank debt of the facility resulted in the term loan and revolving facility now bearing interest at prime plus 1.50% and amounts outstanding under the operating line bearing interest at prime plus 1.25%.

As a result of the repayment and conversion of all outstanding debentures, the previously restricted cash became available for general corporate purposes. These funds have been applied against the bank operating line and the balance is invested in short term investments. These funds are available to the Company to fund operating and capital requirements, payments required under the long term debt and are available to assist in financing acquisitions.

The Company anticipates holding a significant portion of these funds in reserve until such time as the bank facilities, which come due in December 2009, are renewed.

Operating Activities

For the second quarter, net cash flow generated from operating activities was \$0.790 million compared to \$0.049 million in the same period last year principally due to a reduction in the investment in non cash working capital.

For the six month period, net cash flow generated from operating activities was \$0.891 million compared to \$0.144 million in the same period last year. This difference was primarily from a reduction in investment in non-cash working capital items.

Management's Discussion and Analysis *(continued)*

Financing Activities

Cash flow expended on financing activities in the second quarter decreased to (\$1.528) million from \$6.645 million in 2008. The principal financing activities in the quarter related to payment of professional fees relating to the acquisition of the note receivable from Autonomy and the related amalgamation in the fourth quarter of 2008 and the conversion of the debenture in the previous quarter together with the \$0.791 of scheduled repayments of long term debt. In the comparable period in the prior year, financing activities included the proceeds of financing related to the acquisitions of the three central fill operations in British Columbia and Manitoba.

For the six month period, net cash expenditures from financing activities was \$3.434 million compared to cash from financing activities of \$5.881 million in the same period last year. This change was due primarily to the \$8.568 million of proceeds from issuance of shares in conjunction with the conversion of the debenture net of scheduled repayments of long term debt and the partial repayment of the convertible debenture. The cash from financing activities in the corresponding period in the prior year resulted from the financing received in the second quarter that year as described above less scheduled debt repayments.

Investing Activities

Cash flow from investing activities in the second quarter was (\$0.112) million compared to a net investment of (\$6.355) million in the same period last year. The prior year comparable quarter included the acquisitions of the three central fill operations in British Columbia and Manitoba.

For the six month period, net cash injected from investing activities was \$13.448 million compared to \$9.068 million in the same period last year. The current year relates primarily to the conversion of the debenture in the first quarter in which \$13.830 million previously held in escrow were released to the Company net of capital expenditures of \$0.686 million. The prior year comparable period reflected the impact of \$14.830 million of acquisitions; \$1.135 million of capital expenditures less \$7.030 million of funds released from escrow.

Future Liquidity

The company estimates that sufficient means exist to satisfy the Company's working capital needs and debt-service requirements for the coming fiscal year. Any future acquisitions or green field developments may require additional debt and equity financing to ensure compliance with credit facility covenants. As with all businesses today, the Company is subject to the potential impact the recent global credit and financial crisis may have on its ability to raise debt or equity financing at reasonable rates or at all.

TRANSACTIONS WITH RELATED PARTIES

In addition to transactions relating to the convertible debenture which are more fully described in note 11, for the three and six months ended February 28, 2009 the Company recorded an expense of \$0.025 million and \$0.050 million respectively for advisory fees due to Canterbury Park Management Inc. (three and six months ended February 29, 2008 \$0.050 million and \$0.100 million respectively). Canterbury Park Management Inc. serves as the manager for a significant shareholder.

Management's Discussion and Analysis *(continued)*

For the three and six months ended February 28, 2009, the Company expensed \$nil and \$135,000 respectively (2008-\$ nil for both periods) to one member of the Board of Directors for consulting services. The Company also paid \$66,000 for the three months ended, and \$116,000 for the six months ended February 28, 2009 (three and six months ended February 29, 2008 \$87,371 and \$176,890 respectively) in rent for premises leased under operating leases with parties related by virtue of common management and directors. These transactions are in the normal course of operations and have been recorded at the exchange amount, which is the amount agreed to by the related parties.

QUARTERLY INFORMATION

Summary of Quarterly Information

The fiscal year-end of the Company is August 31 with quarter end falling on the following dates: November 30 (Quarter 1); February 28 (Quarter 2); May 31 (Quarter 3); August 31 (Quarter 4). The following table provides a summary of certain selected consolidated financial information for the Company for each of the eight most recently completed fiscal quarters. The consolidated financial statements have been prepared by management in accordance GAAP.

