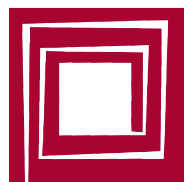
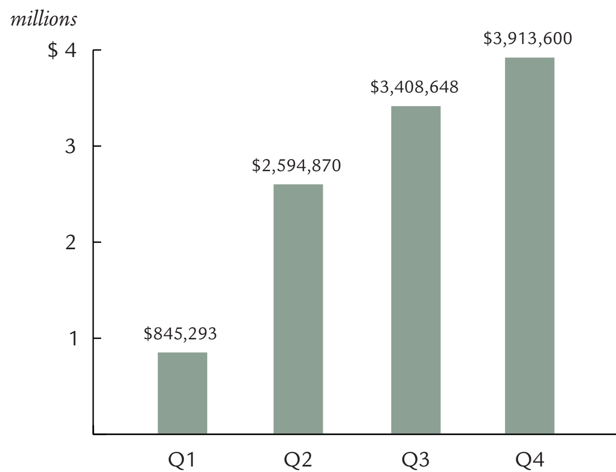
PARETO CORPORATION 2002 ANNUAL REPORT



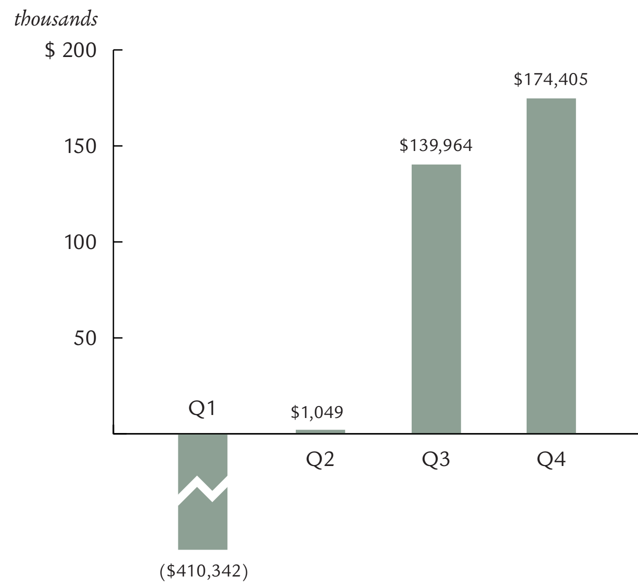
Financial Highlights

For the years ended December 31	2002	2001
Revenue	$ 10,762,411	$ 1,988,067
Gross profit	2,957,470	382,321
EBITDA	(94,924)	(1,960,414)
Net income (loss) for the year	(462,768)	(2,642,429)
Basic and fully diluted earnings (loss) per common share	$ (0.017)	$ (0.14)
Basic and fully diluted weighted average number of common shares outstanding	26,654,873	18,408,857

2002 revenue by quarter



2002 EBITDA by quarter



Pareto Corporation's annual general meeting will take place on June 23, 2003 at 4:30 p.m. in the Gallery of The Exchange Tower, 130 King Street West, Toronto.

Letter to Shareholders

2002 was a year of great progress for Pareto Corporation. I am very pleased with what our new management team has been able to achieve. In a challenging economic environment, Pareto took substantial steps toward a successful business turnaround:

- *New strategic direction and business development.* In 2002, our Company renewed itself under a new brand: Pareto. The change went well beyond a name, to a new focus on our business strategy. This focus brought us significant new business wins.

- *Improved financial performance.* Pareto improved bottom-line performance by more than $2.1 million in 2002, reducing the full-year net loss from $2,642,429 in 2001 to $462,768 in 2002. This improvement was achieved as Pareto's Print and Digital units won substantial amounts of new business. In 2002, our revenues grew by 441%. In addition, Pareto was able to generate higher margins from its services as we focused on delivering services effectively and profitably.

- *Effective acquisitions.* We completed two acquisitions in 2002, purchasing Naylor Event Management and Bridge Sales and Marketing, which, respectively, have become Pareto's Event and Solutions units. The Event unit had a strong showing in 2002, exceeding management's initial forecasts for Pareto's ownership period. This financial contribution is enhanced by Pareto's ability to offer a wider set of marketing service solutions to our clients.

- *Cost controls.* Pareto undertook several cost reduction measures in early 2002, with the goal of having a leaner fixed cost base and a more profitable business. Headcount is now better aligned with our business needs, and a higher proportion of our people are now engaged in the day-to-day work that really matters – delivering high-quality service to our clients.

