

PARAGON PHARMACIES LIMITED**MANAGEMENT DISCUSSION & ANALYSIS
FOR THE 3 AND 9 MONTH PERIODS ENDED MAY 31, 2008****As at July 30, 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 nine month periods ended May 31, 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 nine month periods ended May 31, 2008. The presentation in the interim financial statements for the three month and nine month periods ended May 31, 2008 conforms with that used for the year ended August 31, 2007. Certain accounts for the three month and nine month periods ended May 31, 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 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. This list is not exhaustive of the factors that may affect any of the Company’s forward-looking statements. Investors and others should carefully consider these and other factors and not place undue reliance on these forward-looking statements. In addition, these forward-looking statements relate to the date on which they were made, and the Company disclaims and has no intention or obligation to update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

NON-GAAP FINANCIAL MEASURES

The Company reports its financial results in accordance with Canadian GAAP. However, the foregoing contains references to non-GAAP financial measures, such as operating income, EBITDA (earnings 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.

NON-GAAP FINANCIAL MEASURES *(continued)*

These non-GAAP financial measures have been included in this Management's Discussion and Analysis as they are measures which management uses to assist in evaluating the Company's operating performance against its expectations and against other companies in the retail 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.

STRATEGY AND OUTLOOK

Over the nine months, Paragon has focused its business and growth strategy to benefit from the demographic trends of Canada's aging population and the desire to lead a more healthy and active lifestyle. The Company is well positioned to execute on its plan to acquire pharmacy operations and grow them organically through the provision of an enhanced product and service offering and increased profitability. The Company has secured access to significant growth capital to facilitate its acquisition strategy, and has further developed its corporate infrastructure and management team in order to integrate the acquisitions and transform the Company into a leading community pharmacy services organization.

The Company has continued launching its new retail brand of *Paragon Community Pharmacy* to enhance its value proposition and communication with its customers. In the fall, it expects to introduce this brand to the Company's Alberta retail locations. Paragon continues to develop its stores to better take advantage of the high volume of prescription customers with additional product categories including cosmetics, home health care and giftware. The Company is focused on increasing the penetration of its private label products to further enhance the product offering to customers. The development of these categories, along with its private label introductions, will continue to grow its gross margin.

The Company is enhancing its marketing programs in Alberta to continue to grow and solidify its retail operations in that market. The Company is working aggressively to upgrade its current store locations, currently operating under the Super Drug Mart banner, and move into higher margin product categories, including home health care, cosmetics, and giftware. The Company continues to focus on the growth of its pharmacy operations and position itself to capitalize on the growing prescription demand at both the retail and institutional market segments.

The Company expects to continue to seek out acquisition opportunities in the long-term care pharmacy services area, in addition to continuing to acquire retail pharmacies. As it continues to grow its operations, Paragon has focused on developing strategic long-term relationships with industry leaders and key suppliers, in order to streamline operations and further grow margins.

OVERVIEW

As at May 31, 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.

OVERALL PERFORMANCE

Key Operating, Investing and Financial Metrics

The following provides a summary of the Company's performance for the three month and nine month periods ended May 31, 2008 compared to the three month and nine month periods ended May 31, 2007.

- Third quarter revenue from continuing operations of \$22.357 million (2007: \$17.067 million), an increase of 31.0%. Third quarter pharmacy revenue of \$15.273 million (2007: \$10.145 million) and front store revenue¹ \$7.084 million (2007: \$6.922 million).
 - Nine month revenue from continuing operations of \$61.623 million (2007: \$49.172 million), an increase of 25.3%. Nine month pharmacy revenue of \$39.766 million (2007: \$28.257 million) and front store revenue \$21.858 million (2007: \$20.915 million).
- Third quarter comparable store revenue growth of 2.0% (excluding tobacco and home health care); comparable pharmacy revenue growth of 6.4%; comparable front store revenue¹ growth of -4.8% (excluding tobacco and home health care).
 - Nine month comparable store revenue growth of 4.0% (excluding tobacco and home health care); comparable pharmacy revenue growth of 7.0%; comparable front store revenue¹ growth of -0.5% (excluding tobacco and home health care).
- Third quarter gross margin as a percentage of revenue of 36.9% (2007: 33.7%), an increase of 3.2%. Third quarter pharmacy gross margin as a percentage of revenue of 40.1% (2007: 36.5%) and front store gross margin as a percentage of revenue of 29.9% (2007: 28.6%).
 - Nine month gross margin as a percentage of revenue of 34.9% (2007: 32.9%), an increase of 2.0%. Nine month pharmacy gross margin as a percentage of revenue of 37.2% (2007: 34.8%) and front store gross margin as a percentage of revenue of 30.8% (2007: 30.2%).
- Third quarter operating income of \$1.790 million (2007: \$1.131 million), an increase of 58.3%, primarily a result of operating income from the recent acquisitions.
 - Nine month operating income of \$4.977 million (2007: \$3.725 million), an increase of 33.6%, primarily a result of operating income from the recent acquisitions.
- Third quarter EBITDA² of \$0.909 million (2007: \$0.397 million), an increase of 128.8%.
 - Nine month EBITDA² of \$2.377 million (2007: \$2.132 million), an increase of 11.5%.