Thousands (except per share amounts)	Second Quarter		First Quarter		Fourth Quarter		Third Quarter	
	2009	2008	2009	2008	2008	2007	2008	2007
Revenue	22,204	21,589	21,783	17,677	22,094	16,957	22,357	17,067
EBITDA	1,110	1,118	476	315	(984)	(39)	957	380
- EBITDA per share - Basic	\$0.01	\$0.03	\$0.01	\$0.01	(\$0.03)	\$0.00	\$0.02	\$0.01
- EBITDA per share - Diluted	\$0.01	\$0.03	\$0.01	\$0.01	(\$0.03)	\$0.00	\$0.02	\$0.01
Net (loss) income	(411)	(1,797)	(6,392)	(1,893)	(4,029)	(2,513)	(2,406)	(1,058)
- Net loss per share - Basic	(\$0.01)	(\$0.04)	(\$0.13)	(\$0.05)	(\$0.09)	(\$0.07)	(\$0.06)	(\$0.03)
- Net loss per share - Diluted	(\$0.01)	(\$0.04)	(\$0.13)	(\$0.05)	(\$0.09)	(\$0.07)	(\$0.06)	(\$0.03)

RISKS AND RISK MANAGEMENT

The Company is exposed to a number of operating and financial risks. A summary of these is as follows:

Competition

Pharmacy operations are very competitive, particularly in the front store merchandise and non-prescription drug categories. Many of the Company's current competitors are of a size and scale of operations that greatly exceeds those of the Company. Thus they may have access to more favorable procurement terms and other operating benefits not available to the Company that permits them to have certain cost advantages. Additionally, as the Company's competitors in the retail pharmacy business include independent operators, banner groups, retail chains, mass merchandisers and larger supermarket chains with combination food/drug retail operations, the Company may need to reduce prices in front store merchandise or reduce dispensing fees to maintain or increase market share, which could have an adverse impact on the Company's earnings.

Management's Discussion and Analysis *(continued)*

General economic conditions

The Company currently operates in Western Canada but, like all businesses globally, it will be subject to the impact that the current global credit and financial crisis may have on consumers in its areas of operations and the discretionary spending available to them. Should general economic conditions deteriorate in such a way as to reduce consumer spending the Company's profitability may be reduced.

As well, the Company is subject to the potential impact the crisis may have on its ability to raise debt or equity financing at reasonable rates or at all.

Key Personnel

The successful operation of the Company's business depends upon the abilities, expertise, judgment, discretion, integrity and good faith of its executive officers, management, employees and consultants. In addition, the ability of the Company to expand its services will depend upon the ability to attract qualified personnel as needed. The demand for skilled employees is high and the supply is limited. The unexpected loss of the Company's key personnel or the inability to retain or recruit skilled personnel could have a material adverse effect on the Company's business, financial condition, results of operations and cash flows. In particular, the Company is dependent upon its ability to attract, motivate and retain pharmacists for its stores. Increased competition in the retail pharmacy business has led to a shortage of pharmacists in Western Canada. The inability to attract and retain pharmacists could adversely affect the Company's business and earnings.

Reliance on Information Systems and Technology

The Company's business relies upon information technology systems to support its distribution, merchandise and pharmacy dispensing systems and to service customers at the point of sale. Its information technology systems may be vulnerable to unauthorized access, computer viruses, system failures, other malicious acts or acts of nature. Were a significant disruption to its information technology to occur, the Company's earnings could be adversely affected through loss of revenue and costs to rectify the disruption.

Industry and Regulatory

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

Internal Control Deficiencies

The Company's inability to successfully address potential material weaknesses in internal controls or other control deficiencies may affect its ability to report its financial results on a timely and accurate basis and to comply with disclosure and other requirements.

Management's Discussion and Analysis *(continued)*

Financial covenants in lending agreements

The Company's is dependent upon continued access to capital on terms acceptable to the Company, including bank indebtedness and lending facilities. Prior to the amendments to its banking agreement affected in the first quarter, the Company was in breach of certain financial covenants. There can be no assurance that the Company will be able to comply with any or all such covenants in the future. Should it not be able to meet these covenants or arrange further amendments in the future, the Company would be exposed to the bank realizing on its security, thus hindering the ability of the Company to operate effectively.

Third-party Service Providers

The Company is reliant upon third-party service providers in respect of certain of its operations, including a limited number of major suppliers of prescription drugs. Any negative events affecting these third-party service providers could, in turn, potentially impact the Company. The Company has entered into contractual arrangements to formalize these relationships and, to minimize operating risks; the Company actively manages its relationships with its third-party service providers.

