

PARAGON PHARMACIES LIMITED

MANAGEMENT'S DISCUSSION & ANALYSIS FOR THE YEAR ENDED AUGUST 31, 2010

As at November 18, 2010

The following is a discussion of the consolidated financial condition and results of operations of Paragon Pharmacies Limited ("Paragon" or "the Company") for the year ended August 31, 2010. This discussion and analysis should be read in conjunction with the Company's annual audited consolidated financial statements and accompanying notes for the year ended August 31, 2010. The audited 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. Additional information relating to the Company is available at www.helloparagon.com or www.sedar.com.

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 ability 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 MD&A 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 400 full and part time staff. The Corporation owns and operates 19 retail pharmacies and three central fill pharmacies in British Columbia, Alberta and Manitoba.

STRATEGIES AND OUTLOOK

While Paragon continues to put an emphasis on the long-term improvement of its current operations, the Company is also now placing significant attention on implementing a growth strategy that will be supported both through the acquisition of existing pharmacies and the construction of new pharmacies.

The Company's business strategy for its current operations focuses on improving Paragon's position as a leading community pharmacy in the local markets it serves. Paragon believes that a community pharmacy should provide its customers with a shopping experience that enables them to feel comfortable, supported, and engaged in their pursuit of meeting their health and wellness needs.

The key business initiatives Paragon is currently working on to support our customers' pursuit of health and wellness include; hiring and retaining only pharmacy and front store staff that are committed to provide superior customer service; providing training and support to the Company's pharmacy and front store staff to help them deliver the best possible customer service; expanding Paragon pharmacists' scope of practice to conform with both the emerging regulatory opportunities, and customer needs; developing a market leading in-store diagnostics program; building additional medical clinics; connecting with the community on health issues through organizing in-store clinics and seminars; and developing a health and wellness product offering that fully answers the needs of Paragon's customers.

Paragon is also in the process of changing the structure of its supply chain so that it re-establishes a direct relationship with all of its important vendors, while at the same time maintaining the relationship it has with its key distribution partner. Through this initiative Paragon has taken direct control of its flyer and promotional programs, rather than allowing them to be managed by a third party.

Management's Discussion and Analysis *(continued)*

Paragon continues to monitor regulatory change closely. To date the Alberta regulatory changes have not adversely affected the Company's gross margin. An assessment of the recent changes in British Columbia's generic price structure suggests that there will be a moderately negative impact on operating income in British Columbia.

With the pharmacy industry facing ongoing regulatory change, Paragon believes that opportunities to purchase good stores at reasonable valuations will accelerate as independent operators seek to capitalize past growth they have achieved in their businesses. Paragon also believes that there are good opportunities throughout Western Canada to selectively build stores in conjunction with the medical community.

Paragon is currently looking at several potential acquisition targets. The Company's objective is to increase its pipeline of potential acquisitions steadily over the coming quarters so that it has an ample population of potential acquisitions to generate growth objectives. Because the Company has not acquired any pharmacies recently, it will take some time to develop this pipeline of potential acquisitions. Paragon is also currently looking at several potential new "greenfield" store construction opportunities. The Company's research indicates that the aging population and general shift of Canadians to living healthier and more active lives will support these growth strategies.

Paragon's capital position and its ability to secure financing will enable it to continue to search for new business development opportunities through acquisitions of pharmacies, prescription files and new store developments in Western Canada.

The Company is also focused on developing growth in its long term care operations through improved service and innovative technology and processes. Specifically the Company has begun to automate certain processes in its central fill pharmacies to increase service, enhance quality control and improve efficiencies. The Company has recently hired two key pharmacists with business management, automation, and central fill experience to bolster management of that component of Paragon's business.

SUMMARY

Key Operating, Investing and Financial Metrics

The following provides a summary of the Company's performance for the year ended August 31, 2010 compared to the year ended August 31, 2009.