- *Refinancing.* Pareto successfully completed a $1.2 million private placement equity offering in 2002, as well as obtaining a $1.25 million bank credit facility under more favourable lending terms. Reducing our cost of capital is a critical element in building Pareto's value.

In 2003, we will continue to build the links among our divisions. Pareto will become an efficient, integrated whole. We believe that unity within our business will drive success in developing new business opportunities, as well as provide our clients with the highest standards of service.

Our focus as a company is on the less glamorous, nuts-and-bolts elements of the marketing process – execution. With Pareto's help, in-house marketing teams and creative agencies can focus on what they do best – strategy. Pareto can provide what clients need: a single point of contact and accountability capable of steering projects down the often bumpy road from concept to creative, from design to production, and from execution to fulfillment. The details are where we excel. And every day we're getting even better.

We have a management team with broad strengths and capabilities that stands poised to deliver profitable growth for Pareto. I've been very happy with every addition made to the team this year. We work at this business with passion and excitement, and we expect that commitment to show up in our financial and professional results in the future.

Our work is just beginning. I extend thanks to every one of our stakeholders for your continuing support.

Kerry Shapansky *(signed)*
President & Chief Executive Officer
March 7, 2003

Management's Discussion and Analysis

The following discussion and analysis focuses on Pareto Corporation's (the "Company" or "Pareto") operating performance for the years ended December 31, 2002 and 2001. It reviews the Company's financial performance and financial condition and should be read in conjunction with, and is derived from, the audited consolidated financial statements presented later in this annual report.

Forward-looking statements
The Company and its representatives periodically make written and spoken forward-looking statements, including those contained in this annual report. By their nature, forward-looking statements are subject to risks and uncertainties that could result in actual performance being materially different from anticipated results. The Company cautions readers, when making decisions, to consider the risks and uncertainties of forward-looking statements. The Company relies upon litigation protection for forward-looking statements.

Operating Results

Revenue, gross profit, operating expenses

	2002	2001	$ Change	% Change
Revenue	$ 10,762,411	$ 1,988,067	$ 8,774,344	441%
Direct costs	7,804,941	1,605,746	6,199,195	386%
Gross profit	$ 2,957,470	$ 382,321	$ 2,575,149	674%
Gross profit (%)	27.5%	19.2%		
Expenses				
Facilities	$ 461,193	$ 229,193	$ 232,000	101%
Selling and administration	2,591,201	2,113,542	477,659	23%
	$ 3,052,394	$ 2,342,735	$ 709,659	30%
	$ (94,924)	$ (1,960,414)	$ 1,865,490	(95%)

Revenue
In the year ended December 31, 2002, Pareto generated $10,762,411 of revenue, an increase of 441% over the $1,988,067 recorded in fiscal 2001. This was the result of strong internal growth, as well as a full year of results from the Tone ("Digital") and Campbell Group ("Print") acquisitions. Without the contribution of Naylor Event Management ("Event"), revenue in 2002 increased $4,750,224, or 239%, over 2001. The remainder of the revenue increase came from the acquisition of Event, which contributed $4,024,120 of revenue in the year. With Event's revenue included on a pro forma basis for all of 2002, the Company's 2002 revenue was approximately $14.5 million. The Company's largest customer accounted for 29% of 2002 revenues, compared to 24% in 2001.

Gross profit

As a percentage of sales, gross profit improved to 27.5% in 2002, up from 19.2% in 2001. This increase was the result of certain projects undertaken by the Company in 2001 when it was in a start-up phase. These projects, which generated substantially below-average gross profit percentages, were intended to help build the Company's revenues. The Company now focuses on generating a healthy level of gross profit from all of its projects, which resulted in a substantial improvement in the gross profit percentage in 2002.

Operating expenses

Operating expenses, which include facilities and selling and administration expenses, were $3,052,394 in 2002, an increase of $709,659, or 30%, from 2001. Offsetting the addition of selling and administration expenses from the Event acquisition was the impact of Pareto's cost reduction initiatives in 2002. If Event's selling and administration expenses are removed from consideration in 2002, the Company's selling and administration expenses were substantially unchanged. As a percentage of revenues, operating expenses decreased from 118% in 2001 to 28% in 2002.

EBITDA

EBITDA as defined by the Company (earnings before amortization, interest, special charges, and income taxes) changed from a loss of $1,960,414 in 2001 to a loss of $94,924 in 2002. This significant favourable development was the result of a combination of revenue growth and cost control.