Real Estate

The Company's success is dependent, among other things, on acquiring and maintaining locations suitable for its pharmacy and retail operations. The Company's business may be impacted if it is unable to secure or maintain suitable locations on lease terms that are commercially reasonable.

Seasonality

The Company's core prescription drug operations are not typically subject to seasonal fluctuations. Its front store operations may see quarterly variation resulting from holiday periods such as Christmas or Easter.

Financial Instruments

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

Exposure to Interest Rate Fluctuations

The Company is exposed to fluctuations in interest rates by virtue of its borrowings under its bank credit facilities. Increases or decreases in interest rates will positively or negatively impact the financial performance of the Company. The Company does not consider its exposure to interest rate fluctuations to be material at this time.

Foreign Currency Exchange Risk

The Company does not consider its exposure to foreign currency exchange rate risk to be material at this time as its revenues, costs of sales and expenses are substantially conducted in Canadian \$.

Credit Risk

The Company does not consider its exposure to credit risk to be material as accounts receivable arise primarily in respect of prescription sales billed to governments and third-party drug plans.

REGULATORY CHANGES THAT IMPACT THE COMPANY'S INDUSTRY

The British Columbia government followed the lead of the Alberta government by allowing pharmacists to adapt prescriptions effective January 2009. The move was designed to improve the public's access to drug therapy and reduce medication side-effects and emergency-room visits. Negotiations to establish a funding formula to cover the adaptation services provided by pharmacists are now under way. Additionally, the British Columbia government continues on the path towards introducing other drug program reforms sometime in the next several months. The Ministry of Health Services has already experimented with a tendering approach to procurement of pharmaceuticals and related supplies. Widespread use of tendering could dramatically alter business relationships between pharmacy owners and generic manufacturers, who have traditionally supported pharmacies through professional allowances. Unless the government agrees to significant increases in dispensing fees (which now lag behind actual retailer costs by approximately \$5 per prescription) or begins compensating pharmacists for other services, the economics of the British Columbia pharmacy industry could be severely impacted by a curtailment in such allowances.

On December 12, 2008, the British Columbia government announced an interim agreement that runs for calendar 2009. The agreement specifies no tendering of generic drugs for the duration of the interim agreement, it reduces the allowances paid on newly approved (approved after January 1, 2009) generic molecules, and it limits the capitation on daily and weekly dispensing fees effective February 1, 2009. A new long term agreement relating to the pricing of generic drugs and a fee schedule for services provided by pharmacists is anticipated by the parties to be agreed to in the fall of 2009. The interim agreement will negatively impact the Company's revenues and gross margins in 2009. Management estimates that the impact on store operating income for the balance of fiscal 2009 could be \$0.3 to \$0.5 million.

A second study by the federal Competition Bureau released on November 25, 2008 is recommending that provincial governments and insurance companies seek to recover a portion of their costs from the pharmacies themselves. These and other similar recommendations could adversely affect future revenue of pharmacies.

Alberta is also in the process of developing a new pharmaceutical strategy and while the specifics are not yet detailed, the government has indicated that the strategy will include more effective drug purchasing to decrease costs. Paragon and other pharmacy service providers are planning a round of grassroots meetings that front-line pharmacists will have with local MLA's to discuss opportunities to better use pharmacists' education and expertise to deliver quality healthcare as well as to outline the potential harm to their financial viability resulting from efforts to reduce generic drug prices. As in British Columbia, community pharmacy stakeholders in Alberta are working to raise compensation rates for dispensing services so that cost-cutting measures such as tendering do not force stores to reduce or eliminate services.

Across Canada, much attention is being paid to the latest developments in Ontario's overhaul of its public drug program. Despite a recent study that found a funding gap of up to \$9 per prescription exists in that province, the Ontario government is moving ahead with implementing "competitive agreements" that could further reduce pharmacy revenues by reducing generic allowances available to pharmacies. In early November 2008, the Ontario government awarded contracts of this nature for two commonly-prescribed molecules, Metformin and Enalapril.

Management's Discussion and Analysis *(continued)*

The Company is closely monitoring these developments at the provincial level while seeking opportunities to explore additional pharmacy-related revenue streams to offset the inevitable decline in financial support from generic drug suppliers. It is encouraged by the Alberta government's move to invest \$9 million in short-term demonstration projects of alternate payment models for pharmacists' services that emphasize outcomes of patient care in three areas-medication review, medication management and chronic disease management support.

Effective January 1, 2009, tobacco sales in Alberta are no longer permitted from health care facilities, pharmacies, and stores that contain a pharmacy. Similar requirements in British Columbia have been deferred pending further review by that province.

