

## PARAGON PHARMACIES LIMITED

### MANAGEMENT DISCUSSION & ANALYSIS FOR THE 3 MONTH PERIOD ENDED NOVEMBER 30, 2007

As at January 29, 2008

The following is a discussion of the consolidated financial condition and results of operations of Paragon Pharmacies Limited (“Paragon” or the “Company”) for the three month period ended November 30, 2007. This discussion and analysis should be read in conjunction with the Company’s interim unaudited consolidated financial statements and accompanying notes for the three month period ended November 30, 2007. The presentation in the interim financial statements for the three months ended November 30, 2007 conforms with that used for the year ended August 31, 2007. Certain accounts for the three months ended November 30, 2006 have been reclassified to conform with this. The interim 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. 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.

#### OVERVIEW

As at November 30, 2007, the Company owned and operated 20.5 stores (18.5 retail pharmacies and 2 home health care stores) in British Columbia, Alberta and Manitoba. Paragon Pharmacies Ltd. amalgamated with Rinoa Enterprises Ltd. to form Paragon Pharmacies Limited on October 31, 2006 and accordingly the financial results from the acquired assets are included from the amalgamation date forward. As at November 30, 2007, the Company also owned a 26.4% interest in Catalyst Healthcare Ltd. (servicing the pharmacy needs of long term care service providers) and a 50% beneficial interest in a distribution centre.

### OVERVIEW *(continued)*

Subsequent to the end of the quarter, Paragon acquired central fill pharmacies in BC and Manitoba providing pharmacy services to assisted living and long-term care residents. In December of 2007, Paragon acquired all of the assets of Westcoast Central Fill from Catalyst Healthcare Ltd. with payment of the purchase price consisting of cash and the cancellation of the 2,800,000 shares that Paragon held in the capital of Catalyst Healthcare Ltd giving it a very strong position in the long term care sector in British Columbia. In January of 2008, the Company further developed its long term care sector business by acquiring all of the assets of Alentex Pharmacy in Winnipeg, MB. Alentex is servicing a significant portion of the long term care sector in that city. Both of these acquisitions will provide accretive growth to Paragon's EBITDA in future quarters.

Paragon is a 50% shareholder in ACO Super Drug Mart Ltd. ("ACO"). ACO previously handled the marketing and product distribution for the two ownership groups of the 19 total Super Drug Mart stores in Alberta. Paragon has changed its buying model from direct purchasing to one of purchasing through a wholesaler with drop shipments direct to each store. With this change in product purchasing, the ACO is closing its distribution centre in Calgary, Alberta and ceasing its operations as of March 31, 2008. It is expected that ACO will be wound up shortly thereafter and Paragon anticipates realizing the full value of its investment on wind-up.

### OVERALL PERFORMANCE

#### ***Key Operating, Investing and Financial Metrics***

The following provides a summary of the Company's performance for the three month period ended November 30, 2007 compared to the three month period ended November 30, 2006.

- Revenue from continuing operations of \$17.677 million (2006: \$15.913 million), an increase of 11.1%
- Comparable store revenue growth of 3.9%
  - Comparable store pharmacy revenue growth of 7.5%
  - Comparable store (excluding home health care) front store revenue<sup>1</sup> growth of -2.4%
- Gross margin as a percentage of revenue of 32.9% (2006: 32.4%), an increase of 1.5%
- Operating income of \$1.259 million (2006: \$1.321 million), a decrease of 4.7%, primarily a result of operating expenses as a percentage of sales increasing to 25.8% from 24.1%
- EBITDA<sup>2</sup> of \$0.350 million (2006: \$0.923 million), a decrease of 62.1%, inclusive of \$0.173 million of non-recurring professional fees
- EBITDA margin<sup>3</sup> of 2.0% (2006: 5.8%), a decrease of 65.9%

<sup>1</sup> Front store revenue includes all non-pharmacy revenue.

<sup>2</sup> EBITDA defined as earnings before interest expense, income taxes, amortization, stock-based compensation, other items as defined, and loss from discontinued operations. (See table in the Results of Operations for calculation of EBITDA).

<sup>3</sup> EBITDA margin defined as EBITDA divided by Revenue.

