

PARAGON PHARMACIES LIMITED

MANAGEMENT'S DISCUSSION & ANALYSIS FOR THE THREE AND NINE MONTH PERIODS ENDED MAY 31, 2011

As at July 21, 2011

The following is a discussion of the consolidated financial condition and results of operations of Paragon Pharmacies Limited (the "Company") for the three and nine month periods ended May 31, 2011. This discussion and analysis should be read in conjunction with the Company's interim unaudited consolidated financial statements and accompanying notes for the three and nine month periods ended May 31, 2011. The interim unaudited consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP"). All references to dollars are in Canadian funds unless otherwise indicated. 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 expense, interest income, depreciation and amortization, stock based compensation, other items, 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 pharmacy industry. Management believes that non-GAAP financial measures assist in identifying underlying operating trends.

Management's Discussion and Analysis *(continued)*

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 Company owns and operates 19 retail pharmacies and three central fill pharmacies in British Columbia, Alberta and Manitoba.

STRATEGIES AND OUTLOOK

The pharmacy industry continues to change in response to the ongoing adjustments that are occurring to generic drug pricing models, shifting consumer needs and aging demographics. This transitioning environment provides growth opportunity for participants that have the ability to adapt to these current trends. Paragon's experienced management team and evolving strategies provides the Company with the resources to successfully adapt and grow in this changing market.

The Company continues to focus on business strategies designed to support revenue growth, build customer loyalty, develop its management team, improve profitability and expand brand awareness. This includes measures to improve our existing core business, while also working on initiatives that will evolve our retail model in response to emerging market trends.

The Company has improved service and processes through the adoption of innovative technology in its long term care operations. In the future, the Company will also begin to automate certain processes in its retail pharmacies to enhance quality control and improve efficiencies of those operations.

Using careful recruitment, and through the ongoing development of suitable employee policies, the Company continues to concentrate on building a team of executive and staff that provide sound management and progressive vision for the Company's future.

The hard work and dedication to customer service by the Company's pharmacy, front store, and post office employees are primary contributors to the Company establishing itself as a community pharmacy of choice in the markets in which it competes. To further improve customer service the Company will continue strengthening its training and development programs for employees. Recent changes to pharmacy regulations will allow the Company to expand its professional service offerings to its customers in support of their health and wellness goals, and the Company is actively moving forward on these opportunities.

To improve profitability the Company has put significant effort into improving its supply chain process and relationships in order to optimize gross margin rates over the past three quarters. As a part of that effort, the Company has entered into a number of new supply arrangements for both front store and pharmacy products. In addition, wholesale and distribution processes have been updated to provide the Company with direct control over purchasing programs and closer ties to its key vendors.

SUMMARY

Key Operating, Investing and Financial Metrics

The following provides a summary of the Company's performance for the three and nine month periods ended May 31, 2011 compared to the three and nine month periods ended May 31, 2010.

- Third quarter revenue of \$19.096 million (2010: \$21.025 million), a decrease of 9.2%.
 - Nine month revenue of \$58.865 million (2010: \$62.903 million), a decrease of 6.4%. (Refer to page 5 for further explanation)

Management's Discussion and Analysis *(continued)*

- Third quarter comparable store revenue decline of 8.8%; comparable store pharmacy revenue reduction of 11.6%; comparable front store revenue¹ decline of 2.4%.
 - Nine month comparable store pharmacy revenue reduction of 7.9%
 - Nine month comparable front store revenue¹ reduction of 2.9%. (Refer to page 5 for further explanation)
- Third quarter gross margin² as a percentage of revenue of 38.2% (2010: 38.3%), an decrease of 0.1%.
 - Nine month gross margin² as a percentage of revenue of 38.7% (2010: 37.3%), an increase of 1.4%. (Refer to page 5 for further explanation)
- Third quarter operating income³ of \$1.631 million (2010: \$2.151 million), a decrease of 24.2%.
 - Nine month operating income³ of \$6.023 million (2010: \$6.171 million), a decrease of 2.4%. (Refer to page 6 for further explanation)
- Third quarter EBITDA of \$0.438 million (2010: \$0.890 million), a decrease of 50.8%.
 - Nine month EBITDA of \$2.053 million (2010: \$2.927 million), a decrease of 29.9%. (Refer to page 6 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 expense, amortization, stock based compensation and other items.

