

**PARAGON PHARMACIES LIMITED****MANAGEMENT DISCUSSION & ANALYSIS  
FOR THE 3 AND 6 MONTH PERIODS ENDED FEBRUARY 29, 2008****As at April 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 and six month periods ended February 29, 2008. 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 and six month periods ended February 29, 2008. The presentation in the interim financial statements for the three month and six month periods ended February 29, 2008 conforms with that used for the year ended August 31, 2007. Certain accounts for the three month and six month periods ended February 28, 2007 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 February 29, 2008, the Company owned and operated 23.5 stores (18.5 retail pharmacies, 3 central fill 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 February 29, 2008, the Company also owned a 50% beneficial interest in a distribution centre.

### OVERVIEW *(continued)*

On December 16<sup>th</sup>, 2007, the Company acquired two central fill pharmacies in British Columbia, related by virtue of an equity interest. On January 16<sup>th</sup>, 2008 the Company acquired a central fill pharmacy in Manitoba providing pharmacy services to assisted living and long-term care residents. The acquisition in BC included the cancellation of 2,800,000 shares that the Company held in the capital of the acquired company (previously written down to \$Nil) at a price of \$1.00 per share. Both of these acquisitions have provided accretive growth to Paragon's EBITDA in this quarter.

### OVERALL PERFORMANCE

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

The following provides a summary of the Company's performance for the three month and six month periods ended February 29, 2008 compared to the three month period ended February 28, 2007.

- Second quarter revenue from continuing operations of \$21.589 million (2007: \$16.209 million), an increase of 33.2%. Second quarter pharmacy revenue of \$13.723 million (2007: \$9.122 million) and front store revenue<sup>1</sup> \$7.866 million (2007: \$7.087 million).
  - Six month revenue from continuing operations of \$39.267 million (2007: \$32.122 million), an increase of 22.2%. Six month pharmacy revenue of \$24.481 million (2007: \$18.124 million) and front store revenue \$14.786 million (2007: \$13.998 million).
- Second quarter comparable store revenue growth of 5.7%; comparable pharmacy revenue growth of 7.2%; comparable front store revenue<sup>1</sup> growth of 3.7%.
  - Six month comparable store revenue growth of 4.4%; comparable pharmacy revenue growth of 7.3%; comparable front store revenue<sup>1</sup> growth of 0.6%
- Second quarter gross margin as a percentage of revenue of 34.6% (2007: 32.7%), an increase of 5.8%. Second quarter pharmacy gross margin as a percentage of revenue of 35.9% (2007: 32.7%) and front store gross margin as a percentage of revenue of 32.3% (2007: 30.4%).
  - Six month gross margin as a percentage of revenue of 33.8% (2007: 32.5%), an increase of 4.0%. Six month pharmacy gross margin as a percentage of revenue of 33.8% (2007: 32.5%) and front store gross margin as a percentage of revenue of 31.2% (2007: 30.3%)
- Second quarter operating income of \$1.927 million (2007: \$1.290 million), an increase of 49.4%, primarily a result of operating income from the recent acquisitions
  - Six month operating income of \$3.187 million (2007: \$2.611 million), an increase of 22.0%, primarily a result of operating income from the recent acquisitions
- Second quarter EBITDA<sup>2</sup> of \$1.118 million (2007: \$0.829 million), an increase of 34.9%.
  - Six month EBITDA<sup>2</sup> of \$1.468 million (2007: \$1.752 million), a decrease of 16.2%, inclusive of \$0.173 million of non-recurring professional fees

### **Key Operating, Investing and Financial Metrics *(continued)***

- Second quarter EBITDA margin<sup>3</sup> of 5.2% (2007: 5.1%), an increase of 1.3%
  - Six month EBITDA margin<sup>3</sup> of 3.7% (2007: 5.5%), a decrease of 31.5%

<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.