- Revenue of \$82.918 million (2009: \$86.134 million), a decrease of 3.7%. (Refer to page 7 for further explanation)
- Comparable store revenue reduction of 2.9% (excluding tobacco)
 - Comparable store pharmacy revenue decrease of 1.3%
 - Comparable store front store revenue¹ reduction of 11.0% (excluding tobacco) (Refer to page 7 for further explanation)
- Gross margin² as a percentage of revenue of 37.3% (2009: 36.5%), an increase of 0.8%. (Refer to page 7 for further explanation)

Management's Discussion and Analysis *(continued)*

- Operating income³ of \$8.278 million (2009: \$8.404 million), a decrease of 1.5%. (Refer to page 7 for further explanation)
- EBITDA of \$3.559 million (2009: \$3.907 million), a decrease of 8.9%. (Refer to page 8 for further explanation)

¹ Front store revenue includes all non-pharmacy revenue

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

Fourth Quarter

- During the quarter, the Company completed its implementation phase of its new point-of-sale system in all 22 locations. Standardizing its systems across all locations will allow the Company to improve speed of transactions, introducing loyalty program offerings, and give management the tools to more effectively manage the business.
- The Company constructed a new 3,000 square foot medical clinic adjacent to its Riverbend, Alberta location. The clinic opened in early September 2010 and is part of the Company's continued focus on providing its customers with a wider service solution for their health needs.
- During the quarter, the Company successfully recruited a Director of Pharmacy Operations (BC), a pharmacist with 17 years of pharmacy experience, including director of pharmacy operations and long term care pharmacy experience.

The Company also successfully recruited a pharmacist and MBA as Manager, Central Fill who brings to the Company over 14 years of experience in the pharmaceutical healthcare industry, including more than five years in both in store and corporate management positions.

- In the quarter, the Company continued development of its in-house flyer program. With its first distribution scheduled for mid-November, the new in-house flyer will allow the Company to work directly with vendors to develop product and price offerings that are aimed specifically at the Paragon customer. As part of this program the Company switched over to direct communication with the majority of vendors, rather than purchasing product solely through our distribution partner. This change will allow us to more effectively manage our front store assortment strategy in the future, in order to ensure the value and relevancy of the front store offering to the customer steadily improves.

SELECTED ANNUAL INFORMATION

The following table provides a summary of certain selected consolidated annual financial information for the Company. The 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.

(thousands of dollars)	2010	2009	2008
Revenue	\$82,918	\$86,134	\$83,718
Operating income ¹	8,278	8,404	5,878
EBITDA	3,559	3,907	1,393
Net loss	(2,594)	(7,257)	(10,125)
- Net loss per share - Basic	(\$0.03)	(\$0.08)	(\$0.24)
- Net loss per share – Diluted	(\$0.03)	(\$0.08)	(\$0.24)
Total assets	47,149	57,128	62,837
Total long-term financial liabilities ^{2,3}	7,960	14,190	33,591

¹ 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

² Includes current portion of long-term financial liabilities: 2010: \$952; 2009: \$10,640; 2008: \$2,459.

³ Includes convertible debenture of 2010: \$Nil; 2009:\$Nil. 2008:\$17,233. This liability was eliminated in November 2008 through the conversion and repayment of the debenture and the issuance of equity

2010

In fiscal 2010, total revenue decreased 3.7% and operating income decreased 1.5% from 2009, caused mainly by a decline of 9.6% in front store and post office revenue. Total comparable store revenue declined by 2.3%, comprised of a comparable pharmacy revenue increase of less than 1.0% and comparable front store revenue down 12.9% over 2009. Total gross margin increased from 36.5% in 2009 to 37.3% in 2010. EBITDA decreased 8.9% from 2009 as a result of decreased operating income offset by improved margins from the prior year. (Refer to page 7)

Included in net loss for 2009 were interest and accretion expenses of \$5.413 million relating to the convertible debenture which was retired on November 14, 2008, through execution of a note conversion and subscription agreement.