Third Quarter

Third quarter activities included:

- The completion of the Company's largest medical clinic to date, a 5,500 square foot clinic adjacent to one of its locations in Calgary, Alberta. The clinic opened June 1, 2011. As well as having a staff of six full time doctors, the clinic includes an aesthetics clinic that will create significant synergy with the pharmacy's existing strong Botox practice.
- The Company began development of a health and wellness focused offering for its retail locations. The new Paragon Naturals line pilot program launched in July 2011 which introduces 20 feet of natural health solutions to the Company's front store product mix. This new offering includes a variety of natural health products such as natural vitamins and supplements, body care, homeopathy and food selections. In order to help market and support the new initiative, the Company will also be launching its Paragon Naturals health seminars. The Naturals seminars will be offered on a monthly basis throughout the year at each of the retail locations carrying the new natural health products, with the objective of driving additional sales to new and existing clientele.
- The Company continued to focus on the restructuring of its front store business with the development of systems to facilitate the comprehensive management of its pricing strategy, category management, merchandising strategy, and in-store execution.
- During the quarter, the Company recorded a provision of \$0.310 million in respect to two reviews currently being performed in respect to reimbursements of drug costs claimed under a provincial health program in 2010 (Refer to page 13).
- The Company continued to search for potential acquisition and development targets, and currently has several locations under evaluation.

Management's Discussion and Analysis *(continued)*

RESULTS OF OPERATIONS

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

(Thousands of dollars except per share amounts)	3 Months Ended		9 Months Ended	
	May 31, 2011 \$	May 31, 2010 \$	May 31, 2011 \$	May 31, 2010 \$
Revenue	19,096	21,025	58,865	62,903
Gross Margin	7,286	8,050	22,788	23,434
Operating Expenses ¹	5,655	5,899	16,765	17,263
Operating Income	1,631	2,151	6,023	6,171
Corporate and other costs	1,193	1,261	3,970	3,244
EBITDA ²	438	890	2,053	2,927
Stock-based compensation	17	1	20	2
Amortization	1,377	1,298	4,072	3,737
Interest expense ³	191	198	613	714
Other Items ⁴	1	(23)	(99)	5
Net loss	(1,148)	(584)	(2,553)	(1,531)
EBITDA per common share				
- Basic	\$0.00	\$0.01	\$0.03	\$0.03
- Diluted	\$0.00	\$0.01	\$0.03	\$0.03
Loss per common share				
- Basic	(\$0.01)	(\$0.01)	(\$0.03)	(\$0.02)
- Diluted	(\$0.01)	(\$0.01)	(\$0.03)	(\$0.02)

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 Q3-2011: \$0.019 million (Q3-2010: \$0.051 million), YTD-2011: \$0.077 million (YTD-2010: \$0.116 million); interest and amortization of related financing costs on long term debt Q3-2011: \$0.174 million, (Q3-2010: \$0.151 million), YTD-2011: \$0.546 million (YTD-2010: \$0.620 million) and interest income of Q3-2011: \$0.002 million (Q3-2010: \$0.004 million), YTD-2011: \$0.010 million (YTD-2010: \$0.022 million).

⁴ Other items include gain (loss) on disposal of capital and intangible assets of Q3-2011: \$0.001 million (Q3-2010: \$nil million), YTD-2011: \$0.100 million (YTD-2010 - \$0.028 million).

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

(Thousands of dollars)	3 Months Ended		9 Months Ended	
	May 31, 2011 \$	May 31, 2010 \$	May 31, 2011 \$	May 31, 2010 \$
Net loss	(1,148)	(584)	(2,553)	(1,531)
Add the following:				
Interest expense	191	198	613	714
Amortization	1,377	1,298	4,072	3,737
Stock based compensation	17	1	20	2
Other items	1	(23)	(99)	5
EBITDA	438	890	2,053	2,927

Management's Discussion and Analysis *(continued)*

Revenue

Revenue is comprised of sales to customers of the Company's retail pharmacies and central fill pharmacies. Revenue was \$19.096 million in the third quarter compared to \$21.025 million in the same period last year, a decrease of \$1.929 million or 9.2%.

Pharmacy revenue was impacted by reductions in generic prescription reimbursement rates, primarily due to regulatory reform implemented in British Columbia in the first quarter of 2011, combined with increased generic prescription utilization rates. Pharmacy revenues also declined due to a decrease in script volumes in some regions.

Front store revenue experienced a 1.5% decrease over the third quarter of 2010. The Company recognizes the need for more effective category management, improved pricing strategies, and stronger in-store execution. Management will continue to focus on improving these areas.