ESTIMATES

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates are used when accounting for items such as inventory provisions, income and other taxes and testing goodwill and long-lived assets for impairment. Changes in those estimates could materially affect the consolidated financial statements

OFF-BALANCE SHEET ARRANGEMENTS/VARIABLE INTEREST ENTITIES

The Company has no off-balance sheet arrangements or variable interest entities.

CHANGES IN ACCOUNTING POLICIES

Effective September 1, 2008, the Company adopted several new accounting standards. These include Section 1535, "Capital Disclosures", and Section 1400 "General Standards of Financial Statement Presentation". The impact of these new standards on the consolidated financial statements was additional disclosures being required.

Effective September 1, 2008, the Company also adopted Section 3862 "Financial Instruments Disclosures" and Section 3863 "Financial Instruments Presentation". The effect on the Company was incremental disclosures regarding the significance of financial instruments for the entity's financial position and performance and the nature, extent and management of risks arising from financial instruments to which the entity is exposed.

Except for the adoption of new standards described above, the Company has not changed any accounting policies since August 31, 2008.

FUTURE ACCOUNTING PRONOUNCEMENTS

Effective September 1, 2009 the Company will be required to adopt CICA Section 3064, "Goodwill and Intangible Assets. This section will supersede sections 3062, "Goodwill and Other Intangible Assets" and 3450, "Research and Development Costs", and establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets. The Company is assessing the impact of this new standard on its consolidated financial statements and its implications are still under review.

Management's Discussion and Analysis *(continued)*

Effective September 1, 2009, the Company will need to adopt amendments to CICA Section 1000, "Financial Statement Concepts" that clarify the criteria for recognition of an asset and the timing of expense recognition. The implementation of the amendments to Section 1000 is not expected to have an impact on the Company's results of operations, financial position and disclosures because the amendments are clarifications on the application of Section 1000.

Effective September 1, 2012, the Company will be required to adopt new accounting standards concerning Business Combinations and Consolidated Financial Statements which are based on International Financial Reporting Standards "IFRS" 3 and 27. The new requirements replace existing guidance on accounting for Business Combinations, the preparation of consolidated financial statements and accounting for non-controlling interests. The Company expects to assess the impact of the new standard as part of its overall review of the convergence of Canadian GAAP with IFRS.

In January 2006, the CICA Accounting Standards Board adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, accounting standards in Canada for public companies are expected to converge with International Financial Reporting Standards ("IFRS") by the end of 2011. The Company is assessing the impact of convergence of Canadian GAAP and IFRS.

DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

Multilateral Instrument 52-109 Certification of Disclosure in Issuers' Annual and Interim Filings, requires the President and the Interim Chief Financial Officer ("CFO") of the Company, to file annual and quarterly certificates certifying that they are responsible for establishing and maintaining controls and procedures for the Company, and that they have designed such disclosure controls and procedures, or have caused them to be designed under their supervision, to provide reasonable assurance that material information relating to the Company is made known to them by others within the Company during the period in which the interim filings are being prepared.

Based on that evaluation and in light of the control weaknesses discussed below, the President and the Interim CFO concluded that the disclosure controls and procedures as at the end of the period covered by the interim filings are effective in providing reasonable assurance that material information relating to the Corporation and its consolidated subsidiaries, that is required to be disclosed in reports filed or submitted under applicable securities law, is made known to them by others within these entities.

Internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risks that controls become inadequate because of changes in conditions or personnel, or that the degree of compliance with the policies or procedures may deteriorate.

Management's Discussion and Analysis *(continued)*

In compliance with Multilateral Instrument 52-109, management must disclose in its MD&A any material weakness found to exist within its system of internal control over financial reporting. As reported last year, management had identified a material weakness in lack of segregation of duties. The management group of the Company is small and full segregation of all duties has not been possible. This is a typical issue for smaller companies, and while the Company has experienced significant growth in recent quarters, and has added additional staff to strengthen the segregation of duties, there still exists a lack of such segregation of duties.

The Company has also experienced turnover of personnel in the finance and accounting department over the last year, including changes at both the Chief Financial Officer and Controller levels. The Company has recruited replacement personnel including Interim Chief Financial Officers to fill these responsibilities.

Notwithstanding the above control weaknesses, the President and the Interim CFO have satisfied themselves that the control environment and reporting practices are such that reasonable assurance exists that material information related to the corporation and its subsidiaries has been made known to them.

The Company is currently seeking a Chief Financial Officer on a full-time basis.

The Board of Directors together with the Audit Committee have direct oversight responsibilities for the review and approval of the quarterly and annual financial disclosures.