2009

In fiscal 2009, total revenue increased 2.9% and operating income increased 47.0% from 2008, reflecting the acquisitions in 2008 of Teulon, Alentex and the Okanagan and West Coast central fills for a full year in 2009. Total comparable store revenue declined by 2.8% with comparable pharmacy revenue up 2.6% and comparable front store revenue down 17.1% over 2008. EBITDA increased 180.5% from 2008 as a result of increased operating income and improved margins from prior year. (Refer to page 7)

RESULTS OF OPERATIONS

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

(Thousands of dollars)	2010 \$	2009 \$	2008 \$
Net loss	(2,594)	(7,257)	(10,125)
Add (deduct) the following:			
Interest and accretion expense	885	6,676	7,936
Amortization	5,061	4,391	3,690
Stock based compensation	2	68	121
Other items	205	29	(229)
EBITDA	3,559	3,907	1,393

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

(Thousands of dollars except per share amounts)	2010 \$	2009 \$	\$ Change	% Change
Revenue	82,918	86,134	(3,216)	(3.7%)
Gross Margin	30,931	31,419	(488)	(1.6%)
Operating Expenses ¹	22,653	23,015	(362)	(1.6%)
Operating Income	8,278	8,404	(126)	(1.5%)
Corporate and other costs	4,719	4,497	222	4.9%
EBITDA ²	3,559	3,907	(348)	(8.9%)
Stock-based compensation	2	68	(66)	(97.1%)
Amortization	5,061	4,391	670	15.3%
Interest and accretion expense ³	885	6,676	(5,791)	(86.7%)
Other Items ⁴	205	29	176	606.9%
Net (Loss)	(2,594)	(7,257)	4,663	64.3%
EBITDA per common share				
- Basic	\$0.04	\$0.05	(\$0.01)	(20.0%)
- Diluted	\$0.04	\$0.05	(\$0.01)	(20.0%)
Loss per common share				
- Basic	(\$0.03)	(\$0.08)	\$0.05	62.5%
- Diluted	(\$0.03)	(\$0.08)	\$0.05	62.5%

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 2010: \$0.149 million (2009: \$0.133 million); interest on long term debt 2010: \$0.544 million, (2009: \$0.796 million); and interest income of 2010: \$0.022 million (2009: \$0.153 million). 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 disposal of assets 2010 \$0.206 million (2009: \$0.060 million), gain on equity investment 2010 \$nil million (2009 \$0.031 million)

Revenue

Revenue is comprised of sales to customers of the Company's retail pharmacies and central fill pharmacies. Revenue was \$82.918 million in 2010 compared to \$86.134 million in 2009, a decrease of \$3.216 million or 3.7%. Decreases were a result of a decline in comparable store pharmacy and front store revenue. Front store revenue declined due to the divestiture of the home healthcare business late in fiscal 2009 and continued competitive pressure. Growth in pharmacy revenue was impacted by the increased availability of lower priced generic drugs in the market.

The Company is working on several initiatives to improve store competitiveness, including; working to improve its merchandising and promotions; working to elevate the competency of its store personnel; improving the Company's physical store infrastructure both in design and routine maintenance; improving asset protection to reduce shrinkage and increase margin; and continuing its focus on customer service.

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 and central fill pharmacies. Gross margin was \$30.931 million in 2010 compared to \$31.419 million in 2009, a decrease of \$0.488 million or 1.6%. This is due to a decline in both pharmacy and front store revenue partially offset by an increase in both pharmacy and front store gross margin as a percentage of sales.

Gross margin as a percentage of revenue improved to 37.3%, an increase of 0.8% over 2009. Front store gross margin dollars are down \$0.431 million due primarily to a drop in revenues, offset by the increase in gross margin percentage.

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 \$22.653 million in 2010 compared to \$23.015 million in 2009, a decrease of \$0.362 million or 1.6%. This was primarily a result of decreased operating wages and operating administration costs relating to distribution and retail stores partially offset by an increase in occupancy costs over the same period last year. Operating expenses as a percentage of revenue were 27.3% compared to 26.7% for the same period last year.

