

PARAGON PHARMACIES LIMITED

MANAGEMENT DISCUSSION & ANALYSIS FOR THE YEAR ENDED AUGUST 31, 2008

As at November 28, 2008

The following is a discussion of the consolidated financial condition and results of operations of Paragon Pharmacies Limited (the “Company”) for the year ended August 31, 2008. 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, 2008. 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.

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, loss from discontinued operations 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.

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

Management's Discussion and Analysis *(continued)*

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 500 full and part time staff in its stores and offices. The Corporation owns and operates 18.5 retail pharmacies, 3 central fill locations and 2 home healthcare operations in British Columbia, Alberta and Manitoba.

STRATEGY AND OUTLOOK

The past year presented both growth opportunities and challenges for Paragon.

The company made significant investments in the institutional pharmacy services sector, and is now a major provider of such services to long-term care homes and other similar institutions in Western Canada. These investments, coupled with the acquisition of an additional retail pharmacy, reflect Paragon's strategy to align its business with the demographic trends of Canada's aging population and Canadians' desire to lead more healthy and active lifestyles.

As part of this strategy, the company continued to expand its Paragon Community Pharmacy brand, introduced a new private label program, and invested in store upgrades in various locations. Early this fall, Paragon opened a flagship store in Kelowna, British Columbia reflecting its continued commitment to grow the company.

While Paragon's top line revenue continues to grow, including steady same-store growth, more work is required to ensure strong financial results and increased profitability. Delays in re-branding and integration plans, coupled with the management of complex financing arrangements and difficult markets have highlighted the need to re-focus. In this regard, the company completed the conversion of Canterbury Park's debenture, which will both significantly simplify its accounting and provide Paragon with the necessary capital resources to execute its business plan. On the management side, the company announced the appointments of Lorraine McGrath as President and Ron Lane as President of Operations. Their combined experience in banking and finance, pharmacy and retail operations will orient the company to secure bottom line growth. Working with other members of the management team, the newly appointed leadership will continue to build a strong community pharmacy chain and enhance the value proposition for both its customers and its shareholders.

The priority of the new leadership team is to complete the integration of the new acquisitions, standardize operational processes and finalize the re-branding of new acquisitions in order to expand the Paragon Community Pharmacy brand. The company will focus on gross margin improvement through the streamlining of operations, the expansion of its own private label product lines and the development of a service value proposition for its customers. This in turn will allow the company to continue to re-invest in new opportunities and income enhancing acquisitions.

SUMMARY

Key Operating, Investing and Financials Metrics

The following provides a summary of the Company's performance for the year ended August 31, 2008 compared to the year ended August 31, 2007.

- Revenue from continuing operations of \$83.718 million (2007: \$66.146 million), an increase of 26.6%
- Same store revenue growth of 6%
 - Same store pharmacy revenue growth of 11%
 - Same store front store revenue¹ growth of nil%
- Gross margin² as a percentage of revenue of 33.8% (2007: 32.9%), an increase of 0.9%
- Operating income³ of \$5.878 million (2007: \$4.787 million), an increase of 22.8%
- EBITDA⁴ of \$1.393 million (2007: \$2.093 million), a decrease of 33.4%

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, other items as defined, and loss from discontinued operations.

Fourth Quarter

- During the quarter the Company continued with the expansion of the Paragon Community Pharmacy brand with the re-branding of its 2 retail pharmacies in Manitoba.
- The Company continued with construction of a new 12,000 square foot retail pharmacy, including a third party medical clinic in Kelowna. The store opened in October 2008 and brings total retail square footage to approximately 130,000 square feet. The clinic opened in November 2008.
- In August 2008, through successful execution of the previously announced debt repurchase agreement, the Company acquired and cancelled 8,000,000 shares representing approximately 20% of the outstanding share capital.
- In November 2008, the company announced the completion of the note conversion and share subscription agreement that eliminated the \$20-million convertible debenture and resulted in an increase in available cash of approximately \$13.5 million.
- Following Craig Cameron's announcement regarding his intention to step down as President and CEO, the Company embarked on a search process resulting in the appointments in November 2008 of Lorraine McGrath as President and Ron Lane as President of Operations.

Management's Discussion and Analysis *(continued)*

- On November 28, 2008 the Company announced a loss of \$10.125 million for the year ended August 31, 2008, including \$4.029 million in the fourth quarter (see "Summary of Quarterly Information").