OVERALL PERFORMANCE *(continued)*

- Third quarter EBITDA margin³ of 4.1% (2007: 2.3%), an increase of 78.3%
 - Nine month EBITDA margin³ of 3.9% (2007: 4.3%), a decrease of 9.3%.

¹ Front store revenue includes all non-pharmacy revenue.

² 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).

³ EBITDA margin defined as EBITDA divided by Revenue.

CORPORATE DEVELOPMENT HIGHLIGHTS

- During the quarter the Company concluded successful negotiations with Canterbury Park ("Canterbury") to retain the unused convertible debenture funds and gain access to \$4,000,000 of the funds without matching senior debt.
- During the quarter the Company continued with the expansion of the Paragon Community Pharmacy brand with the re-branding of its 2 retail pharmacies in Manitoba.
- During the quarter the Company continued with a focus on front store operations in Alberta with store upgrading to simplify and enhance the shopping experience for our customers.
- During the quarter the Company continued with construction of a new 12,000 square foot retail pharmacy including a third party medical clinic in Kelowna. The store will be opened in September 2008 and brings our total retail square footage to approximately 130,000 square feet.
- The Company continued the process of implementing the previously announced debt repurchase agreement with the net effect being the proposed cancellation of 8,000,000 shares which represents approximately 20% of the outstanding share capital. A Special Meeting of shareholders will be held in August to approve the transaction.

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		9 Months Ended	
	May 31 2008	May 31 2007	May 31 2008	May 31 2007
Revenue	22,356,824	17,067,123	61,623,421	49,171,845
Gross Margin	8,242,180	5,749,954	21,529,466	16,186,150
Operating Expenses ¹	6,452,062	4,619,025	16,552,383	12,460,981
Operating Income	1,790,118	1,130,929	4,977,083	3,725,169
Corporate Expenses	881,508	733,883	2,600,541	1,593,055
EBITDA ²	908,610	397,046	2,376,542	2,132,114
Stock-based compensation	123,696	139,676	170,961	139,676
Amortization	1,079,480	598,047	2,480,122	1,606,814
Interest expense ³	161,541	122,868	196,698	494,875
Financing costs on convertible debenture ⁴	1,934,955	493,375	5,451,435	493,375
Other Items ⁵	14,805	45,454	173,064	366,987
Net income (loss) from continuing operations	(2,405,867)	(1,002,374)	(6,095,738)	(969,612)
Loss from discontinued operations	0	(55,250)	0	(92,220)
Net Income (loss)	(2,405,867)	(1,057,624)	(6,095,738)	(1,061,832)
EBITDA per common share				
- Basic net earnings EBITDA	\$0.02	\$0.01	\$0.06	\$0.06
- Diluted net earnings EBITDA	\$0.02	\$0.01	\$0.06	\$0.06
Earnings per common share				
- Basic net loss	(\$0.06)	(\$0.03)	(\$0.15)	(\$0.03)
- Diluted net loss	(\$0.06)	(\$0.03)	(\$0.15)	(\$0.03)

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

³ Interest expense includes bank charges and interest Q3-2008: \$45,487 (Q3-2007: \$30,655), YTD-2008: \$123,650 (YTD-2007: \$102,745); interest on long term debt Q3-2008: \$259,718 (Q3-2007: \$151,568), YTD-2008: \$606,633, (YTD-2007: \$494,168); , and interest income of Q3-2008: \$143,664 (Q3-2007: \$59,355), YTD-2008: \$533,585 (YTD-2007: \$102,038).