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 \$8.278 million in 2010 compared to \$8.404 million in 2009, a decrease of \$0.126 million or 1.5%. The decrease in operating income is a result of the reduction of front store revenue offset by reduced operating expenses of \$0.362 million over the same period in the prior year.

Corporate and Other Costs

Corporate and other costs include all costs related to the corporate and administration offices including wages, benefits, occupancy, administration, and public company costs but excluding stock based compensation. Corporate and other costs were \$4.719 million in 2010 compared to \$4.497 million in 2009, an increase of \$0.222 million or 4.9%. The increase was a result of higher human resource and information technology spending partially offset by lower corporate wages.

EBITDA

EBITDA was \$3.559 million in 2010 compared to \$3.907 million in 2009, a decrease of \$0.348 million or 8.9%. The decrease in EBITDA was primarily a result of the reduction in front store revenue, increased corporate expenses, offset by a reduction of operating expenses.

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.

Interest and accretion expense, excluding amounts related to the convertible debenture, was \$0.885 million compared to \$1.263 million in 2009, a decrease of \$0.378 million. Bank charges and interest were \$0.149 million (2009 - \$0.133 million); interest and amortization of related financing costs on long-term debt was \$0.758 million (2009 - \$1.283 million) due to lower debt levels; and interest income was \$0.022 million (2009 - \$0.153 million). Interest income declined due to the repayment of long term debt with cash on hand.

Financing costs on the convertible debenture comprised of accretion, accrued interest, and amortization of financing costs. Total financing costs on the convertible debenture were \$nil million in 2010 compared to \$5.413 million in 2009.

Amortization

Amortization of capital and intangible assets was \$5.061 million in 2010 compared to \$4.391 million in 2009, an increase of \$0.670 million or 15.3%. This increase is due to amortization on capital and intangible asset additions.

Stock based compensation

Stock based compensation was \$0.002 million in 2010 compared to \$0.068 million in 2009, a decrease of \$0.066 million or 97.1%.

Net loss

The net loss was \$2.594 million compared to a net loss of \$7.257 million in 2009, a decrease of \$4.663 million or 64.3%. The improvement is primarily due to a reduction in financing costs relating to the convertible 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:

Thousands of dollars	2010 \$	2009 \$
Cash and cash equivalents	(4,285)	(14,980)
Current portion of long-term debt and capital leases	952	10,640
Long-term debt and capital leases	7,008	3,550
Net debt ¹	3,675	(790)
Shareholders' equity	29,523	33,572
Total capitalization	33,198	32,782
Net debt: Shareholders' equity	0.12:1	(0.02:1)
Net debt: Total capitalization	0.11:1	(0.02:1)
EBITDA: Cash interest expense ²	5.30:1	5.03:1

¹ Net debt is defined as total bank indebtedness, long term debt (including current portion), capital leases (including current portion), and is net of cash and restricted cash.

² 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 is authorized to issue an unlimited number of common shares and an unlimited number of preferred shares. As at August 31, 2010 the Company had 93.3 million (2009 – 97.6 million) issued common shares outstanding. No preferred shares were outstanding during or at the end of these periods. As at November 17, 2010 the Company had 92.5 million common shares outstanding as result of cancellation of 0.8 million through normal course issuer bids ("NCIB") initiated in October 2009 and 2010. Further details are available in Note 11 to the audited consolidated financial statements as at August 31, 2010.

The Company has an incentive stock option plan for certain employees, officers and directors. As at August 31, 2010, 0.3 million (2009 - 0.6 million) options to acquire its common shares were outstanding. As at August 31, 2010, 2,478,379 (2009 – 2,301,524) common shares remain reserved for issuance under the stock option plan. As of November 18, 2010, no additional stock options have been granted under the plan.

On October 8, 2010, the Company received approval for the renewal of the NCIB which allows the Company to purchase up to an additional 4,637,794 common shares until the renewed NCIB expires on October 11, 2011.