### **Corporate Development Highlights**

- Acquired 2 central fill pharmacies in December 2007 and 1 central fill pharmacy in January 2008 and began their integration into Paragon.
- The Company has entered into a debt re-purchase agreement with the net effect being the cancellation of 8,000,000 shares which represents approximately 20% of the outstanding float. This transaction is currently pending approval of the Ontario Securities Commission.
- Continued with a focus on front store operations in Alberta with store re-alignments and resets to simplify and enhance the shopping experience for our customers.
- Subsequent to the quarter end 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 entered into a new debt facility. This facility includes an increase in the committed operating loan from \$2,500,000 to \$3,000,000, refinancing of the reducing term loan of \$7,500,000, and an added revolving acquisition loan facility of \$7,500,000.
- The Company has commenced construction of a new 12,000 square foot retail pharmacy with an adjacent medical clinic in Kelowna. The store is expected to be completed in the fourth quarter of 2008. This brings our total retail square footage to approximately 130,000 square feet.

## 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.

	3 Months Ended		6 Months Ended	
	February 29 2008	February 28 2007	February 29 2008	February 28 2007
Revenue	21,589,743	16,208,970	39,266,597	32,121,800
Gross Margin	7,463,826	5,297,913	13,287,286	10,453,274
Operating Expenses <sup>1</sup>	5,536,340	4,007,964	10,100,321	7,841,956
Operating Income	1,927,486	1,289,949	3,186,965	2,611,318
Corporate Expenses	822,042	460,987	1,766,298	859,172
EBITDA <sup>2</sup>	1,118,089	828,962	1,467,932	1,752,146
Stock-based compensation	12,645	0	47,265	0
Amortization	837,816	495,978	1,400,642	1,008,767
Interest expense <sup>3</sup>	70,635	172,849	35,154	389,084
Financing costs on convertible debenture <sup>4</sup>	1,894,800	0	3,516,483	0
Other Items <sup>5</sup>	99,306	63,912	158,259	321,533
Net income (loss) from continuing operations	(1,797,113)	96,233	(3,689,871)	32,762
Loss from discontinued operations	0	(14,380)	0	(36,970)
Net Income (loss)	(1,797,113)	81,843	(3,689,871)	(4,208)
EBITDA per common share				
- Basic net earnings EBITDA	\$0.03	\$0.02	\$0.04	\$0.05
- Diluted net earnings EBITDA	\$0.02	\$0.02	\$0.03	\$0.04
Earnings per common share				
- Basic net earnings	(\$0.04)	\$0.00	(\$0.09)	\$0.00
- Diluted net earnings	(\$0.04)	\$0.00	(\$0.09)	\$0.00

<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 Q2-2008: \$37,612 (Q2-2007: \$32,126), YTD-2008: \$77,468 (YTD-2007: \$71,693); interest on long term debt Q2-2008: \$195,461 (Q2-2007: \$166,328), YTD-2008: \$347,607, (YTD-2007: \$343,736); financing costs on convertible debenture Q2-2008: \$1,894,800 (Q2-2007: \$Nil), YTD-2008: \$3,516,483 (YTD-2007: \$Nil), and interest income of Q2-2008: \$162,438 (Q2-2007: \$25,605), YTD-2008: \$389,921 (YTD-2007: \$26,345).

<sup>4</sup> The financing costs on the convertible debenture are a non-cash item and include interest and accretion on the debenture.

<sup>5</sup> Other items include amalgamation costs in excess of cash received of Q2-2008: \$Nil (2007: \$29,822), YTD-2008:\$Nil (YTD-2007: \$188,765) and loss on equity investments of Q2-2008: \$99,306 (2007: \$34,090), YTD-2008:\$158,260 (YTD-2007: \$132,768).

**RESULTS OF OPERATIONS** (continued)

**Revenue**

Revenue is comprised of sales to customers of the Company's retail pharmacies, central fill pharmacies and home health care stores. Revenue in the second quarter was \$21.590 million compared to \$16.209 million for the same period last year, an increase of \$5.381 million or 33.2%. Increases were a result of growth in same store revenue of \$0.918 million and revenue from acquisitions of \$4.463 million. On a pro-forma basis (calculated from historical data since the date of acquisition) for the complete quarter, the acquisitions would have generated an additional \$1.286 million in revenue.