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

⁵ Other items include amalgamation costs in excess of cash received of Q3-2008: \$Nil (2007: \$2,203), YTD-2008: \$Nil (YTD-2007: \$190,968) and loss on equity investments of Q3-2008: \$14,805 (2007: \$43,251), YTD-2008: \$173,064 (YTD-2007: \$176,019).

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 third quarter was \$22.357 million compared to \$17.067 million for the same period last year, an increase of \$5.290 million or 31.0%. Increases were primarily a result of growth from acquisitions.

Revenue for the nine month period was \$61.623 million compared to \$49.172 million for the same period last year, an increase of \$12.452 million or 25.3%. Increases were primarily a result of growth 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, central fill pharmacies and home health care stores. Gross margin was \$8.242 million in the third quarter compared to \$5.750 million for the same period last year, an increase of \$2.492 million or 43.3%. 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 318 basis points to 36.9% from 33.7% in the same period last year.

Gross margin was \$21.529 million for the nine month period compared to \$16.186 million for the same period last year, an increase of \$5.343 million or 33.0%. 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 202 basis points to 34.9% from 32.9% 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 third quarter were \$6.452 million compared to \$4.619 million for the same period last year, an increase of \$1.833 million or 39.7%. This was primarily a result of operating expenses from the stores acquired of \$1.505 million. Other factors included 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 180 basis points to 28.9% from 27.1% 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 \$1.790 million in the third quarter compared to \$1.131 million for the same period last year, an increase of \$0.659 million or 58.3%.

Operating income was \$4.977 million for the nine month period compared to \$3.725 million for the same period last year, an increase of \$1.252 million or 33.6%.

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 excluding stock based compensation.

Corporate expenses in the third quarter were \$0.882 million compared to \$0.734 million for the same period last year, an increase of \$0.148 million. Corporate expenses have grown over the past year due to one-time corporate activities and professional fees.

Corporate expenses for the nine month period were \$2.601 million compared to \$1.593 million for the same period last year, an increase of \$1.007 million. This increase is partially due to higher staffing levels required for the integration of our acquisitions. This in addition to the expenses described in the third 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 \$0.909 million in the third quarter compared to \$0.397 million for the same period last year, an increase of \$0.512 million or 128.8%. EBITDA margin, defined as EBITDA divided by Revenue, increased to 4.1% in the third quarter from 2.3% 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 and EBITDA from acquisitions.

EBITDA was \$2.377 million for the nine month period compared to \$2.132 million for the same period last year, an increase of \$0.244 million or 11.1%. EBITDA margin, defined as EBITDA divided by Revenue, decreased to 3.9% for the nine month period from 4.3% 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 third quarter was \$0.124 million compared to \$0.140 million for the same period last year.

Stock based compensation for the nine month period was \$0.171 million compared to \$0.140 million for the same period last year.

Amortization

Amortization of capital and intangible assets were \$1.079 million in the third quarter compared to \$0.598 million for the same period last year, an increase of \$0.481 million or 80.5%. This increase is primarily a result of amortization resulting from the acquisitions.

Amortization of capital and intangible assets were \$2.480 million for the nine month period compared to \$1.607 million for the same period last year, an increase of \$0.873 million or 54.4%. This increase is primarily a result of amortization resulting from the acquisitions.

RESULTS OF OPERATIONS (continued)

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 \$0.162 million in the third quarter compared to an expense of \$0.123 million for the same period last year, an increase of \$0.039 million. Bank charges and interest were \$0.045 million (2007: \$0.031 million); interest on long term debt was \$0.260 million (2007: \$0.152 million); and interest income of \$0.144 million (2007: \$0.059 million).

Interest expense was \$0.197 million for the nine month period compared to an expense of \$0.495 million for the same period last year, a decrease of \$0.298 million. Bank charges and interest were \$0.124 million (2007: \$0.103 million); interest on long term debt was \$0.607 million (2007: \$0.494 million); and interest income of \$0.534 million (2007: \$0.102 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 third quarter were \$1.935 million compared to \$0.493 million for the same period last year and included accretion of \$0.922 million, accrued interest of \$0.804 million and financing fees of \$0.209 million.