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)	2008	2007	2006
Revenue	\$83,718	\$66,146	\$37,777
Operating income ¹	5,878	4,787	1,930
Net loss	(10,125)	(3,575)	(1,622)
- Net loss per share - Basic	(\$0.24)	(\$0.10)	(\$0.10)
- Net loss per share – Diluted	(\$0.24)	(\$0.10)	(\$0.10)
Total assets	62,837	57,787	34,055
Total long-term financial liabilities ^{2,3}	31,132	20,578	7,978
Cash dividends	Nil	Nil	Nil

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 Does not include current portion of long-term financial liabilities: 2008: \$2,327; 2007: \$2,824; 2006: \$3,099.

³ Includes convertible debenture of 2008: \$17,233 2007:\$14,732. This liability was eliminated in November 2008 through the conversion and repayment of the debenture and the issuance of equity

2008

In fiscal 2008, total revenue increased 26.6% and operating income increased 22.8% from 2007, reflecting the new acquisitions of Teulon, Alentex and the Okanagan and WestCoast central fills as well as Nordic for a full year in 2008. Total same store revenue was up 6% with pharmacy same store revenue up 11% and front store same store revenue (all non-pharmacy revenue) flat year over year.

Included in total net loss for 2008 and 2007 were interest and accretion expenses of \$7.527 million and \$2.322 million respectively. On November 14, 2008, the Company has announced it had eliminated this debenture through execution of a note conversion and subscription agreement with Canterbury Park (see "Subsequent Events").

2007

In fiscal 2007, total revenue increased 75.1% and operating income increased 148.0% from 2006, reflecting the first full year of operations of the Super Drug Mart stores in Alberta. Total same store revenue was up 8.0% with pharmacy same store revenue up 8.1% and front store same store revenue (all non-pharmacy revenue) up 7.8% reflecting the growth in the BC pharmacies.

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	2008	2007	\$ Change	% Change
Revenue	83,718	66,146	17,572	26.6%
Gross Margin	28,300	21,741	6,559	30.2%
Operating Expenses ¹	22,422	16,954	5,468	32.3%
Operating Income	5,878	4,787	1,091	22.8%
Corporate and other costs	4,485	2,694	1,791	66.5%
EBITDA ²	1,393	2,093	(700)	(33.4%)
Stock-based compensation	121	200	(79)	(39.5%)
Interest and accretion expense	7,936	2,856	5,080	177.9%
Other Items	(229)	375	604	161.1%
Loss from continuing operations	(10,125)	(3,497)	(6,628)	(189.5%)
Loss from discontinued operations	Nil	(78)	78	100.0%
Net loss and comprehensive loss	(10,125)	(3,575)	(6,550)	(183.2%)
EBITDA per common share				
- Basic	\$0.03	\$0.06	(\$0.03)	(50.0%)
- Diluted	\$0.03	\$0.06	(\$0.03)	(50.0%)
Loss per common share				
- Basic	(\$0.24)	(\$0.10)	(\$0.14)	(140.0%)
- Diluted	(\$0.24)	(\$0.10)	(\$0.14)	(140.0%)

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

² EBITDA defined as earnings before interest expense, income taxes, amortization, stock based compensation, other items as defined and loss from discontinued operations.

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

thousands	2008	2007
Net loss	\$ (10,125)	\$ (3,575)
Add (deduct) the following:		
Interest and accretion expense	7,936	2,856
Amortization	3,690	2,159
Stock based compensation	121	200
Other items	(229)	375
EBITDA	\$ 1,393	\$ 2,093

Revenue

Revenue is comprised of sales to customers of the Company's retail pharmacies, home health care stores and central fill pharmacies. Revenue was \$83.718 million in 2008 compared to \$66.146 million in 2007, an increase of \$17.572 million or 26.6%. Increases were a result of growth in same store revenue and the Alentex, Teulon, and Central Fill acquisitions in 2008 as well as a full year of operations for Nordic (that operated for 6 months in 2007).

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 stores and central fill pharmacies. Gross margin was \$28.300 million in 2008 compared to \$21.741 million in 2007, an increase of \$6.559 million or 30.2%. This was primarily a result of the acquisition of the Alentex, Teulon and Central Fill acquisitions in the current fiscal year as well as a full year of operations for Nordic (that operated for 6 months in 2007). Gross margin as a percentage of revenue increased to 33.8% from 32.9% in 2007 due to the increase in revenue from higher margin pharmacy revenues.