## Management's Discussion and Analysis *(continued)*

### OVERALL PERFORMANCE *(continued)*

#### Corporate Development Highlights

- Acquired a retail pharmacy on November 1, 2007
- Carried on extensive acquisition related activities with two acquisitions in the long term care sector closing subsequent to November 30, 2007
- Completed a \$17.5 million debt financing with a chartered bank including a \$7.5 million facility to assist in financing acquisitions, approximately \$7.0 million to replace the existing term debt, and a \$3.0 million operating facility replacing the current \$2.5 million facility

### RESULTS OF OPERATIONS

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

	3 Months Ended		\$ Change	% Change
	November 30 2007	November 30 2006		
Revenue	17,676,854	15,912,830	1,764,024	11.1%
Gross Profit	5,823,460	5,155,361	668,099	13.0%
Operating Expenses <sup>1</sup>	4,563,981	3,833,992	729,989	19.0%
Operating Income	1,259,479	1,321,369	(61,890)	(4.7%)
Corporate Expenses	909,636	398,185	511,451	128.4%
EBITDA <sup>2</sup>	349,843	923,184	(573,341)	(62.1%)
Stock-based compensation	34,620	0	34,620	100.0%
Amortization	562,826	512,789	50,037	9.8%
Interest expense <sup>3</sup>	1,586,202	216,235	1,369,967	633.6%
Other Items <sup>4</sup>	58,953	257,621	(198,668)	(77.1%)
Net loss from continuing operations	(1,892,758)	(63,461)	(1,829,297)	(2,882.6%)
Loss from discontinued operations	0	(22,590)	22,590	100.0%
Net loss	(1,892,758)	(86,051)	(1,806,707)	(2,099.6%)
EBITDA per common share				
- Basic net earnings EBITDA	\$0.01	\$0.03	(\$0.02)	
- Diluted net earnings EBITDA	\$0.01	\$0.03	(\$0.02)	
Earnings per common share				
- Basic net earnings	(\$0.05)	\$0.00	(\$0.05)	
- Diluted net earnings	(\$0.05)	\$0.00	(\$0.05)	

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

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

<sup>3</sup> Interest expense includes bank charges and interest \$39,856 (2006 - \$39,567), interest on long term debt \$152,146 (2006 - \$177,408), financing costs on convertible debenture \$1,540,125 (2006 - \$Nil), and interest income of \$227,483 (2006 - \$Nil).

<sup>4</sup> Other items include amalgamation costs in excess of cash received of \$Nil (2006 - \$158,943) and loss on equity investments of \$58,954 (2006 - \$98,678).

**RESULTS OF OPERATIONS** (continued)

**Revenue**

Revenue is comprised of sales to customers of the Company's retail pharmacies and home health care stores. Revenue in the first quarter was \$17.677 million compared to \$15.913 million for the same period last year, an increase of \$1.764 million or 11.1%. Increases were a result of growth in same store revenue of \$0.614 million, and revenue from acquisitions.

**Gross Margin**

Gross margin is calculated as revenue less cost of sales. Cost of sales is comprised of the cost of goods sold through the Company's retail pharmacies and home health care stores. Gross margin was \$5.823 million in the first quarter compared to \$5.155 million for the same period last year, an increase of \$0.668 million or 13.0%. This was primarily a result of an increase in gross margin as a percentage of sales and gross margin from acquisitions completed in March 2007 and November 2007. Gross margin as a percentage of sales increased 55 basis points to 32.9% from 32.4% in the same period last year.

**Operating Expenses**

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

Operating expenses in the first quarter were \$4.564 million compared to \$3.834 million for the same period last year, an increase of \$0.730 million or 19.0%. This was primarily a result of operating expenses from the stores acquired of \$0.262 million, the introduction of a defined benefit contribution pension plan to assist in the retention and recruitment of employees of \$0.061 million, and wage pressure in the Alberta market due to low unemployment rates of \$0.175 million. Operating expenses as a percentage of sales increased 173 basis points to 25.8% from 24.1% in the same period last year.

**Operating Income**

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

Operating income was \$1.259 million in the first quarter compared to \$1.321 million for the same period last year, a decrease of \$0.062 million or 4.7%. This was primarily a result of the increase in operating expenses explained above. Of the \$1.259 million, a total of \$0.191 million is attributed to acquisitions. The primary decline in same store operating income is from the Alberta market. Paragon is moving forward with aggressive changes to its product purchasing model, store lay-outs, and flyer program in Alberta and expects these changes to have a positive impact on sales and overall operating income.