The Company continues to work on several initiatives to improve store competitiveness, including: working to improve its merchandising and promotions; 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.

Revenue for the nine month period ending May 31, 2011 was \$58.865 million compared to \$62.903 million for the same period last year, a decrease of \$4.038 million or 6.4%. Pharmacy revenue declined by 7.9% year over year, mainly due to British Columbia regulatory reimbursement reform and a decline in the number of prescriptions filled. Front store revenues declined year over year by 2.9% and continues to be the focus for improvement by the Company.

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 and central fill pharmacies. Gross margin was \$7.286 million in the third quarter compared to \$8.050 million in the same period last year, a decrease of \$0.764 million or 9.5%. This is the result of declined sales offset by a greater utilization of higher margin generic prescriptions compared to prior year. Gross margin was also impacted by the \$0.310 million audit contingency (Refer to page 3).

Gross margin as a percentage of revenue decreased to 38.2% from 38.3% in the same period last year partially due to declined margin contribution from lower sales which was offset by increased pharmacy revenue sales resulting from higher margin generic prescriptions.

Gross margin was \$22.788 million for the nine month period compared to \$23.434 million for the same period last year, a decrease of \$0.646 million or 2.8%. This was primarily a result of declined sales offset by improved pharmacy margins due to increased availability of higher margin generic drugs combined with a 1.4% improvement in gross margin as a percentage of front store sales. Overall gross margin increased to 38.7% from 37.3% in the same period last year.

Operating Expenses

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

Operating expenses were \$5.655 million in the third quarter compared to \$5.899 million in the same period last year, a decrease of \$0.244 million or 4.1%. This was primarily a result of decreased marketing and administrative costs over the same period last year. The largest component of operating expenses, operating wages, also saw a modest decrease period over period. Operating expenses as a percentage of revenue were 29.1% compared to 28.1% for the same period last year.

Management's Discussion and Analysis *(continued)*

Operating expenses were \$16.765 million for the nine month period compared to \$17.263 million for the same period last year, a decrease of \$0.498 million or 2.9%. This was primarily a result of decreased marketing and occupancy costs over the same period last year, which was slightly offset by increased operating wages. Operating expenses as a percentage of revenue were 28.3% compared to 27.4% for the same period last year.

Operating Income

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

Operating income was \$1.631 million in the third quarter compared to \$2.151 million in the same period last year, a decrease of \$0.520 million or 24.2%. This decrease is a result of a decline in gross margin which was offset by cost containment initiatives.

Operating income was \$6.023 million for the nine month period compared to \$6.171 million for the same period last year, a decrease of \$0.148 million or 2.4%. This decrease is a result of improved pharmacy and front store margins as well as the reduction of operating expenses by 2.9% over 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 \$1.193 million in the third quarter compared to \$1.261 million in the same period last year, a decrease of \$0.068 million or 5.4%. This decrease is due to reduced travel and management fee spending offset by increased public company expenses.

Corporate expenses for the nine month period were \$3.970 million compared to \$3.244 million for the same period last year, an increase of \$0.726 million or 22.4%. This is due to increased compensation and benefit costs due to building the senior management team in order to have enhanced capabilities to focus on improving and growing the business.

EBITDA

EBITDA was \$0.438 million in the third quarter compared to \$0.890 million in the same period last year, a decrease of \$0.452 million or 50.8%. The decrease in EBITDA was primarily a result of decreased revenue and increased corporate costs offset by a stronger gross margin percentage over the same period last year.

EBITDA was \$2.053 million for the nine month period compared to \$2.927 million for the same period last year, a decrease of \$0.874 million or 29.9%. The decrease in EBITDA was mainly a result of decreased revenue and higher corporate and other costs. This was slightly offset by stronger gross margin percentages realized year over year and reduced operating costs.

Interest Expense

Interest expense includes financing costs, bank charges and interest, interest on long-term debt and capital leases and is reported net of interest income.

Interest expense was \$0.191 million in the third quarter compared to \$0.198 million in the same period last year, a decrease of \$0.007 million. Bank charges and interest were \$0.019 million (2010 - \$0.051 million); interest and amortization of related financing costs on long-term debt was \$0.174 million (2010 - \$0.151 million); and interest income was \$0.002 million (2010 - \$0.004 million).

Bank charges and interest were \$0.077 million for the nine month period (2010: \$0.116 million); interest and amortization of related financing costs on long-term debt was \$0.546 million (2010: \$0.620 million); and interest income of \$0.010 million (2010: \$0.022 million).