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 \$22.422 million in 2008 compared to \$16.954 million in 2007, an increase of \$5.468 million or 32.3%. This was primarily a result of the acquisition of the Alentex, Teulon and Central Fill acquisitions in the in 2008 as well as a full year of operations for Nordic (that operated for 6 months in 2007). Operating expenses as a percentage of revenue were 26.8% compared to 25.6% for 2007.

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 \$5.878 million in 2008 compared to \$4.787 million in 2007, an increase of \$1.091 million or 22.8% for the reasons noted above.

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 \$4.485 million in 2008 compared to \$2.694 million in 2007, an increase of \$1.791 million or 66.5%. This increase is a result of multiple factors related primarily to a full year of corporate and other costs related to the Super Drug Mart acquisition, increased head office personnel complement, increased corporate and marketing expenditures to accommodate planned growth, an increase in professional and advisory fees and other public company related costs, and increased costs related to corporate acquisition activities.

EBITDA

EBITDA was \$1.393 million in 2008 compared to \$2.093 million in 2007, a decrease of \$0.700 million or 33.4%. The reduction in EBITDA was primarily a result of increased 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.

Management's Discussion and Analysis *(continued)*

Financing costs on the convertible debenture were all non-cash and were comprised of accretion, accrued interest, and amortization of financing costs. Total financing costs on the convertible debenture were \$7.527 million in 2008 compared to \$2.322 in 2007 and included accretion of \$3.557 million, accrued interest of \$3.223 million, and \$0.747 million of amortization of financing costs.

Interest and accretion expense, excluding amounts related to the convertible debenture, were \$0.409 million compared to \$0.534 million in 2006, a decrease of \$0.125 million. Bank charges and interest were \$0.229 million (2007 - \$0.156 million); interest and amortization of related financing costs on long-term debt was \$0.848 million (2007 - \$0.659 million) due to higher debt levels; and interest income was \$0.668 million (2007 - \$0.281 million) due to interest on restricted cash being earned for a full year in 2008.

Amortization

Amortization of capital and intangible assets were \$3.690 million in 2008 compared to \$2.159 million in 2007, an increase of \$1.531 million or 70.9%. This increase is primarily a result of a amortization on the capital and intangible assets acquired in the Alentex, Teulon and Central Fill acquisitions during the year and a full year amortization of similar items for Nordic.

Stock based compensation

Stock based compensation was \$0.121 million in 2008 compared to \$0.200 million in 2007, a decrease of \$0.079 million or 39.5%.

Net loss

The net loss was \$10.125 million compared to a net loss of \$3.575 million in 2007, an increased loss of \$6.550 million or 183.2%. Of the increased loss, \$5.205 million is attributable to a full year of costs for the convertible debenture, including an increase in certain interest costs in May 2008, and \$1.791 million to operating activities stemming from increased corporate and other costs.

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

	August 31, 2008	August 31, 2007
Cash	\$541	\$2,834
Restricted cash	13,728	20,111
Bank indebtedness	921	-
Current portion of long-term liabilities	2,459	2,823
Long-term liabilities ¹	38,656	27,879
Net debt ²	27,767	7,757
Shareholders' equity ³	10,789	21,645
Total capitalization	38,556	29,402
Net debt: Shareholders' equity	2.56:1	0.36:1
Net debt: Total capitalization	0.72:1	0.26:1
EBITDA: Cash interest expense ⁴	3.97:1	3.92:1

¹ Includes the equity portion of the convertible debenture of 2008: \$7,524; 2007: \$7,301.

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 Excludes the equity portion of the convertible debenture of 2008: \$7,524; 2007: \$7,301.

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 39,407,043 common shares outstanding at August 31, 2008 (see also "Share cancellation" and "Subsequent events") and outstanding options to acquire 1,201,000 of its common shares and outstanding warrants to acquire 4,725,000 of its common shares. Further details are available in Note 15 of the audited consolidated financial statements as at August 31, 2008.

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, and that 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, 2008, the Company had issued letters of credit aggregating \$0.5 million (2007 - \$0.5 million) and had cheques issued in excess of funds on deposit of \$0.9 million, leaving \$1.6 million of the \$3 million facility available.

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. During the previous year the Company issued a convertible debenture, the proceeds of which were restricted for future acquisitions and which required matching senior debt (see also "Subsequent event").

During the second quarter, the Company secured a \$7.5 million revolving loan to be used for acquisitions to be matched with the convertible debenture funds on a dollar for dollar basis. To date, approximately \$7.1 million of this loan was drawn. As a result of amendments to its banking arrangements subsequent to year end, no further amounts may be drawn upon this revolving loan.