Amortization, interest, other charges, income taxes

	2002	2001	$ Change	% Change
Amortization of capital assets	$ 194,060	$ 110,068	$ 83,992	76%
Amortization of intangible assets	22,208	–	22,208	–
Interest and finance charges	162,076	14,178	147,898	1043%
Unsuccessful acquisition costs	–	279,941	(279,941)	(100%)
Loss on disposal of assets	–	24,597	(24,597)	(100%)
Restructuring expenses	–	47,354	(47,354)	(100%)
Writedown of goodwill	–	242,000	(242,000)	(100%)
	$ 378,344	$ 718,138	$ (339,794)	(47%)
Net loss before income taxes	$ (473,268)	$ (2,678,552)	$ 2,205,284	(82%)
Income taxes:				
Current	–	(5,123)	5,123	(100%)
Future	(10,500)	(31,000)	20,500	(66%)
	$ (10,500)	$ (36,123)	$ 25,623	(71%)
Net loss for the year	$ (462,768)	$ (2,642,429)	$ 2,179,661	(82%)

Amortization of capital assets

Capital asset amortization increased from $110,068 in 2001 to $194,060 in 2002. The increase was partly caused by the full-year amortization of capital assets acquired in 2001. The increase was also driven by certain software additions in 2002 that were fully depreciated during the year. Pareto's business does not require extensive investment in capital assets. Additions of $44,820 in 2002 were equivalent to 0.4% of revenues.

Interest and finance charges

Interest and finance charges increased from $14,178 in 2001 to $162,076 in 2002. The majority of the Company's long-term debt was incurred to finance the Event acquisition. The Company's long-term debt was $1,350,000 at December 31, 2002, up from $30,000 at December 31, 2001. Interest-bearing long-term debt outstanding at year end included $1,000,000 of secured debt bearing interest at prime plus 2.5% per annum and $350,000 of unsecured debt bearing interest at 8.75% per annum. Cash interest expense for 2002 was $84,535. Interest expense included $48,541 of deferred finance cost amortization and $29,000 of interest imputed with respect to the acquisition of Event.

Other expense items

The Company's 2002 results were not impacted by unsuccessful acquisition costs, loss on disposal of assets, restructuring expenses, and writedown of goodwill, which collectively reduced 2001 income by $593,892.

Income taxes

In 2002, the Company recorded no current income taxes, and a future income tax recovery of $10,500. The Company did not record a higher income tax recovery in 2002 because of an increase in the valuation allowance for the Company's tax loss carryforwards. Future taxable income will be reduced by these non-capital loss carryforwards, which totaled approximately $1,930,000 at December 31, 2002.

Net loss

Pareto's net loss in 2002 was $462,768 or $0.017 per share, improving from a net loss of $2,642,429 or $0.14 per share in 2001. The decrease in the net loss was the result of increased revenues and improved margins, control over costs, and the absence of significant writedowns in 2002, which had a significant impact on 2001 results.

Liquidity and Capital Resources

Cash and equivalents decreased from $1,163,440 at December 31, 2001 to $685,489 at December 31, 2002, down $477,951.

Operating activities

Cash used in operating activities was ($917,684) in 2002, an improvement from ($2,198,387) in 2001. The $1,280,703 decrease in the cash outflow from operations was primarily the result of the $2,179,661 decrease in Pareto's net loss in 2002, which was partially offset by the absence of the addback of non-cash expense items such as writedown of goodwill and loss on disposal of assets, both of which affected 2001 results.

Another factor which reduced operating cash flow in 2002 was an outflow associated with changes in non-cash working capital of $748,725. The primary cause of this change was seasonality in the Event business. Summer and fall are seasons of high activity in the business, and therefore at the acquisition date, May 31, 2002, Event had one of its lowest levels of working capital for the year. At December 31, 2002, this working capital balance had increased significantly. This buildup of Event's working capital over the seven-month period had a negative impact on Pareto's operating cash flow for the period.

Investing activities

Investing activities consumed $1,278,135 in 2002, a significant increase from $151,525 in the prior year. The increase was the result of the acquisition of Event, which used $1,233,315 in cash in 2002. Capital asset additions of $44,820 in 2002 were down 48% from $85,659 in 2001.

Financing activities

Financing activities contributed $1,717,868 in 2002, a decrease of 51% from $3,512,352 in 2001. Cash flows from financing were primarily obtained to provide funds for investing purposes in 2002.