Management's Discussion and Analysis *(continued)*

Amortization

Amortization of capital and intangible assets was \$1.377 million in the third quarter compared to \$1.298 million in the same period last year, an increase of \$0.079 million or 6.1%. This increase is due to amortization on capital and intangible asset additions.

Amortization of capital and intangible assets was \$4.072 million for the nine month period compared to \$3.737 million for the same period last year, an increase of \$0.335 million or 9.0%. This increase is due to amortization on capital and intangible asset additions.

Stock based compensation

Stock based compensation was \$0.017 million in the third quarter compared to \$0.001 million in the same period last year, an increase of \$0.016 million.

Stock based compensation was \$0.020 million for the nine month period compared to \$0.002 million for the same period last year, an increase of \$0.018 million.

Net loss

The net loss was \$1.148 million in the third quarter compared to a net loss of \$0.584 million in the same period last year, an increase in the loss of \$0.564 million or 96.6%. This change is primarily due to the reasons described above in EBITDA along with an increase in amortization.

The net loss was \$2.553 million for the nine month period compared to a net loss of \$1.531 million for the same period last year, an increase in the loss of \$1.022 million or 66.8%. This change is primarily due to decreasing revenues and increased corporate costs offset by improved gross margins and decreased operating expenses.

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	May 31, 2011 \$	August 31, 2010 \$
Cash and cash equivalents	(2,414)	(4,285)
Current portion of long-term debt and capital leases	940	952
Long-term debt	6,175	7,008
Net debt ¹	4,701	3,675
Shareholders' equity	25,707	29,523
Total capitalization	30,408	33,198
Net debt: Shareholders' equity	0.18:1	0.12:1
Net debt: Total capitalization	0.15:1	0.11:1
EBITDA: Cash interest expense ²	4.00:1	5.30:1

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 cash equivalents.

² Cash interest expense excludes amortization of financing costs and is net of interest income.

OUTSTANDING SHARE DATA

As of May 31, 2011 the Company had 89.0 million issued common shares outstanding compared to 93.3 million at August 31, 2010. This reduction in common shares is the result of cancellation of 4.4 million shares through a normal course issuer bid initiated in October 2009 and renewed in October 2010. Further details are available in Note 7 of the unaudited consolidated financial statements as at May 31, 2011.

LIQUIDITY AND CAPITAL RESOURCES

The Company has 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 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 May 31, 2011, the Company had issued letters of credit aggregating \$0.5 million (August 31, 2010 - \$0.5 million) leaving \$4.5 million (August 31, 2010 - \$4.5 million) of the \$5.0 million (August 31, 2010 - \$5.0 million) facility available. The Company was in compliance with its financial covenants as at May 31, 2011 and for the period 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 May 31, 2011 the Company had, in addition to its bank facilities, on deposit \$2.4 million available to fund capital projects relating to existing stores as well as for working capital and acquisitions.

Operating Activities

Cash flow generated from operating activities in the third quarter increased to \$2.115 million from \$1.293 million in the same period last year. The increase is largely due to a reduction realized by the Company in relation to working capital investment.

For the nine month period, net cash flow generated from operating activities was \$2.130 million compared to \$1.134 million in the same period last year. The increase is largely due to a reduction realized by the Company in relation to working capital investment.

Financing Activities

Net cash expenditures used in financing activities was \$0.707 million in the third quarter compared to \$5.411 million in the same period last year. The Company repaid net \$0.248 million of long term debt obligations during the third quarter compared to net repayments of \$4.729 million during the same period last year. The Company repurchased shares for \$0.455 million in the quarter under the Normal Course Issuer Bid that commenced October 9, 2009 and was renewed October 12, 2010, compared to \$0.498 million for the same period last year.

For the nine month period, net cash expenditures used in financing activities was \$2.226 million compared to net cash expenditures used in financing activities of \$7.273 million in the same period last year. The Company repaid net \$0.916 million of long term debt obligations compared to net repayments of \$5.918 million during the same period last year. The Company repurchased shares for \$1.281 million under the Normal Course Issuer Bid that commenced October 9, 2009 and was renewed October 12, 2010, compared to \$1.132 million for the same period last year.

Investing Activities

Net cash expenditure for investing activities was \$0.582 million in the third quarter compared to a \$0.192 million in the same period last year. The current period investing activities relates to the purchase of capital assets of \$0.635 million including pharmacy equipment upgrades, computer equipment and leasehold improvements and the purchase of intangible assets \$0.034 million which is comprised mainly of computer software acquisitions.