Subsequent to year end, the Company obtained an amendment to the Senior Debt Covenants effective for the quarter-ended August 31, 2008. The Company is in compliance with the amended covenants. Prior to receiving the amendment, the Company was not in compliance with its financial covenants as at August 31, 2008. See also "Subsequent Events".

Operating Activities

Cash flow from operating activities in 2008 increased to \$3.528 million from \$2.224 million in 2007. The increase was primarily due to cash flow generated from the Company's acquisitions in 2007 and 2008, including changes in non-cash working capital.

Financing Activities

Cash flow from financing activities in 2008 decreased to \$4.538 million from \$21.462 million in 2007. In 2008, the Company increased debt through its revolving loan by \$7.060 million to fund acquisition activities as well as increasing its operating line by \$0.921 million to fund day to day operations and its capital program. The Company also repaid \$1.667 of its term loan and \$0.748 of other long-term obligations. In 2007, the Company realized a net amount of \$18.246 million on the issuance of the convertible debenture and \$5.659 million from the issuance of common shares.

Investing Activities

Cash flow expended on investing activities in 2008 decreased to \$10.359 million from \$20.938 million in 2007. In 2008, the Company expended \$14.173 million on three significant acquisitions as well as expending \$2.717 million on capital assets, including the leasehold improvements related to its new Centuria store in British Columbia and upgrades to its Glen Park store in British Columbia and its Strathmore store in Alberta. It was able to draw upon \$7.051 million of restricted cash to apply to the acquisitions. In 2007, the company increased restricted cash by the funds received from the convertible debenture issue and related interest income while using \$1.815 million to fund acquisitions and \$0.792 million to fund new capital assets.

Convertible Debenture

In May 2007, the Company issued a \$20.0 million convertible debenture ("Convertible Debenture") to Canterbury Park Capital L.P. and Canterbury Park Capital (US) L.P. (collectively "Canterbury"). The Convertible Debenture had a term of two years and bore interest at 15% per annum, compounded annually and maturing in May 2, 2009. There was a provision in the debenture that if 50% of the principal amount was not expended within 360 days of its issuance, then the holder, at its option, could demand repayment of the unspent funds along with interest to be paid in cash. If the holder demanded repayment of these funds, there was an interest rate

Management's Discussion and Analysis *(continued)*

increase of 5% which would bring the total interest rate to 20% from original issuance until the Company made the repayment of the unspent funds, including interest.

By May 2, 2008, the first anniversary date of the Convertible Debenture, the Company had not met the requirement of spending 50% of the funds on acquisitions and therefore the unspent funds became payable upon demand with a corresponding interest rate increase of 5% retro-active to the original date of the issuance. The Company and Canterbury agreed to terms and conditions by which the Company retained the unspent funds. On May 5, 2008, as per the terms of the agreement, interest was paid on the debenture funds for the first year in the amount of \$3.0 million through the issuance of 6,322,445 common shares to Canterbury. The interest rate on the unspent funds accrued at 20% and the interest on the spent funds accrued at 15%. In addition, the contingent exposure of up to \$1,000,000 for inventory valuation penalties and certain other adjustments, as disclosed in Note 20 of the February 29, 2008 Interim Financial Statements of the Company, was eliminated.

Funds from the Convertible Debenture financing were restricted for future acquisitions as reviewed and approved by the Board of Directors and thus were not available for general corporate purposes. Cash from the issuance of the debentures, to the extent not invested, had been held in escrow and its use restricted.

On November 14, 2008, the Company announced that it had concluded with Canterbury a note conversion and share subscription agreement. The agreement provided the Company with approximately \$13.7 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. The agreement resulted in:

- 1) a conversion of \$11,550,000 million principal convertible notes ("the Converted Notes") that Canterbury held to Paragon common shares at \$0.8028 per share for an aggregate of 14,387,145 Paragon common shares;
- 2) accrued interest and accrued interest adjustment on the Converted Notes in the aggregate of \$2,159,055, convertible at \$0.35 per share for an aggregate of 6,168,729 Paragon common shares;
- 3) a conversion inducement fee equal to forgone interest for early conversion at the rate otherwise payable to the scheduled maturity of May 2, 2009 and an agreed interest adjustment amount, in the aggregate of \$1,374,170, convertible at \$0.35 per share for an aggregate of 3,926,200 Paragon common shares; and
- 4) a repayment to Canterbury of \$8,450,000 million principal convertible notes plus accrued interest of \$316,486 with an immediate reinvestment in Paragon common shares of these amounts by way of private placement at \$0.26 per common share, resulting in issuance of an aggregate of 33,717,264 Paragon common shares.