In 2002, Pareto issued 6,000,000 shares of its common stock in a private placement, raising a total of $1,200,000. As a result of the Company's financing and investing activities in 2002, shares outstanding increased from 22,311,581 at December 31, 2001 to 32,056,081 at December 31, 2002. The Company also obtained $1,350,000 in long-term debt financing during the year, which was used to pay the initial cash consideration on the Event acquisition and to repay outstanding bank indebtedness, which totaled $458,405 at December 31, 2001.

Senior debt

Under the terms of Pareto's senior lending agreement, the Company is required to maintain certain ratios with respect to its net worth, debt service, and debt to earnings before interest, taxes, depreciation, and amortization. As at December 31, 2002, the Company was in compliance with all of these covenants.

Acquisition notes payable

Under the terms of its acquisitions of Event and Bridge Sales and Marketing Inc., subsequently renamed Pareto Solutions ("Solutions"), the Company is obligated to pay a total of $952,500 in cash: $426,250 will be paid in 2003, $426,250 in 2004, and $100,000 in 2005.

Dividends

The Company did not pay any dividends in the year ended December 31, 2002, and does not anticipate paying any dividends in the foreseeable future.

New Accounting Pronouncements

Stock options

Section 3870 of the Canadian Institute of Chartered Accountants Handbook (the "CICA Handbook") encourages but does not require companies to use the fair value method when stock options are granted to employees. This section of the CICA Handbook applies to companies with fiscal year ends commencing on or after January 1, 2002. Consequently, the Company has applied this section in the 2002 fiscal year. The Company has chosen not to use the fair value method to account for stock-based employee compensation plans, but to disclose pro forma information for options granted after January 1, 2002. The Company records no compensation expense when options are issued to employees. Any consideration paid by employees on the exercise of the options is credited to capital stock. Please see Note 5 to the consolidated financial statements.

Business combinations, goodwill, and other intangible assets

Under Section 1581 of the CICA Handbook, business combinations initiated after June 30, 2001 are required to be accounted for using the purchase method of accounting. All of the Company's acquisitions have been accounted for using the purchase method of accounting. Under Section 3062 on Goodwill and Other Intangible Assets, recorded goodwill and intangible assets are evaluated against new criteria for recording intangible assets separately from goodwill. Section 3062 also requires the non-amortization approach to account for purchased goodwill. Under the non-amortization approach, goodwill is not amortized but is instead reviewed annually for impairment.

Risks and Uncertainties

Economic uncertainty
The marketing services industry is subject to the effects of economic downturns. The Company is also exposed to the risk of clients changing their business plans or reducing their budgets for the Company's services. As a result, the Company's business, financial condition or operating results may be affected in a materially adverse manner.

Access to capital resources
While the Company expects to generate positive cash flow from operations in the coming year, the Company may raise capital to fund its future growth, either from incurring short-term or long-term indebtedness or the issuance of equity securities. Although the Company has been able to obtain such financing in the past, there is no assurance that required capital will continue to be available or that the Company will be able to refinance current or future indebtedness on terms that are acceptable to the Company.

Incurring additional indebtedness may result in increased interest expense or decreased net income and the issuance of additional equity securities could result in dilution of existing equity positions.

Competition
The marketing industry is highly competitive. In all major markets in which the Company does business, its competitors range from large multinational companies to smaller, regional agencies. The Company must compete with these companies, firms and agencies in order to maintain existing client relationships and to obtain new clients and assignments. Competitive factors include account management, creative capabilities and reputation, management, personal relationships, quality and reliability of service, and expertise in particular niche areas of the marketplace. Although the price of services may be a competitive factor in obtaining new clients, it is generally of less importance once a client relationship has been established.

Dependence on key personnel
The Company's success is dependent on the leadership of a number of key executive and management personnel. If one of these key individuals leaves the Company, the relationships he or she has with certain of the Company's clients could be lost. In addition, the Company's ability to generate revenue is dependent on the number and expertise of individuals who perform project work. The competition for the most experienced and able employees is intense, even during cyclical downturns in the industry. As a result, if the Company fails to retain existing employees or hire new employees when necessary, the Company's business, financial condition or operating results could be materially and adversely affected.

Although certain members of Pareto's senior management team have entered into employment contracts that include non-competition and non-solicitation agreements, those agreements may not be effective in retaining key personnel. All key employees are shareholders of the Company.