Revenue for the six month period was \$39.267 million compared to \$32.122 million for the same period last year, an increase of \$7.145 million or 22.2%. Increases were a result of growth in same store revenue of \$1.408 million and revenue from acquisitions of \$5.736 million.

**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, central fill pharmacies and home health care stores. Gross margin was \$7.464 million in the second quarter compared to \$5.298 million for the same period last year, an increase of \$2.166 million or 40.9%. This was primarily a result of an increase in gross margin as a percentage of sales and gross margin from acquisitions. Gross margin as a percentage of sales increased 189 basis points to 34.6% from 32.7% in the same period last year.

Gross margin was \$13.287 million for the six month period compared to \$10.453 million for the same period last year, an increase of \$2.834 million or 27.1%. This was primarily a result of an increase in gross margin as a percentage of sales and gross margin from acquisitions. Gross margin as a percentage of sales increased 130 basis points to 33.8% from 32.5% 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 second quarter were \$5.536 million compared to \$4.008 million for the same period last year, an increase of \$1.528 million or 38.1%. This was primarily a result of operating expenses from the stores acquired of \$1.012 million. Other factors included the introduction of a defined contribution pension plan to assist in the retention and recruitment of employees in the BC and Alberta markets, increased occupancy expenses in the Alberta market due to the planned introduction of medical clinics adjacent to the stores and also lease renewals with rent increases, and increased security provisions that were introduced in the first quarter. Operating expenses as a percentage of sales increased 92 basis points to 25.6% from 24.7% in the same period last year.

### RESULTS OF OPERATIONS *(continued)*

Operating expenses for the six month period were \$10.100 million compared to \$7.842 million for the same period last year, an increase of \$2.258 million or 28.8%. This was primarily a result of operating expenses from the stores acquired of \$1.274 million, and the reasons explained above for the second quarter. Operating expenses as a percentage of sales increased 131 basis points to 25.7% from 24.4% 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 \$1.927 million in the second quarter compared to \$1.290 million for the same period last year, an increase of \$0.638 million or 49.4%. Of the \$1.927 million, a total of \$0.606 million is attributed to acquisitions.

Operating income was \$3.187 million for the six month period compared to \$2.611 million for the same period last year, an increase of \$0.576 million or 22.0%. Of the \$3.187 million, a total of \$0.797 million is attributed to acquisitions.

#### **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 excluding stock based compensation.

Corporate expenses in the second quarter were \$0.809 million compared to \$0.461 million for the same period last year, an increase of \$0.348 million. Corporate expenses have grown over the past year due to increased staffing levels at head office in both operations and accounting by \$0.200 million. These increased staffing levels were necessary to assist in the integration of our acquisitions and to fulfill our public company reporting obligations. In addition, the Company incurred public company costs including the review of Internal Controls over Financial Reporting, Directors Fees, and Advisory fees totaling \$0.138 million in the quarter.

Corporate expenses for the six month period were \$1.719 million compared to \$0.859 million for the same period last year, an increase of \$0.860 million. During the first quarter of 2008 the Company incurred \$0.146 million related to the review of Internal Controls over Financial Reporting. This in addition to the additional expenses described in the second quarter account for the total variance.

#### **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 \$1.118 million in the second quarter compared to \$0.829 million for the same period last year, an increase of \$0.289 million or 34.9%. EBITDA margin, defined as EBITDA divided by Revenue, increased to 5.2% in the second quarter from 5.1% in the same period last year. The increase in EBITDA margin was primarily a result of the increased gross margin as a percentage of sales. On a pro-forma basis (calculated from historical data since the date of acquisition) for the complete quarter, the acquisitions would have generated an additional \$0.263 million in EBITDA.

**RESULTS OF OPERATIONS** (continued)

EBITDA was \$1.468 million for the six month period compared to \$1.752 million for the same period last year, a decrease of \$0.284 million or 16.2%. EBITDA margin, defined as EBITDA divided by Revenue, decreased to 3.7% for the six month period from 5.5% 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 second quarter was \$0.013 million compared to \$Nil for the same period last year.

Stock based compensation for the six month period was \$0.047 million compared to \$Nil for the same period last year.