LIQUIDITY AND CAPITAL RESOURCES

On April 6, 2010, the Company secured a three year credit facility which includes a \$5.0 million operating line which bears interest at prime plus 1% to prime plus 2% which is adjusted each quarter dependent on Company specific covenants outlined in the agreement. The Company's previous credit facility, which matured April 6, 2010, contained a \$3.0 million operating line, 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 August 31, 2010, the Company had issued letters of credit aggregating \$0.5 million (2009 - \$0.5 million) leaving \$4.5 million (2009 - \$2.5 million) of the \$5.0 million (2009 - \$3.0 million) facility available. The Company was in compliance with its financial covenants as at August 31, 2010 and for the year then ended.

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 has been obtained through a combination of cash, debt financing and the issuance of common shares.

At August 31, 2010 the Company had, in addition to its bank facilities, on deposit \$4.3 million available to fund capital projects relating to existing stores as well as for working capital and acquisitions.

Operating Activities

Cash flow from operating activities in 2010 decreased to \$1.128 million from \$6.349 million in 2009. The decrease in cash flow from operating activities was primarily due to an increase in accounts receivable and inventory.

Financing Activities

Net cash expenditures used in financing activities was \$7.901 million in 2010 compared to \$4.530 million in 2009. The Company raised \$4.781 million net of financing costs, and used these funds and cash on hand to repay long term debt obligations totaling \$11.184 million. In addition the Company used cash totaling \$1.457 million for the repurchase of Company common shares through the normal course issuer bid. The cash used in financing activities in 2009 primarily related to the repayment of the convertible debenture \$8.450 million and long term debt and bank indebtedness of \$3.415 million, offset by shares issued through reinvestment of capital of \$8.568 million.

Investing Activities

Net cash used in investing activities was \$3.922 million in 2010 compared to cash provided by investing activities of \$12.620 million in 2009. The cash used in investing activities in the current year relates primarily to the purchase of capital assets of \$2.515 million and intangible assets of \$1.428 million. The cash provided by investing activities in the prior year relates primarily to the conversion of the debenture in the first quarter in which \$13.830 million of funds previously held in escrow were released to the Company, net of capital and intangible asset expenditures of \$1.813 million.

Future Liquidity

The Company estimates that sufficient means exist to satisfy the Company's working capital needs, a limited number of acquisitions or greenfield developments and debt-service requirements for the coming fiscal year. Further acquisitions or greenfield developments may require additional debt and equity financing to ensure compliance with credit facility covenants. The Company remains subject to future impact of pharmacy reform and how it impacts the Company's ability to raise new debt or equity financing, or refinance existing debt.

The Company has secured a three year credit facility with a \$5.0 million operating line, \$5.0 million term loan and \$15.0 million acquisition facility effective April 6, 2010 with interest rates of prime plus 1% to prime plus 2% which is adjusted every quarter dependent on Company specific covenants outlined in the agreement. The term loan is payable in quarterly principal installments amortized over five years from advance date. Advances under the acquisition facility are payable in quarterly principal installments amortized over five years from each advance date. The facility 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.

TRANSACTIONS WITH RELATED PARTIES

During 2010, the Company expensed \$0.183 million (2009 - \$0.15 million) a year for advisory services. During the year, the Company also expensed \$0.200 million (2009 - \$nil million) for executive services provided by Canterbury Park Management Inc. Canterbury Park Management Inc. provides management services as a shareholder.

For the year ended August 31, 2010, the Company had no expenses from members of the Board of Directors for consulting services (2009 - \$0.14 million to one member of the Board of Directors for consulting services). The Company also paid \$0.19 million for the year ended August 31, 2010 (2009 - \$0.19 million) 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 with GAAP.