**RESULTS OF OPERATIONS** *(continued)*

**Corporate Expenses**

Corporate expenses include all costs related to the corporate and administration offices which includes wages, benefits, pension, occupancy, marketing, administration, and public company costs including stock based compensation. Corporate expenses in the first quarter were \$0.910 million compared to \$0.398 million for the same period last year, an increase of \$0.511 million. This increase is a result of multiple factors including increased corporate expenditures to accommodate planned growth, the addition of public company costs, and corporate acquisition activities. More specifically, this includes the introduction of a defined benefit contribution pension plan in March of 2007 of

\$0.029 million, Internal Controls Over Financial Reporting costs of \$0.146 million, corporate acquisition costs written off of \$0.028 million, and the addition of new operations and accounting staff of \$0.113 million. Corporate costs, excluding non-recurring items, were stable at \$0.737 million in the first quarter compared to \$0.709 million in the fourth quarter of last year.

**EBITDA**

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

EBITDA was \$0.350 million in the first quarter compared to \$0.923 million for the same period last year, a decrease of \$0.573 million or 62.1%. EBITDA margin, defined as EBITDA divided by Revenue, decreased to 2.0% in the first quarter from 5.8% in the same period last year. The reduction in EBITDA margin was a result of increased operating and corporate costs as summarized above.

**Stock based compensation**

Stock based compensation in the first quarter was \$0.035 million compared to \$Nil for the same period last year.

**Amortization**

Amortization of capital and intangible assets were \$0.563 million in the first quarter compared to \$0.513 million for the same period last year, an increase of \$0.050 million or 9.8%. This increase is primarily a result of amortization resulting from the acquisitions completed in March 2007 and November 2007.

**Interest Expense**

Interest expense is defined as bank charges and interest, interest on long-term debt and capital leases, financing costs on convertible debenture, net of interest income.

Financing costs on the convertible debenture were comprised of accretion, accrued interest, and amortization on deferred debt financing costs. These are non-cash items. Total financing costs on the convertible debenture in the first quarter were \$1.622 million compared to \$Nil for the same period last year and included accretion of \$0.872 million, and accrued interest of \$0.750 million.

**RESULTS OF OPERATIONS** (continued)

**Interest Expense**

Interest expense, net of financing costs on the convertible debenture and interest income, was \$0.192 million in the first quarter compared to an expense of \$0.217 million for the same period last year, a decrease of \$0.025 million. Bank charges and interest were \$0.040 million (2006 - \$0.040 million); interest on long term debt was \$0.152 million (2006 - \$0.177 million); and interest income of \$0.227 million (2006 - \$0.001 million).

**Other Items** (continued)

Amalgamation costs in excess of cash received resulted during the amalgamation with Rinoa Enterprises Ltd., a capital pool company, on October 31, 2006 to form Paragon Pharmacies Limited. The loss on equity investments resulted from the Company's share of losses recognized on its equity investments in ACO Super Drug Mart Ltd. (distribution centre), 1036985 Alberta Ltd. (Cochrane Super Drug Mart), and (Catalyst Healthcare Ltd. Loss on discontinued operations resulted from the Company's disposition of the assets of a pharmacy on May 8, 2007.

Amalgamation costs in excess of cash received was \$Nil in the first quarter compared to \$0.159 million in the same period last year, loss on equity investments was \$0.059 million in the first quarter compared to \$0.099 million in the same period last year, and loss on discontinued operations was \$Nil in the first quarter compared to \$0.023 million in the same period last year.

**Net Loss**

The net loss in the first quarter was \$1.893 million compared to a loss of \$0.086 million for the same period last year, an increase of \$1.807 million or 2,099.6%. Of the \$1.893 million loss, \$1.622 million is attributed to the financing costs on the convertible debenture and stock based compensation costs of \$0.035 million. On a diluted basis, earnings per share in the first quarter were negative \$0.05 compared to \$0.00 for the same period last year.

## 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.

	November 30, 2007	August 31, 2007
Cash and cash "in trust"	0	\$2,833,569
Restricted cash	18,671,029	20,110,574
Bank Indebtedness	548,000	0
Current portion of long-term debt and capital leases and compensation obligation	2,472,415	2,823,547
Long-term debt and capital leases <sup>1</sup>	27,205,004	27,879,324
Net debt <sup>2</sup>	11,554,390	7,758,728
Shareholders' equity <sup>3</sup>	20,073,503	21,644,615
Total capitalization <sup>4</sup>	31,627,893	29,403,343
Net debt: Shareholders' equity	0.58:1	0.36:1
Net debt: Total capitalization	0.37:1	0.26:1
Net debt: EBITDA <sup>5</sup>	33.03:1	(201.67:1)
EBITDA <sup>5</sup> : Cash interest expense <sup>6</sup>	2.30:1	(0.24:1)

<sup>1</sup> Includes the equity portion of the Convertible debenture.