Total financing costs on the convertible debenture for the nine month period were \$5.451 million compared to \$0.493 million for the same period last year and included accretion of \$2.635 million, accrued interest of \$2.304 million and financing fees of \$0.513 million.

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 third quarter was \$2.406 million compared to a loss of \$1.058 million for the same period last year, a difference of \$1.348 million. The loss is attributed to one-time corporate activities and professional fees. On a diluted basis, earnings per share in the third quarter were negative \$0.06 compared to negative \$0.03 for the same period last year.

The net loss for the nine month period was \$6.096 million compared to a loss of \$1.062 million for the same period last year, an increase of \$5.033 million. The loss is attributed to increased staffing levels necessary to assist in the integration of our acquisitions. On a diluted basis, earnings per share for the nine month period were negative \$0.15 compared to negative \$0.03 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.

	May 31, 2008	August 31, 2007
Cash and cash "in trust"	0	2,833,569
Restricted cash	13,483,846	20,110,574
Bank Indebtedness	1,173,151	0
Current portion of long-term debt and capital leases and compensation obligation	12,853,831	2,823,547
Long-term debt and capital leases ¹	23,142,194	27,879,324
Net debt ²	23,685,330	7,758,728
Shareholders' equity ³	19,006,864	21,644,615
Total capitalization ⁴	42,692,194	29,403,343

¹ Includes the equity portion of the Convertible debenture.

² 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.

³ Excludes the equity portion of the Convertible debenture.

⁴ Total capitalization equals net debt plus shareholders' equity.

⁵ EBITDA defined as earnings before interest expense, income taxes, amortization, stock-based compensation, other items as defined, and loss from discontinued operations.

⁶ Cash interest expense defined as interest on long term debt only.

OFF-BALANCE SHEET ARRANGEMENTS

The Company has no off-balance sheet arrangements.

OUTSTANDING SHARE DATA

The Company had 47,407,043 common shares outstanding at May 31, 2008. As at this same date, the Company had outstanding options to acquire 1,212,583 of its common shares and warrants to acquire 6,725,000 of its common shares. Further details are available in Note 12 of the interim unaudited consolidated financial statements at May 31, 2008.

LIQUIDITY AND CAPITAL RESOURCES

At May 31, 2008 the ratio of current assets to current liabilities was 1.49 compared to 1.90 at August 31, 2007. Working capital was \$9.989 million compared to \$7.442 million at August 31, 2007.

LIQUIDITY AND CAPITAL RESOURCES (continued)

The Company also had access to a \$3.0 million operating line with a Canadian chartered bank as at May 31, 2008. The Company utilized \$480,000 of the operating line for letter of credits and had cheques issued in excess of funds on deposit of \$1,173,151, of the \$3,000,000 facility, leaving \$1,346,849 available.

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 access the convertible debenture funds.

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

The Company expects to be in compliance with its financial covenants at August 31, 2008, unless it is unsuccessful in completing the conversion of the convertible debenture by August 31, 2008

Operating Activities

For the third quarter, net cash flow generated from operating activities from continuing operations was \$0.639 million compared to \$0.240 million in the same period last year.

For the nine month period, net cash flow generated from operating activities from continuing operations was \$0.783 million compared to \$1.857 million in the same period last year. This difference was primarily from changes in non-cash working capital items.

Financing Activities

For the third quarter, net cash used in financing activities was \$1.410 million compared to net cash injection of \$20.106 million in the same period last year. This decrease relates primarily to the issuance of the convertible debenture and share capital last year.

For the nine month period, net cash injection from financing activities was \$4.470 million compared to net cash injection of \$22.442 million in the same period last year. This decrease relates primarily to the issuance of the convertible debenture and share capital last year.

LIQUIDITY AND CAPITAL RESOURCES (continued)

Investing Activities

For the third quarter, net cash used in investing activities was \$0.192 million compared to \$21.175 million in the same period last year. This decrease relates primarily to the restricted cash from the convertible debenture last year.

For the nine month period, net cash used in investing activities was \$9.260 million compared to \$21.834 million in the same period last year. This decrease relates primarily to decreased acquisitions.