Thousands of dollars (except per share amounts)	Fourth Quarter		Third Quarter		Second Quarter		First Quarter	
	2010	2009	2010	2009	2010	2009	2010	2009
Revenue	20,260	20,532	20,947	21,615	20,785	22,204	20,926	21,783
EBITDA	632	965	890	1,529	976	1,110	1,061	303
- EBITDA per share - Basic	\$0.01	\$0.01	\$0.01	\$0.02	\$0.01	\$0.01	\$0.01	\$0.01
- EBITDA per share - Diluted	\$0.01	\$0.01	\$0.01	\$0.02	\$0.01	\$0.01	\$0.01	\$0.01
Net (loss) income	(1,063)	(469)	(584)	171	(464)	(401)	(483)	(6,558)
- Net loss per share - Basic	(\$0.01)	(\$0.01)	\$0.01	\$0.00	(\$0.01)	(\$0.01)	(\$0.01)	(\$0.13)
- Net loss per share - Diluted	(\$0.01)	(\$0.01)	\$0.01	\$0.00	(\$0.01)	(\$0.01)	(\$0.01)	(\$0.13)

* Prior quarters adjusted for Goodwill and intangible assets Section 3064 accounting policy change noted in the consolidated financial statements

The Company experienced a loss of \$1.063 million in the fourth quarter as compared to a loss of \$0.469 million in the same period in 2009. In the fourth quarter, the Company realized operating income of \$1.935 million (2009 - \$2.156 million) as a result of a 1.3% decline in total revenues partially offset by a 0.3% increase in gross margin as a percentage of revenue. Corporate costs were \$1.303 million for the fourth quarter (2009 - \$1.191 million). This increase over the prior year is mainly due to increases in information technology of \$0.137 million, and public company costs of \$0.054 million offset by decreased spending on wages and benefits.

RISKS AND RISK MANAGEMENT

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

General economic conditions

The Company currently operates in Western Canada and has been subject to the impact of the economic downturn and decrease of discretionary spending available to its customer base. Should these conditions continue to prevail, there will be further pressure on the Company's profitability.

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.

On April 1, 2010 a new Chief Executive Officer (CEO), Mr. R. Gordon Gooding, was appointed for the Company. Mr. Gooding brings extensive experience in the retail sector having served as CEO, President and Chief Financial Officer of a U.S. retail organization he established and grew to a 50-store chain. Despite Mr. Gooding's extensive knowledge in merchandising and general management and his strong financial background, the Company may be exposed to the risks associated with transition to new leadership such as change of management style and amended strategic focus.

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.

Financial covenants in lending agreements

The Company is dependent upon continued access to capital on terms acceptable to the Company, including bank indebtedness and lending facilities. There is no assurance that the Company will be able to comply with any or all financial covenants in the future. Should it not be able to meet covenants or arrange for 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 and specialized pharmacy equipment and software. 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 exposure 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 dollars.

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 Provincial jurisdictions in which the Company operates have undergone regulatory reform over the past several months.

On December 12, 2008, the British Columbia government announced an interim agreement that initially was to expire on December 31, 2009. The agreement was extended to July 28, 2010. The agreement specified no tendering of generic drugs for the duration of the interim agreement, it reduced the allowances paid on newly approved (approved after January 1, 2009) generic molecules, and it limited the capitation on daily and weekly dispensing fees effective February 1, 2009. This agreement has impacted revenues and margins by an estimated \$1.110 million since inception and \$0.700 million of that estimated to have impacted the twelve months ended August 31, 2010.

In British Columbia, on July 9, 2010, the Ministry of Health Services announced a new long term agreement relating to the pricing of generic drugs and a fee schedule for services provided by pharmacists. The British Columbia strategy aims to reduce generic drug prices and make improvements to the drug system to benefit all residents of the province. The agreement limits the price of generic drugs previously set at up to 70% of the brand name equivalent, to 35% in step down phases over the next two year period. To help preserve the future viability of the community pharmacy, an increase in dispensing fee reimbursements by PharmaCare to pharmacies is also included in the agreement. Dispensing fees will increase from current rate of \$8.60 per prescription to \$10.50 gradually through April 2, 2012. Expansion of clinical pharmacy services is also expected and will be defined over the course of the agreement.