For the nine month period, net investment from investing activities was \$1.775 million compared to \$1.896 million in the same period last year. The current year relates primarily to the purchase of additional capital assets of \$1.841 million which includes additional leaseholds at a number of the Company's locations, pharmacy equipment upgrades and computer equipment. There were also intangible assets additions of \$0.222 million for the current year which is comprised mainly of computer software additions. The prior year relates primarily to the acquisition of the prescription file of a pharmacy in Calgary, Alberta, for \$0.500 million and other capital and intangible asset expenditures of \$1.418 million on additional leaseholds as well as computer hardware and software.

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 competitive or economic reform and the impact of pharmacy regulatory reform, and how these impact the Company's ability to raise new debt or equity financing, refinance existing debt, and meet existing debt covenants.

The Company has a three year credit facility that comprises a \$5.0 million operating line, a \$5.0 million term loan and a \$15.0 million acquisition facility 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 instalments 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.

Subsequent to the end of the quarter, the Company amended the credit facility to increase the term loan to \$5.8 million from the original \$5.0 million. The amended term loan still bears interest at prime plus 1% to prime plus 2% per annum depending on Company specific covenants and is due April 8, 2013. Quarterly installment payments will increase to \$0.30 million plus interest to cover the additional \$0.80 million advanced under the term loan subsequent to the end of the quarter. The operating line and acquisition facility have remained unchanged under the Company's amended credit facility.

TRANSACTIONS WITH RELATED PARTIES

During the three and nine month periods ended May 31, 2011, the Company expensed \$0.05 million and \$0.15 million (May 31, 2010 - \$0.10 million and \$0.33 million) for advisory and executive services fees due to Canterbury Park Management Inc. Canterbury Park Management Inc. provides management services as a shareholder.

The Company also paid \$0.05 million and \$0.15 million, respectively, for the three and nine month periods ended May 31, 2011 (May 31, 2010 - \$0.05 million and \$0.14 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 (except per share amounts)	Third Quarter		Second Quarter		First Quarter		Fourth Quarter	
	2011	2010	2011	2010	2011	2010	2010	2009
Revenue	19,096	21,025	20,034	20,865	19,735	21,013	20,339	20,620
EBITDA	438	890	813	976	802	1,061	632	965
- EBITDA per share - Basic	\$0.01	\$0.01	\$0.01	\$0.01	\$0.01	\$0.01	\$0.01	\$0.01
- EBITDA per share - Diluted	\$0.01	\$0.01	\$0.01	\$0.01	\$0.01	\$0.01	\$0.01	\$0.01
Net loss	(1,148)	(584)	(640)	(464)	(765)	(483)	(1,063)	(469)
- Net loss per share - Basic	(\$0.01)	(\$0.01)	(\$0.01)	(\$0.01)	(\$0.01)	(\$0.00)	(\$0.01)	(\$0.01)
- Net loss per share - Diluted	(\$0.01)	(\$0.01)	(\$0.01)	(\$0.01)	(\$0.01)	(\$0.00)	(\$0.01)	(\$0.01)

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.

In the current quarter, the Company submitted their response to the request for proposal in relation to the 3,500 beds it services in its Manitoba operations under a contract that expires March 31, 2012.

General economic conditions

General economic conditions have resulted in reduced consumer spending and have impacted the Company's profitability. 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.

Management's Discussion and Analysis *(continued)*

Ability to Manage Growth and Maintain Profitability

The Company may make acquisitions of other pharmacies or develop greenfield opportunities from time to time. Growth transactions will increase the size of operations, increase the amount of indebtedness that may need to be serviced by the Company, and place additional demands on the Company's management resources. Although the Company has enhanced its systems to effectively manage growth, there is no assurance that the Company will be able to successfully integrate any future acquisitions and failure to do so could adversely affect the Company's business and earnings.

Reliance on Information Systems and Technology

The Company's business relies upon information technology systems to support its distribution, merchandise management, adjudication of third-party prescriptions in the pharmacy dispensing systems, and real-time debit and credit approval through the point of sales system. 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".

The Company is subject to periodic post reimbursement review of drug costs and dispensing fees by provincial health and third party authorities.

Alternative Arrangements for Generic Drug Supply

As the utilization rate of generic drugs increases, the guaranteed supply from the Company's current providers may be at risk. The Company's inability to source the required generic drug supply could adversely affect the Company's ability to maximize gross margin dollars, operating results and profits.