Canterbury Park

In May 2007, the Company issued a \$20.0 million convertible debenture ("Convertible Debenture"). The Convertible Debenture has a term of 2 years. As of July 30, 2008, \$12,939,820 remains unspent. In May 2008, the Company and the debenture holder have agreed to terms and conditions by which Paragon will retain the unspent funds. Interest was paid on the debenture funds for the first year in the amount of \$3,000,000 by the issuance of 6,322,445 shares to the debenture holder was determined in accordance with the agreement. The interest rate on the unspent funds will accrue at 20% and the interest on the spent funds will continue to accrue at 15%. The company also gained access to \$4,000,000 of the unspent funds without matching senior debt.

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 as described in the agreement. 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 May 31, 2008 for further information.

Future Liquidity

Based on forecasted operations the company estimates 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. \$104,088; and 1036985 Alberta Ltd. (Cochrane Super Drug Mart) \$644,721. The amounts due are non-interest bearing, unsecured with no fixed terms of repayment. The Company has a 50% interest in these companies.

TRANSACTIONS WITH RELATED PARTIES *(continued)*

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 and nine months ended May 31, 2008, the Company has paid \$41,667 and \$141,667 respectively to Canterbury related to this advisory agreement.

For the three months ended May 31, 2008, the Company paid \$80,636 (2007: \$70,421) in rent for premises leased under operating leases with related parties, which are related by virtue of common management and directors. For the nine months ended May 31 2008, the Company paid \$218,933 (2007: \$212,718) 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.

	Third Quarter		Second Quarter		First Quarter		Fourth Quarter	
	2008	2007	2008	2007	2008	2007	2007	2006
Revenue	22,356,824	17,067,123	21,589,743	16,208,970	17,676,854	15,912,830	16,973,971	16,659,660
Income (loss) before other items ¹	(2,391,062)	(956,920)	(1,896,419)	17,931	(1,833,804)	194,160	(2,505,880)	(22,288)
- Loss per share - Basic	(\$0.06)	(\$0.03)	(\$0.05)	\$0.00	(\$0.04)	\$0.01	(\$0.07)	\$0.00
- Loss per share - Diluted	(\$0.06)	(\$0.03)	(\$0.05)	\$0.00	(\$0.04)	\$0.01	(\$0.05)	\$0.00
Net (loss)income	(2,405,867)	(1,057,624)	(1,797,113)	81,843	(1,892,758)	(86,051)	(2,513,097)	(66,102)
- Net loss per share - Basic	(\$0.06)	(\$0.03)	(\$0.04)	\$0.00	(\$0.05)	\$0.00	(\$0.07)	\$0.00
- Net loss per share - Diluted	(\$0.06)	(\$0.03)	(\$0.04)	\$0.00	(\$0.05)	\$0.00	(\$0.05)	\$0.00

Note: All information taken from Management prepared financial statements.

¹ Loss on equity investment in Q3-2008: \$14,805, Q3-2007: \$43,251, Q2-2008: \$99,306, Q2-2007: \$34,090, Q1-2008: \$58,954, Q1-2007: \$98,678, Q4-2007: \$7,874, Q4-2006: (\$48,219); Loss from discontinued operations of Q3-2008: \$Nil, Q3-2007: \$111,495, Q2-2008: \$Nil, Q2-2007: \$14,380, Q1-2008: \$Nil, Q1-2007: \$22,590, Q4-2007: \$657, Q4-2006 \$62,211; Gain on disposition of pharmacy in Q3-2007: \$56,245 (\$Nil in all other periods) and Amalgamation costs greater than cash received of Q3-2008: \$Nil, Q3-2007: \$2,203, Q2-2008: \$Nil, Q2-2007: \$29,822, Q1-2008: \$Nil, Q1-2007: \$158,943, Q4-2006: \$29,822.

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

RISKS AND RISK MANAGEMENT

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

Competition

Pharmacy operations are very competitive and many of the Company's current competitors are of a size and scale of operations that greatly exceeds those of the Company. Thus they may have access to more favourable procurement terms and other operating benefits not available to the Company that permits them to have certain cost advantages.

General economic conditions

The Company currently operates in Western Canada. Should general economic conditions deteriorate in such a way as to reduce consumer spending the Company's profitability may be impacted.