**Amortization**

Amortization of capital and intangible assets were \$0.838 million in the second quarter compared to \$0.496 million for the same period last year, an increase of \$0.342 million or 68.9%. This increase is primarily a result of amortization resulting from the acquisitions.

Amortization of capital and intangible assets were \$1.401 million for the six month period compared to \$1.009 million for the same period last year, an increase of \$0.392 million or 38.8%. This increase is primarily a result of amortization resulting from the acquisitions.

**Interest Expense**

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

Interest expense was \$0.071 million in the second quarter compared to an expense of \$0.173 million for the same period last year, a decrease of \$0.102 million. Bank charges and interest were \$0.038 million (2007: \$0.032 million); interest on long term debt was \$0.195 million (2007: \$0.166 million); and interest income of \$0.162 million (2007: \$0.026 million).

Interest expense was \$0.035 million for the six month period compared to an expense of \$0.389 million for the same period last year, a decrease of \$0.354 million. Bank charges and interest were \$0.077 million (2007: \$0.072 million); interest on long term debt was \$0.348 million (2007: \$0.344 million); and interest income of \$0.390 million (2007: \$0.026 million).

**Financing Costs on the Convertible Debenture**

Financing costs on the convertible debenture were comprised of accretion and accrued interest. These are non-cash items. Total financing costs on the convertible debenture in the second quarter were \$1.895 million compared to \$Nil for the same period last year and included accretion of \$1.145 million, and accrued interest of \$0.750 million.

Total financing costs on the convertible debenture for the six month period were \$3.516 million compared to \$Nil for the same period last year and included accretion of \$2.016 million, and accrued interest of \$1.500 million.

**RESULTS OF OPERATIONS** (continued)

**Other Items**

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), and 1036985 Alberta Ltd. (Cochrane Super Drug Mart). Loss on discontinued operations resulted from the Company's disposition of the assets of a pharmacy on May 8, 2007.

**Net Loss**

The net loss in the second quarter was \$1.797 million compared to a gain of \$0.082 million for the same period last year, a difference of \$1.879 million. The loss is attributed to the financing costs on the convertible debenture. On a diluted basis, earnings per share in the second quarter were negative \$0.04 compared to \$0.00 for the same period last year.

The net loss for the six month period was \$3.690 million compared to a loss of \$0.004 million for the same period last year, an increase of \$3.686 million. The loss is attributed to the financing costs on the convertible. On a diluted basis, earnings per share for the six month period were negative \$0.09 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.

	February 29, 2008	August 31, 2007
Cash and cash "in trust"	0	2,833,569
Restricted cash	13,475,754	20,110,574
Bank Indebtedness	209,414	0
Current portion of long-term debt and capital leases and compensation obligation	2,461,647	2,823,547
Long-term debt and capital leases <sup>1</sup>	35,983,515	27,879,324
Net debt <sup>2</sup>	25,178,822	7,758,728
Shareholders' equity <sup>3</sup>	18,289,035	21,644,615
Total capitalization <sup>4</sup>	43,467,857	29,403,343
Net debt: Shareholders' equity	1.38:1	0.36:1
Net debt: Total capitalization	0.58:1	0.26:1
Net debt: EBITDA <sup>5</sup>	22.6:1	(201.67:1)
EBITDA <sup>5</sup> : Cash interest expense <sup>6</sup>	5.95:1	(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 February 29, 2008. As at this same date, the Company had outstanding options to acquire 850,500 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 February 29, 2008.

## LIQUIDITY AND CAPITAL RESOURCES

At February 29, 2008 the ratio of current assets to current liabilities was 1.91:1 compared to 1.90:1 at August 31, 2007. Working capital was \$7.671 million compared to \$7.442 million at August 31, 2007. During the second quarter, 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 \$3.0 million operating line with a Canadian chartered bank as at February 29, 2008. The Company utilized \$480,000 of the operating line for letter of credits.

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.

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, \$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*

For the second quarter, net cash flow generated from operating activities from continued operations was \$0.049 million compared to cash used of \$0.037 million in the same period last year. This difference was primarily from changes in non-cash working capital items.