Management's Discussion and Analysis *(continued)*

The recently announced changes in British Columbia have been assessed to determine their impact on both Paragon's profitability and future strategy. The Company is working with its supply chain partners to develop more effective supply chain strategies that may help ensure that there is only moderate impact from these regulatory changes.

While regulatory changes do pose significant risks to Paragon's economic model, they also provide for new and alternative revenue stream opportunities. The Company is currently working to expand its scope of pharmacy practice to take advantage of these additional funding programs that are being simultaneously introduced. Companies such as Paragon with capital to implement changes to take advantage of these opportunities are positioned to succeed.

Alberta is also in the process of developing a new pharmaceutical strategy and announced Phase 2 of its strategy on October 20, 2009. The Alberta strategy aims to reduce prescription drug costs for Alberta residents, employers and government, improve prescription drug use and provide better care and improved health of all individuals in the province. The strategy also targets generic drug spending. With many new generic drugs coming available in the next three to five years, the Alberta government wants to reduce spending on generics. The strategy limits the price of new generic drugs, added to the Alberta Drug Benefit List after October 1, 2009 at 45% of the brand name product, which was previously set at 75%. Alberta has provided certain transitional and regional relief which will initially mitigate the effect of the changes announced to date.

Further reductions to generic drug pricing were announced. Effective April 1, 2010, the prices of existing generic drugs have been limited to 56% of the brand name product. Paragon, other pharmacy service providers and pharmacy focused organizations continue to discuss opportunities to better utilize 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.

The Company is also monitoring possible Manitoba regulatory change in reaction to the latest announcements in Alberta and British Columbia; however, no change has been announced at this time.

Effective January 1, 2009, tobacco sales in Alberta were 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

In March 2009, the Canadian Accounting Standards Board announced it has agreed to adopt recent amendments to International Financial Reporting Standards ("IFRS") 7, Financial Instruments: Disclosures, into Section 3862, Financial Instruments – Disclosures. The amendments to Section 3862 will apply to annual financial statements for years ending after September 30, 2009. The amendments require that an entity disclose the classification, for each class of financial instrument, of fair value measurements within a fair value hierarchy. The hierarchy includes three levels: Level 1 – quoted prices in active markets for identical assets or liabilities, Level 2 – measurements determined using valuation models that employ observable inputs and Level 3 – measurements determined using valuation models that employ unobservable inputs. The Company has adopted this standard and has reflected the required changes to its disclosures in the consolidated financial statements.

The Company adopted a new accounting standard Handbook Section 3064 "Goodwill and Intangible Assets". This section replaces the existing guidance on goodwill and other intangible assets and research and development costs, and provides additional guidance on measuring the cost of goodwill and intangible assets. Section 1000, "Financial Statement Concepts", was also amended to provide consistency with this new standard to clarify the criteria for recognition of an asset and the timing of expense recognition.

Following the adoption of Section 3064, the Company reclassified the net carrying value of computer software that met the definition of intangible assets from capital assets to intangible assets on the consolidated balance sheet. The Company also wrote-off pre-operating costs through opening deficit. The prior year's net loss for the year ended August 31, 2009 was restated to recognize pre-operating costs relating to new store openings as operating expenses and to eliminate the amortization of pre-operating costs in the interim consolidated statement of operations.

Cumulative adjustments, following the adoption of Section 3064, to the consolidated balance sheet as at August 31, 2009 and to the consolidated statements of operations and cash flows for the year ended August 31, 2009, are disclosed in Note 3 of the August 31, 2010 audited financial statements.

FUTURE ACCOUNTING PRONOUNCEMENTS

In January 2009, the CICA issued new accounting standards concerning Business Combinations and Consolidated Financial Statements which is based on International Financial Reporting Standards "IFRS" IAS3 and IAS27. The new section replaces existing guidance on accounting for business combinations, the preparation of consolidated financial statements and accounting for non-controlling interests. The standards are effective for fiscal years beginning on or after January 1, 2011. The Company will apply the new accounting standards at the beginning of its 2011 fiscal year.