Key Personnel

The successful operation of the Company's business depends upon the abilities, expertise, judgment, discretion, integrity and good faith of its executive officers, general managers, employees and consultants. In addition, the ability of the Company to expand its services will depend upon the ability to attract qualified personnel as needed. The demand for skilled employees is high, and the supply is limited. The unexpected loss of the Company's key personnel or the inability to retain or recruit skilled personnel could have a material adverse effect on the Company's business, financial condition, results of operations and cash flows.

Internal Control Deficiencies

The Company's inability to successfully address potential material weaknesses in internal controls or other control deficiencies may affect its ability to report its financial results on a timely and accurate basis and to comply with disclosure and other requirements.

Breach of financial covenants

The Company's is dependent upon continued access to capital on terms acceptable to the Company, including bank indebtedness and lending facilities. Prior to the recent amendments to its banking agreement, the Company was in breach of certain financial covenants. There can be no assurance that the Company will be able to comply with such any or all such covenants in the future. Should it not be able to meet these covenants or arrange further amendments in the future, the Company would be exposed to the bank realizing on its security, thus hindering the ability of the Company to operate effectively.

Financial Instruments

The following discussion on Risks and Risk Management provides certain of the required disclosures under CICA Handbook Section 3862, "Financial Instruments – Disclosures" related to the nature and extent of risks arising from financial instruments, as permitted by the standard. Therefore, this section forms an integral part of the unaudited interim consolidated financial statements for the three and nine month periods ended May 31, 2008.

RISKS AND RISK MANAGEMENT *(continued)*

Financial Instruments (continued)

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 exposures are interest rate risk and liquidity risk. The Company's exposures to foreign currency risk, credit risk and other price risk are not considered to be material. The Company may use derivative financial instruments to manage certain of these risks. The Company does not use derivative financial instruments for trading or speculative purposes.

Exposure to Interest Rate Fluctuations

The Company is exposed to fluctuations in interest rates by virtue of its borrowings under its bank credit facilities and commercial paper program. Increases or decreases in interest rates will positively or negatively impact the financial performance of the Company.

As at May 31, 2008 the Company had \$1.173 million of unhedged floating rate debt. During the 3 months ended May 31, 2008, the Company's average outstanding unhedged floating rate debt was \$0.850 million. The Company does not consider its exposure to interest rate fluctuations to be material at this time.

Foreign Currency Exchange Risk

The Company conducts the vast majority of its business in Canadian dollars. The Company's foreign currency exchange risk principally relates to purchases made in U.S. dollars and this risk is tied to fluctuations in the exchange rate of the Canadian dollar. The Company does not consider its exposure to foreign currency exchange rate risk to be material.

Credit Risk

Accounts receivable arise primarily in respect of prescription sales billed to governments and third-party drug plans and as a result, collection risk is low. There is no concentration of balances with debtors in the remaining accounts receivable. The Company does not consider its exposure to credit risk to be material.

Liquidity Risk

The Company's primary objectives when managing its capital and liquidity are to profitably grow its business while maintaining adequate financing flexibility to fund attractive new investment opportunities and other unanticipated requirements or opportunities that may arise. Profitable growth is defined as earnings growth commensurate with the additional capital being invested in the business in order that the Company earns an attractive rate of return on that capital. The primary investments undertaken by the Company to drive profitable growth include additions to the selling square footage of its store network via the construction of new, relocated and expanded stores, including related leasehold improvements and fixtures, as well as through the acquisition of independent drug stores or their prescription files. In addition, the Company makes capital investments in information technology and its distribution capabilities to support an expanding store network.

REGULATORY CHANGES THAT IMPACT THE COMPANY'S INDUSTRY

The BC government has signaled its intention to bring proposals for drug program reforms to Cabinet before the end of 2008. The Ministry of Health Services has already experimented with a tendering approach to procurement of pharmaceuticals and related supplies. Retail pharmacy operations are concerned that widespread use of tendering could dramatically alter business relationships they have with generic manufacturers, who have traditionally supported pharmacy through professional allowances. Unless government agrees to significant increases in dispensing fees (which now lag behind actual retailer costs by approximately \$5 per prescription) or begins compensating pharmacists for other services, the economics of the BC pharmacy industry could be severely impacted by a curtailment in allowances.