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

<sup>3</sup> Excludes the equity portion of the Convertible debenture.

<sup>4</sup> Total capitalization equals net debt plus shareholders' equity.

<sup>5</sup> EBITDA defined as earnings before interest expense, income taxes, amortization, stock-based compensation, other items as defined, and loss from discontinued operations. EBITDA in the fourth quarter of 2007 was (\$38,473).

<sup>6</sup> Cash interest expense defined as interest on long term debt only. Interest expense in the fourth quarter of 2007 was \$160,007.

## OUTSTANDING SHARE DATA

The Company had 41,084,599 common shares outstanding at November 30, 2007. As at this same date, the Company had outstanding options to acquire 1,440,502 of its common shares and warrants to acquire 10,360,000 of its common shares. Further details are available in Note 12 of the interim unaudited consolidated financial statements at November 30, 2007.

## LIQUIDITY AND CAPITAL RESOURCES

At November 30, 2007 the ratio of current assets to current liabilities was 1.55:1 compared to 1.90:1 at August 31, 2007. Working capital was \$4.995 million compared to \$7.442 million at August 31, 2007. Subsequent to the quarter end, the Company obtained bank financing in the amount of \$1.705 million for an acquisition that was completed in November 1, 2007 and previously financed out of working capital.

The Company also had access to a \$2.5 million operating line with a Canadian chartered bank as at November 30, 2007. The Company utilized \$480,000 of the operating line for letter of credits, \$36,000 for general operations and \$512,000 for outstanding cheques.

The Company's principal capital requirements are to fund working capital needs, renovate existing stores and acquire new stores in connection with its expansion strategy. These capital requirements have generally been satisfied by a combination of cash flow from operations and borrowings under its term and operating loans and the issuance of common shares. During the previous year the Company issued a convertible debenture, the proceeds of which are restricted for future acquisitions, which require matching senior debt.

Subsequent to the 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, \$7.060 million of this loan has been drawn. The Company continues to seek out additional senior debt financing to ensure 100% matching of the convertible debenture funds.

### *Operating Activities*

Net cash flow generated from operating activities from continued operations was \$0.094 million in the first quarter compared to \$1.653 million in the same period last year. This difference was primarily from changes in non-cash working capital items.

### *Investing Activities*

Net cash used in investing activities was \$2.712 million in the first quarter compared to cash realized of \$1.654 million in the same period last year. Investing activities in this quarter included the acquisition net of restricted funds and the purchase of capital assets.

### *Financing Activities*

Net cash flow from financing activities net of restricted cash was a use of \$0.764 million in the first quarter compared to a use of \$0.615 million in the same period last year. This decrease relates primarily to a decrease in advances from related parties.

### LIQUIDITY AND CAPITAL RESOURCES *(continued)*

#### *Canterbury Park Investment*

In May 2007, the Company issued a \$20.0 million convertible debenture ("Convertible Debenture"). The Convertible Debenture has a term of 2 years and bears interest at 15% per annum, compounded annually and maturing in May 2009 and if 50% of the principal amount has not been expended within 360 days then the convertible debenture holder can seek repayment of unutilized funds and the interest rate would increase by 5%. The interest rate on the Convertible Debenture is subject to adjustment in certain circumstances and will convert into common shares under certain circumstances, or at the option of the lender. The debenture converts into 24,912,085 shares on the principal amount and subject to regulatory approval, the accrued interest will be paid in shares based on current share trading prices. The Company has reserved an additional 8,034,380 shares to facilitate future accrued interest settlements. See Note 16 in the interim unaudited consolidated financial statements at November 30, 2007 for further information.

#### *Future Liquidity*

Based on current operations there will be sufficient means to satisfy the Company's working capital needs and debt-service requirements for the coming fiscal year. During the quarter, the Company used \$1.705 million of working capital to acquire an independent pharmacy. This amount was refinanced in January of 2008 replenishing the working capital. In addition, there was \$174,000 of non-recurring costs expensed in the quarter. Any future acquisitions or Greenfield developments may require additional debt and equity financing while maintaining the existing covenants (see Financing Activities).

### OFF-BALANCE SHEET ARRANGEMENTS

The Company has no off-balance sheet arrangements.