For the six month period, net cash flow generated from operating activities from continued operations was \$0.144 million compared to \$1.616 million in the same period last year. This difference was primarily from changes in non-cash working capital items.

### *Financing Activities*

For the second quarter, net cash flow from financing activities was \$6.645 million compared to \$2.952 million in the same period last year. This increase relates primarily to the increase in debt for acquisitions purposes offset by issuance of share capital last year.

For the six month period, net cash flow from financing activities was negative \$5.881 million compared to \$2.337 million in the same period last year. This increase relates primarily to the increase in debt for acquisitions purposes offset by issuance of share capital last year.

### *Investing Activities*

For the second quarter, net cash used in investing activities was \$6.355 million compared to \$2.312 million in the same period last year. Investing activities in this quarter included the three central fill pharmacy acquisitions and the purchase of capital assets.

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

For the six month period, net cash used in investing activities was \$9.068 million compared to \$0.658 million in the same period last year. Investing activities in this six month period quarter included the one retail pharmacy and three central fill pharmacy acquisitions and the purchase of capital assets.

#### *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. There is a provision in the debenture that if 50% of the principal amount is not expended within 360 days of its issuance then the holder, at its option, can demand repayment of the unspent funds along with interest to be paid in cash. If the holder demands repayment of these funds, there is an interest rate increase of 5% which would bring the total interest rate to 20% from original issuance until the Company makes the repayment of the unspent funds including interest. As of April 29, 2008, \$12,939,820 remains unspent. The Company and the debenture holder have agreed to extend the notice period for withdrawal of the funds to May 2, 2008 while the terms of the Convertible Debenture are re-negotiated. If the debenture holder demanded repayment of the unspent funds at this time, the Company would be obligated to pay \$15,527,784 including interest of \$2,587,964 to the holder subject to the Company being compliant with the financial covenants of the senior debt in place. There is currently \$13,569,754 in restricted cash to repay the holder.

The interest rate on the Convertible Debenture is subject to adjustment in certain circumstances and the interest payments will be made by way of 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 February 29, 2008 for further information.

Pursuant to the Convertible Debenture (Note 16), certain financial remedies are available to the debenture holder for non compliance with certain clauses in the Convertible Debenture. As such, the Company has a contingent exposure of up to \$1,000,000 for inventory valuation penalties and other certain adjustments. The terms of the Convertible Debenture are currently being re-negotiated. No accrual has been provided for this amount as management believes it is unlikely that the Company will suffer a material loss as a result of this contingency.

#### *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 including the Greenfield development in Kelowna previously referenced under Corporate Development Highlights. 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. \$67,514; and 1036985 Alberta Ltd. (Cochrane Super Drug Mart) \$499,289. 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 a minimum of \$300,000 to be paid over a two year term commencing May 2007, with Canterbury, for ongoing consulting and advisory services. For the three months ended February 29, 2008, the Company has paid \$50,000 to Canterbury related to this advisory agreement.

For the three months ended February 29, 2008, the Company paid \$69,060 (2007: \$71,194) in rent for premises leased under operating leases with related parties, which are related by virtue of common management and directors. For the six months ended February 29, 2008, the Company paid \$138,297 (2007: \$142,297) respectively for the same premises. 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.

	Second Quarter		First Quarter		Fourth Quarter		Third Quarter	
	2008	2007	2008	2007	2007	2006	2007	2006
Revenue	21,589,743	16,208,970	17,676,854	15,912,830	16,973,971	16,659,660	17,067,123	7,581,945
Loss before other items <sup>1</sup>	(1,896,419)	17,931	(1,833,804)	194,160	(2,505,880)	(22,288)	(956,920)	(547,958)
- Loss per share - Basic	(\$0.05)	\$0.00	(\$0.04)	\$0.01	(\$0.07)	\$0.00	(\$0.02)	(\$0.02)
- Loss per share - Diluted	(\$0.05)	\$0.00	(\$0.04)	\$0.01	(\$0.05)	\$0.00	(\$0.01)	(\$0.02)
Net loss	(1,797,113)	81,843	(1,892,758)	(86,051)	(2,513,097)	(66,102)	(1,057,624)	(649,369)
- Net loss per share - Basic	(\$0.04)	\$0.00	(\$0.05)	\$0.00	(\$0.07)	\$0.00	(\$0.03)	(\$0.02)
- Net loss per share - Diluted	(\$0.04)	\$0.00	(\$0.05)	\$0.00	(\$0.05)	\$0.00	(\$0.01)	(\$0.02)

Note: All information taken from Management prepared financial statements.