Alberta is also in the process of developing a provincial pharmaceutical strategy. Paragon and other pharmacy stakeholders are scheduled to meet in late July with Jonathan Denis, the government MLA appointed to advise the Minister of Health and Wellness on possible directions to maximize the value for patients of drug programs administered by Alberta Blue Cross. Premier Ed Stelmach publicly supports working with other western provinces to establish a bulk-buy policy for health equipment, drugs and supplies. As in BC, community pharmacy is working behind the scenes to raise compensation rates for dispensing services so that cost-cutting measures such as tendering do not force stores to cut services or even close their doors.

Across Canada, much attention is being paid to the latest developments in Ontario's overhaul of its public drug program. With a recent study determining that a funding gap of up to \$9 per prescription exists in that province, the sudden move to implement "competitive agreements" to source the most common molecules could further reduce drug store revenues by diverting a portion of generic allowances away from pharmacies and into public coffers. Protests from the Canadian Association of Chain Drug Stores and other groups prompted the Minister of Health to delay the plans until further consultations can be held.

The Company is closely monitoring these developments at the provincial level while seeking opportunities to explore additional pharmacy-related revenue streams to offset the inevitable decline in financial support from generic drug suppliers. It is encouraged by the Alberta government's move to invest \$9 million in short-term demonstration projects of alternate payment models for pharmacists' services that emphasize outcomes of patient care.

Effective January 1, 2009, tobacco sales will no longer be permitted from health care facilities, pharmacies, and stores that contain a pharmacy. The Company is committed in adhering to the Canadian governments Tobacco Reduction Act and will eliminate tobacco from its stores by the end of 2008.

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.

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 is currently seeking a full-time Chief Financial Officer who is supported by 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.

SUBSEQUENT EVENTS

Conversion of debenture

On July 30, 2008, the Company and Canterbury Park agreed on terms to convert the \$20,000,000 convertible debenture and accrued interest to shares that will result in the issuance of a total of 38,189,922 shares at an average price of approximately \$0.645 per share. The effective date of the conversion will be August 31, 2008.

The outstanding debenture principal of \$20,000,000 will be converted at the conversion price agreed in the original debenture of \$0.8028 per share resulting in the issuance of 24,912,805 shares.

Accrued interest of \$1,209,003 and an interest adjustment of \$566,000, both calculated in accordance with the terms of the debenture, will be paid in shares priced at \$0.35 per share for a total issuance of 5,071,437 shares.

SUBSEQUENT EVENTS

Conversion of debenture (continued)

A conversion inducement fee of \$2,871,988, representing interest that would otherwise have been earned in accordance with the debenture terms from August 31, 2008 to the maturity date of the debenture of \$2,437,988 and an agreed interest adjustment of \$434,000, will also be paid in shares priced at \$0.35 per share resulting in the issuance of 8,205,680 shares.

The transaction is subject to certain closing conditions including regulatory approval, satisfactory negotiations with the Company's bankers, the receipt by the Company of a satisfactory third party fairness opinion on the transaction and shareholder approval of the transaction outlined below.

Share cancellation

On January 31, 2008 the Company announced that it had entered into a purchase and sale agreement (the "Agreement") to acquire a promissory note representing debt in the principal amount of \$7,139,000 from an arm's length third party (the "Lender"). In conjunction with the acquisition of the debt, the Company is also acquiring all rights and benefits of the Lender to recover repayment of such indebtedness including any and all security interests granted by the borrower to the Lender.

The purchase price for the debt is \$4,139,000 which is payable through \$139,000 in cash at closing and a deferred payment of \$4,000,000 bearing interest at 6.0% per annum to be paid in full no later than September 30, 2017.

Security for the debt includes, among other things, 8,000,000 common shares in the capital of Paragon. It is the Company's intention to immediately realize on the 8,000,000 common shares comprising a portion of the security on the debt. The common shares will then be cancelled by Paragon. This cancellation will reduce the amount of the debt owed Paragon by the borrower by \$4,400,000 leaving an outstanding balance of \$2,739,000. The Company is unable to determine, at this time, whether the outstanding balance will be collectible.

The agreement and the transaction remain subject to shareholder and regulatory approval and a shareholder meeting to approve has been scheduled for August 29, 2008.