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 is 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.

In British Columbia in 2010, the Ministry of Health Services executed a long term agreement which lowered the cost of generic prescription drugs in 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 \$9.60 per prescription to \$10.50 gradually through April 2, 2012. The British Columbia government has committed to a \$35 million dollar expansion of new clinical pharmacy services effective April 1, 2012.

In Alberta, effective April 2010, the prices of existing generic drugs at 75% of the equivalent brand name price have been limited to 56% of such price. Alberta has provided certain transitional and regional relief which will mitigate the effect of the changes announced from April 2010 to March 2013. The Company, 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.

The previously announced changes in British Columbia and Alberta have been assessed to determine their impact on both Paragon's profitability and future strategy. The Company is working with its supply

Management's Discussion and Analysis *(continued)*

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 risks to the Company'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.

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.

The Company's claim for reimbursement of drug costs and dispensing fees in 2010 at two of its facilities is currently under review by a provincial health authority. The outcome of these reviews on claims made is unknown at this time. The Company provided an allowance of \$0.300 million in the third quarter of 2011 in respect to these matters. Adjustments to this allowance will be reflected in the accounts once known.

OFF-BALANCE SHEET ARRANGEMENTS/VARIABLE INTEREST ENTITIES

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

FUTURE ACCOUNTING PRONOUNCEMENTS

International Financial Reporting Standards ("IFRS") 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 progress 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 continuing 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.

Management's Discussion and Analysis *(continued)*

2. Detailed evaluation and design phase. The Company commenced 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 commenced this phase concurrent with many of the phase 2 activities in fiscal 2011 and is considering 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 Company's Audit Committee.
4. Integration phase. The Company will commence this phase after the completion of the second and third phases during the fourth quarter of fiscal 2011. 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.

The Company is completing its technical review of identified Canadian GAAP and IFRS differences and is focusing its efforts on the following standards:

IAS 36, Impairment of Assets

The objective of IAS 36, "Impairment of Assets" ("IAS 36") is to ensure that assets are carried at no more than their recoverable amount, through use or sale. An asset carried at more than its recoverable amount is considered impaired and an impairment loss must be recognized in income. A previously recognized impairment loss on an asset may be reversed if the factors have changed that were used to determine the asset's recoverable amount. An impairment loss for goodwill may not be reversed.

The requirements in IAS 36 are similar to those that exist in Canadian GAAP however there are differences in identification of cash-generating units, reversals in previously recognized impairment losses and the methodology for calculating the recoverable amount, including the use of discounting. The Company is currently reviewing the implications of IAS 36.

IFRS 3, Business Combinations

The primary effects of adopting IFRS 3, "Business Combinations" ("IFRS 3"), compared to the current Canadian GAAP requirements are: the inability to capitalize acquisition costs which are currently considered part of the purchase price; subsequent acquisition purchase price adjustments (within 12 months) will require retroactive application and a restatement of prior periods; greater limitations exist for establishing restructuring provisions, thereby reducing the number or amount of provisions recognized on acquisition; and intangible assets (liabilities) arising from favourable (unfavourable) operating leases are

Management's Discussion and Analysis *(continued)*

recognized as a component of the leased asset where they are currently recognized as separate intangible assets or liabilities.

IFRS 1, "First-time adoption of International Financial Reporting Standards" ("IFRS 1"), states that first-time adopters may elect not to apply IFRS 3 retrospectively to business combinations that occurred before the date of transition to IFRS. The Company's current intention is to make election under IFRS 1 and only apply IFRS 3 to business combinations prospectively, or after September 1, 2010.

Other Standards

This list should not be regarded as a complete list of the IFRS standards that may have an impact on the Company's results of operations, financial position and disclosures. The list is intended to highlight areas the Company has identified that may be significant. Final conclusions could change as the Company progresses through its implementation plan.

The International Accounting Standards Board ("IASB") has ongoing projects, which management is monitoring, that could affect the ultimate differences between Canadian GAAP and IFRS and the impact those differences have on the Company's results of operations, financial position and disclosures.

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 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 CEO and the CFO concluded that the disclosure controls and procedures as at the end of the period covered by the interim filings are effective in providing reasonable assurance that material information relating to the Company 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 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 Board of Directors together with the Audit Committee have direct oversight responsibilities for the review and approval of the quarterly and annual financial disclosures.