Management's Discussion and Analysis *(continued)*

In February 2008, the Accounting Standards Board ("AcSB") of Canada confirmed that International Financial Reporting Standards will replace Canadian GAAP for Canadian publically accountable enterprises effective for fiscal years beginning on or after January 1, 2011. The Company will implement these standards on September 1, 2011.

In accordance with IFRS, the Company will be required to report its results commencing with its fiscal year ending August 31, 2012, with the quarter ending November 30, 2011 being the first set of consolidated financial statements prepared under IFRS. Comparative figures for the quarter ending November 30, 2010 and year ended August 31, 2011 also need to be restated and presented, including an opening balance sheet as at September 1, 2010 reconciled from current Canadian GAAP to IFRS. For the year ended August 31, 2011 and comparative year ended August 31, 2010, the Company will continue to report its results in accordance with Canadian GAAP.

The Company commenced its process to transition to IFRS and developed an implementation plan of five phases, which in certain cases will be in process concurrently. The five phases are: (1) preliminary diagnostic and scoping; (2) detailed evaluation and design; (3) solution development; (4) integration; and (5) post-implementation review. To date, the Company is progressing according to its implementation plan, has completed the first phase and is beginning to work through the detailed evaluation and design. Below is a summary of the key deliverables for each phase, along with the project status.

1. Preliminary diagnostic and scoping phase. The Company completed this phase in the fourth quarter of fiscal 2010. During this phase, the Company: (1) developed its project structure; (2) established an estimated timeline for the plan completion; (3) created a project team to plan for and achieve a smooth transition to IFRS; (4) engaged a public accounting firm to assist with the high-level assessment of the significant differences between Canadian GAAP and IFRS specific to the Company; and (5) prioritized potentially affected areas based on their financial reporting impact, business impact and overall complexity to the Company.
2. Detailed evaluation and design phase. The Company will commence this phase in the first quarter of fiscal 2011 and plans to: (1) evaluate the IFRS standards, including the transitional provisions of IFRS 1, First-time Adoption of International Financial Reporting Standards; (2) assess policy alternatives allowed under the standards and any resulting impact to the Company; (3) select accounting policies when alternatives are available; and (4) develop draft IFRS consolidated financial statements and note disclosures. Any potential choice of policies and optional exemptions recommended during this phase will be reviewed by the Company's Audit Committee.
3. Solution development phase. The Company will commence this phase concurrent with many of the phase 2 activities in fiscal 2011 and plans to: consider the impact of the IFRS conversion on the Company's business processes, including information technology and data systems, internal control over financial reporting, disclosure control and procedures, financial reporting expertise, and other business activities; (2) develop and document solutions to each business process; and (3) quantify the impact of accounting policies chosen under IFRS at the date of transition and thereafter. Any significant impacts identified during this stage will be reviewed by the Audit Committee.

Management's Discussion and Analysis *(continued)*

4. Integration phase. The Company will commence this phase after the completion of the second and third phases. This phase of the work plan will include: (1) the approval, testing, and execution of solutions to each business process identified in the third phase; and (2) the collection of financial information necessary to compile IFRS compliant financial statements, including any information required to reconcile Canadian GAAP to IFRS at transition. The Company's Audit Committee will review and approve the IFRS-compliant financial statements.
5. Post-implementation review phase. The Company will commence this stage after the changeover to IFRS and completion of the fourth phase. This phase involves assessing and evaluating the overall project performance.

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 Chief Executive Officer ("CEO") and the Director of Finance and Administration 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 CEO and the Director of Finance and Administration concluded that the disclosure controls and procedures as at the end of the period covered by the annual 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.

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. Management believes this is a typical issue for smaller companies.

Notwithstanding the above control weaknesses, the CEO and Director of Finance and Administration 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 Board of Directors together with the Audit Committee have direct oversight responsibilities for the review and approval of the quarterly and annual financial disclosures.