<sup>1</sup> Loss on equity investment in Q2-2008: \$99,306, Q2-2007: \$34,090, Q1-2008: \$58,954, Q1-2007: \$98,678, Q4-2007: \$7,874, Q4-2006: (\$48,219), Q3-2007: \$43,251, Q3-2006: \$75,885; Loss from discontinued operations of Q2-2008: \$Nil, Q2-2007: \$14,380, Q1-2008: \$Nil, Q1-2007: \$22,590, Q4-2007: gain of \$657, Q4-2006: \$62,211, Q3-2007: \$111,495, Q3-2006: \$25,526; Gain on disposition of pharmacy in Q3-2007: \$56,245 (\$Nil in all other periods) and Amalgamation costs greater than cash received of Q2-2008: \$Nil, Q2-2007: \$29,822, 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.

#### *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

Restrictions on tobacco retailing continue to impact community pharmacy including the Company's stores in Alberta and British Columbia. BC enacted a ban on displays of tobacco in any retail outlet, which took effect on March 31, 2008 with full compliance by the Company. Meanwhile, Alberta will introduce a similar measure as of July 1, 2008 and then ban completely the sale of tobacco in pharmacies effective January 1, 2009.

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

BC's Pharmaceutical Task Force, which was appointed by the provincial health minister last November, has concluded its consultations and drafted proposals for major reforms to the province's PharmaCare program. With the release of the task force report now scheduled for May 1, 2008, the possibility of moving to a tendering system for acquiring generic drugs has already been publicly discussed by the minister. The Company has been closely monitoring developments related to the task force deliberations.

Alberta has also signaled that it is reviewing the procedure for approving the addition of new drugs to its provincial formulary. Industry stakeholders responded to a call for submissions by the former minister of health and wellness. After the recent election, which saw the Progressive Conservative Party re-elected by a wide margin, the province indicated its interest in working with other western provinces to establish a bulk-buy policy for health equipment, drugs and supplies. The government has also started negotiations on the dispensing fee for pharmacy, which has been frozen at the same rate scale for several years. That move is viewed as a positive sign that compensation for pharmacy services will be increased in Alberta.

One of the initiatives for immediate action by the newly appointed health minister is to expand the role of Alberta pharmacists in preventing illness and managing chronic diseases, particularly in rural communities. The government has invested \$9 million in short-term demonstration projects of alternate payment models for pharmacists' services that emphasize outcomes of care.

The process to amend the Manitoba Pharmaceutical Act has been derailed by a vote of pharmacists rejecting the changes proposed by the Manitoba Pharmaceutical Association. Largely fueled by the MPA's efforts to restrict the sale of prescription drugs via the Internet, pharmacists indicated they want to start over with the painstaking task of developing new regulations. A new strategy for amending the Act is due to be tabled at a special meeting of the MPA in early May. Meanwhile, the province will begin shortly negotiations on compensation for pharmacy service to personal care homes—a significant activity for the Company in its Manitoba operations.

An on-going development in both Alberta and BC is the upgrade of technology systems connecting pharmacies to Alberta Blue Cross and PharmaNet respectively. Although the changes entail substantial costs for government and industry, the enhanced network systems are intended to streamline the important links between pharmacists and physicians and eventually establish complete electronic health records for all patients while allowing the use of electronic prescribing. The Company views these measures as very promising and expects to build on its already strong relationship with many doctors in offering a collaborative approach to serving patients' healthcare needs.

**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.

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. During the quarter, the other party disposed of its retail operations and therefore their reliance on the system is now minimal.

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.