As a result of the agreement, Canterbury increased its ownership in Paragon from 25.6% (undiluted) to approximately 70% (undiluted) of the outstanding common shares.

A condition of the agreement was a successful negotiation of amendments to the Company's credit facility. The amendments include a change in the method of calculating the Company's credit facility covenants effective August 31, 2008, resulting in the Corporation meeting its covenants for the quarter ended on that date. The amendments also altered the pricing on the

Management's Discussion and Analysis *(continued)*

Company's bank debt. Amounts outstanding on the term loan and revolving facility will now bear interest at prime plus 1.50% and amounts outstanding under the operating line will bear 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 and has been reclassified as a current asset.

Share cancellation

Paragon and a third party pharmaceutical supplier entered into a Debt Purchase Agreement on December 19, 2007 whereby the Company agreed to acquire from the third party pharmaceutical supplier a loan in the principal amount of \$7,139,000 owing by Autonomy Pharma Inc. ("Autonomy") to the third party pharmaceutical supplier (the "Autonomy Loan"). The purchase price pursuant to the Debt Purchase Agreement was \$4,139,000, with a cash payment of \$139,000 on closing and the \$4,000,000 balance of the purchase price being deferred and payable over a ten year period ending September 30, 2017. Interest is to accrue at the rate of 6% per annum, payable annually on August 31st of each year.

The security for the Autonomy Loan included a pledge of 8,000,000 Paragon Pharmacies Limited common shares registered in the name of Autonomy ("the Shares") having a deemed value of \$4,400,001 and warrants to purchase an additional 2,000,000 Paragon Pharmacies Limited common shares ("the Warrants") at a price of \$1.25 per share. In exchange, the Company and Autonomy agreed that the cancellation of these securities results in the partial satisfaction of \$4,400,000 of the Autonomy Loan.

On August 29, 2008, Autonomy transferred the Shares into 1405257 Alberta Ltd. The Company purchased all of the 1405257 Alberta Ltd. shares and, as consideration, Autonomy received a non-interest bearing promissory note from the Company in the principal amount of \$4,400,001 (the "Autonomy Note"). The Company and Autonomy entered into a debt set off agreement, whereby the Autonomy Note was set off against the equivalent amount of the Autonomy Loan and, as a result, the principal amount of the Autonomy Loan after the set off is \$2,738,999, which will remain owing by Autonomy to Paragon and remain subject to the Autonomy security. The Company may claim against Autonomy for this amount but at this time the Company does not believe that Autonomy has assets that are available to repay any additional portion of the Autonomy Loan and thus has not recorded this amount as a loan receivable.

Upon amalgamation, the Company cancelled the Shares and the Warrants and paid the major third party pharmaceutical supplier the cash portion of the purchase price of \$139,000 pursuant to the Debt Purchase Agreement.

Future Liquidity

Based on forecasted operations and the additional liquidity available to the company, as of November 28, 2008 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

For the year ended August 31, 2008, the Company recorded an expense of \$0.2 million (2007 - \$0.1 million) for advisory fees due to Canterbury Park Management Inc. Canterbury Park Management Inc. is the manager of the holders of the Convertible Debenture who are significant shareholders of the Company.

For the year ended August 31, 2008, the Company expensed \$63,000 (2007 - \$Nil) paid to two members of the Board of Directors for consulting services. The Company also paid \$0.3 million (2007 - \$0.3 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 GAAP.

Thousands (except per share amounts)	Fourth Quarter		Third Quarter		Second Quarter		First Quarter	
	2008	2007	2008	2007	2008	2007	2008	2007
Revenue	22,094	16,957	22,357	17,067	21,590	16,209	17,677	15,913
EBITDA	(984)	(39)	957	380	1,105	829	315	923
- EBITDA per share - Basic	(\$0.03)	\$0.00	\$0.02	\$0.01	\$0.03	\$0.02	\$0.01	\$0.03
- EBITDA per share - Diluted	(\$0.03)	\$0.00	\$0.02	\$0.01	\$0.03	\$0.02	\$0.01	\$0.03
Net (loss) income	(4,029)	(2,513)	(2,406)	(1,058)	(1,797)	82	(1,893)	(86)
- Net loss per share - Basic	(\$0.09)	(\$0.07)	(\$0.06)	(\$0.03)	(\$0.04)	\$0.00	(\$0.05)	\$0.00
- Net loss per share - Diluted	(\$0.09)	(\$0.07)	(\$0.06)	(\$0.03)	(\$0.04)	\$0.00	(\$0.05)	\$0.00