### TRANSACTIONS WITH RELATED PARTIES

The Company has the following amounts due from related parties: ACO Super Drug Mart Ltd. (\$166,385); and 1036985 Alberta Ltd. (Cochrane Super Drug Mart) \$504,807. The amounts due are non-interest bearing, unsecured with no fixed terms of repayment. The parties are related as they have common shareholders.

During the year ended August 31, 2007, the Company completed a \$3,000,000 private placement and issued a \$20,000,000 Convertible Debenture. The convertible debenture is held by Canterbury Park Capital L.P. and Canterbury Park Capital (U.S.) L.P. (collectively the "Partnerships"). Canterbury Park Management Inc. ("Canterbury") is, the manager of the Partnerships. The Company has an advisory agreement, for \$400,000 to be paid over a two year term commencing May 2007, with Canterbury, for ongoing consulting and advisory services. For the three months ended November 30, 2007, the Company has paid \$50,000 to Canterbury related to this advisory agreement.

**TRANSACTIONS WITH RELATED PARTIES (continued)**

For the three months ended November 30, 2007, the Company paid \$69,237 (2006 – \$71,194) in rent for premises leased under operating leases with related parties, which are 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 Canadian generally accepted accounting principles ("GAAP"). All references to dollars are in Canadian funds unless otherwise indicated.

	First Quarter		Fourth Quarter		Third Quarter		Second Quarter	
	2008	2007	2007	2006	2007	2006	2007	2006
Revenue	17,676,854	15,912,830	16,973,971	16,659,660	17,067,123	7,581,945	16,208,971	7,193,213
Loss before other items <sup>1</sup>	(1,833,804)	194,160	(2,505,880)	(22,288)	(956,920)	(547,958)	145,755	(576,355)
- Loss per share - Basic	(\$0.04)	\$0.01	(\$0.07)	\$0.00	(\$0.02)	(\$0.02)	\$0.00	(\$0.02)
- Loss per share - Diluted	(\$0.04)	\$0.01	(\$0.05)	\$0.00	(\$0.01)	(\$0.02)	\$0.00	(\$0.02)
Net loss	(1,892,758)	(86,051)	(2,513,097)	(66,102)	(1,057,624)	(649,369)	81,843	(636,879)
- Net loss per share - Basic	(\$0.05)	\$0.00	(\$0.07)	\$0.00	(\$0.03)	(\$0.02)	\$0.00	(\$0.02)
- Net loss per share - Diluted	(\$0.05)	\$0.00	(\$0.05)	\$0.00	(\$0.01)	(\$0.02)	\$0.00	(\$0.02)

Note: All information taken from Management prepared financial statements.

<sup>1</sup> Loss on equity investment in Q1-2008: \$58,954, Q1-2007: \$98,678, Q4-2007:\$7,874, Q4-2006: (\$48,219); Q3-2007: \$43,251, Q3-2006: \$75,885; Q2-2007: 34,090; Q2-2006: \$61,157; Loss from discontinued operations of Q1-2008: \$Nil, Q1-2007: \$22,590, Q4-2007: gain of \$657, Q4-2006 \$62,211; Q3-2007: \$111,495, Q3-2006: \$25,526; Q2-2007: \$Nil, Q2-2006: \$Nil; Gain on disposition of pharmacy in Q307: \$56,245 (\$Nil in all other periods) and Amalgamation costs greater than cash received of Q1-2008: \$Nil, Q1-2007: \$158,943; Q4-2006: \$29,822, Q3-2007: \$2,203.

**CHANGES IN ACCOUNTING POLICIES**

**Comprehensive Income**

The new standards introduce comprehensive income, which consists of net earnings and other comprehensive income ("OCI"). Because the Company does not have any OCI, the Company's interim consolidated financial statements do not include a Statement of Comprehensive Income which would otherwise describe the components of comprehensive income. Accordingly, since there are no cumulative changes in OCI to be included in accumulated other comprehensive income ("AOCI"), the Company has not presented AOCI as a new category within shareholders' equity in the interim consolidated balance sheet and has not included a Statement of Accumulated Other Comprehensive Income, which would otherwise provide the continuity of the AOCI balance.

### CHANGES IN ACCOUNTING POLICIES *(continued)*

#### *Financial Instruments*

In 2006, the Canadian Institute of Chartered Accountants ("CICA") issued new accounting standards concerning financial instruments: Financial Instruments – Recognition and Measurement ("Section 3855"); Financial Instruments – Disclosure and Presentation ("Section 3861"), Hedges ("Section 3865"); and Comprehensive Income ("Section 1530"). The standards require prospective application and were effective for the Company's current quarter of fiscal 2008. The Company applied the new accounting standards at the beginning of its current fiscal year. Further details are available in Note 2 of the interim unaudited consolidated financial statements at November 30, 2007.

#### *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 interim consolidated financial statements.

### ESTIMATES

The preparation of the consolidated financial statements in conformity with Canadian generally accepted accounting principles 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

### REGULATORY CHANGES THAT IMPACT THE COMPANY'S INDUSTRY

On November 14, 2007, Bill 45, The Tobacco Reduction Act passed third and final reading in the Alberta legislature. Several sections of the Bill will affect retail pharmacies in the province. All retailers will be required to remove all visible displays, promotions and advertising for tobacco products by July 1, 2008. In addition, tobacco sales in pharmacies, health care facilities and post-secondary campuses will be prohibited as of January 1, 2009. The Company is taking steps to comply fully with these new regulations.

The Manitoba government is in the process of developing new regulations for its Pharmaceutical Act. While still not finalized, the new regulations are expected to allow pharmacists to prescribe medications pursuant to a limited formulary for treatment of minor conditions. The amended Act may also introduce restrictions on inducements offered by pharmacies and put new rules in place for cross-border prescription businesses. With the final version of the legislation expected to be tabled in mid-2008, it is unlikely that any of the changes will adversely impact on the Company's operations in Manitoba.

### REGULATORY CHANGES THAT IMPACT THE COMPANY'S INDUSTRY *(continued)*

The province of British Columbia has indicated it wants to proceed with major reforms to its PharmaCare program, with a study of current drug procurement and listing procedures now being carried out by a nine-member pharmaceutical task force appointed by the Health Minister. In recent months, the Pharmaceutical Services Division has also consulted with generic manufacturers to explore the possibility of tendering in several high-volume categories. Such a move (already challenged in court by one generic company) could threaten the professional allowances paid to pharmacies in support of store-level patient education programs.

The activity in B.C. and other provinces is largely driven by concerns over rising health care expenditures, which are expected to increase nationally by 58 per cent over the next 12 years, and the rising demand for prescription drugs, partly due to the ageing demographics in the country. Canada's over-55 category will climb from 22 per cent to 32 per cent of the total population in the same time period.

Governments are focusing considerable attention on generic pricing practices. Earlier this year, Ontario put in place rigid limits on the allowances which generic companies can offer for both public and private prescriptions. Quebec followed suit with similar restrictions and, starting on February 1, 2008, the province of Newfoundland and Labrador will apply new regulations which stipulate that generic drugs in that province are priced at the same level as in Ontario.

Community pharmacy stakeholders will be stepping up efforts in the coming year to win government support for new compensation schemes that would reimburse pharmacies for such clinical services as medication reviews and chronic disease management which, in turn, relieve pressure on other health care providers and contribute to better patient outcomes.

### 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 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.

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. In the last two quarters, the Company engaged an outside consulting group to review and assist in the evaluation of the internal controls of the Company. Through this process, management has 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 which strengthens the segregation of duties, there still exists a lack of such segregation of duties. Management believes, however, that the risks associated with the lack of segregation of duties have been mitigated by the implementation of other controls.

**DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS OVER FINANCIAL REPORTING** *(continued)*

As part of the purchase of the Super Drug Mart stores in April, 2006, the company purchased an IT platform shared with another party. As such, the company does not have complete control over this platform and management had identified this as a material weakness at the time of the acquisition. As of November 30, 2007, the company continued to use this IT system and recognized the material weakness involved. Management believes, however, that the risks associated with the weakness are mitigated by the implementation of other controls. The Company expects to eliminate this deficiency by the end of the second fiscal quarter.

The CEO and CFO believe controls and procedures have been designed to provide reasonable assurance that all information is made known to them and the reliability of the financial reporting and the preparation of financial statements for external purposes.

The Company has qualified senior accounting personnel engaged on a full time basis to manage the Company's financial disclosures. 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.

**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, EBITDA (earning before stock-based compensation, interest, taxes, depreciation and amortization, loss from discontinued operations, loss on equity investments, amalgamation costs greater than cash received and interest income), EBITDA margin and 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 drug store industry. Management believes that non-GAAP financial measures assist in identifying underlying operating trends.

These non-GAAP financial measures, particularly EBITDA and EBITDA margin, 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.