The Company experienced a loss of \$4.029 million in the fourth quarter as compared to a loss of \$2.513 million in the same period in 2007. In the fourth quarter, the Company realized operating income of \$0.901 (2007 - \$1.062 million) that was impacted by reduced vendor rebates and provisions for certain front store inventory categories. Corporate costs were \$1.885 million (2007 - \$1.101 million) and reflected higher personnel costs and professional fees, a write-off of previously incurred corporate development activity costs and a reduction in estimated revenues under a new distribution agreement effective for fiscal 2008. Interest and accretion expense increased to \$2.288 million from \$1.868 million in 2007 due to higher levels of debt and an increase in the interest rate on a portion of the convertible debenture. Amortization was \$1.210 million (2007 - \$0.552 million) reflecting the increased capital and intangible assets acquired during the 2008 fiscal year. Lastly, other items were a gain of \$0.229 in 2008 versus a loss of (\$0.375) million in 2007, primarily due to a 2008 gain on the disposal of intangible assets of \$0.506 million.

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 favourable 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 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, general managers, 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 and merchandise management 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.

Breach of financial covenants

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 recent amendments to its banking agreement, the Company was in breach of certain financial covenants. There can be no assurance that the Company will be able to comply with such 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 has followed the lead of Alberta government by announcing that pharmacists will be able to adapt prescriptions effective January 2009. The move is 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. 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 pharmacy funding from pharmacies themselves. With the British Columbia government now forecasting a decline of \$3 billion in provincial revenues over the next three years, there is doubt that overall compensation for community pharmacy will be increased.

Alberta is also in the process of developing a provincial pharmaceutical strategy. Health and Wellness Minister Ron Liepert is expected to announce progress on that front as part of an update on his ministerial action plan in mid-December 2008. 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

Management's Discussion and Analysis *(continued)*

prescription exists in that province, the Ontario government is moving ahead with implementing "competitive agreements" that could further reduce drug store revenues by diverting a portion of generic allowances away from pharmacies and into public coffers. In early November 2008, the Ontario government awarded contracts of this nature for two commonly-prescribed molecules, Metformin and Enalapril.

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 will no longer be permitted from health care facilities, pharmacies, and stores that contain a pharmacy. The Company is committed to adhering to the federal Tobacco Reduction Act and will eliminate tobacco from its stores by the end of 2008.

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

Comprehensive Income/Financial Instruments

On September 1, 2007, the Company adopted the Canadian Institute of Chartered Accountants (CICA) handbook section 1530 "Comprehensive Income," section 3251 "Equity," section 3855 "Financial Instruments – Recognition and Measurement" and section 3865 "Hedges." These standards result in changes in the accounting for financial instruments and hedges as well as introduce comprehensive income as a separate component of shareholders' equity. As required, these standards have been adopted retroactively without restatement. Further details are available in Note 2 of the audited consolidated financial statements at August 31, 2008.

Inventory

As of September 1, 2007, the Company adopted *CICA Handbook Section 3031, Inventory*. This new standard is effective for interim and annual financial statements relating to fiscal years beginning on or after July 1, 2007. This new standard has no impact on the Company's consolidated financial statements.

Except for the adoption of new standards described above, the Company has not changed any accounting policies since August 31, 2007.

FUTURE ACCOUNTING PRONOUNCEMENTS

Effective September 1, 2008, the Company will be required to adopt several new accounting standards. These include Section 1535, "Capital Disclosures", and Section 1400 "General Standards of Financial Statement Presentation". The Company is assessing the impact of these new standards on its consolidated financial statements and anticipates the main impact will be in terms of additional disclosures required.

Effective September 1, 2008, the Company will also be required to adopt Section 3862 "Financial Instruments Disclosures" and Section 3863 "Financial Instruments Presentation". It is expected the only effect on the Company will be 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.

Lastly, 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.

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 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

Management's Discussion and Analysis *(continued)*

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. 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.

Lastly, in this challenged personnel environment the company has integrated several new acquisitions that have comprised differing accounting systems and financial operating policies and procedures.

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 full-time 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.