Consolidation of accounts
Large business organizations have shown a tendency toward consolidating their marketing services providers so that one firm provides these services for all national and international locations. While the Company could benefit from this trend, it is also possible that the Company could lose client relationships if certain clients elected to consolidate their marketing services relationship with another agency. To the extent that Pareto loses revenue as a result of this trend, the Company's business, financial condition or operating results could be affected in a materially adverse manner.

Management's Statement of Responsibility

The accompanying consolidated financial statements have been prepared by management and approved by the Board of Directors of the Company. Management is responsible for the preparation and presentation of these financial statements and all the financial information contained within this annual report within reasonable limits of materiality. The financial statements have been prepared in accordance with Canadian generally accepted accounting principles. In the preparation of these statements, estimates are sometimes necessary because a precise determination of certain assets and liabilities is dependent on future events. Management believes such estimates have been based on careful judgments and have been properly reflected in the accompanying consolidated financial statements. The financial information throughout the text of this annual report is consistent with that in the consolidated financial statements.

To assist management in discharging these responsibilities, the Company maintains a system of internal control which is designed to provide reasonable assurance that its assets are safeguarded, that transactions are executed in accordance with management's authorization, and that the financial records form a reliable base for the preparation of accurate and timely financial information.

Management recognizes its responsibility to conduct the Company's affairs in compliance with established financial standards and applicable laws, and to maintain proper standards of conduct in its activities.

BDO Dunwoody LLP, Chartered Accountants, are appointed by the shareholders and have audited the consolidated financial statements in accordance with Canadian generally accepted auditing standards. Their report outlines the nature of their audit and expresses their opinion on the consolidated financial statements of the Company.

Annually, the Board of Directors appoints an Audit Committee composed of at least three directors who are not members of management. The Audit Committee meets periodically with management and the auditors to discuss internal control over the financial reporting process, auditing matters and financial reporting issues. It is responsible for reviewing the annual and interim consolidated financial statements and the report of the auditors. The Audit Committee reports the results of such review to the Board of Directors and makes recommendations with respect to the appointment of the Company's auditors. In addition, the Board of Directors may refer to the Audit Committee on other matters and questions relating to the financial position of the Company and its affiliates.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and approving the consolidated financial statements for presentation to shareholders.

Kerry Shapansky *(signed)*
President and Chief Executive Officer
March 7, 2003

Clint Becker *(signed)*
Chief Financial Officer

Auditors' Report

To the Shareholders of Pareto Corporation

We have audited the consolidated balance sheets of Pareto Corporation as at December 31, 2002 and 2001 and the consolidated statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2002 and 2001 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

BDO Dunwoody LLP, Toronto *(signed)*
Chartered Accountants

Toronto, Ontario
March 7, 2003

Pareto Corporation
Consolidated Balance Sheets

December 31	2002	2001
Assets		
Current assets		
Cash and equivalents	$ 685,489	$ 1,163,440
Accounts receivable	2,458,341	799,951
Income and other taxes recoverable	748,336	718,251
Work in progress	149,321	64,150
Inventory and other current assets	62,553	73,056
	4,104,040	2,818,848
Deferred finance costs	71,459	–
Capital assets (Note 2)	533,240	615,775
Goodwill and intangible assets (Note 3)	5,730,775	1,333,396
	$ 10,439,514	$ 4,768,019
Liabilities and Shareholders' Equity		
Current		
Bank indebtedness	$ –	$ 458,405
Accounts payable and accrued liabilities	3,145,043	1,837,048
Deferred revenue	997,580	–
Current portion of long-term debt (Note 4)	300,000	30,000
Current portion of acquisition notes payable (Note 1)	426,250	250,000
	4,868,873	2,575,453
Future income tax liability (Note 6)	272,620	121,000
Acquisition notes payable (Note 1)	526,250	–
Long-term debt (Note 4)	1,050,000	–
	6,717,743	2,696,453
Shareholders' equity		
Share capital (Note 5(b))	4,044,539	4,713,995
Special warrants (Note 5(d))	140,000	–
Deficit	(462,768)	(2,642,429)
	3,721,771	2,071,566
	$ 10,439,514	$ 4,768,019

The accompanying notes and summary of significant accounting policies are integral parts of these financial statements.

On behalf of the Board:

Kerry G. Shapansky *(signed)*
Director

David H. Atkins *(signed)*
Director

Pareto Corporation
Consolidated Statements of Operations and Deficit

For the years ended December 31	2002	2001
Revenue	$ 10,762,411	$ 1,988,067
Direct costs	7,804,941	1,605,746
Gross profit	2,957,470	382,321
Expenses		
Facilities	461,193	229,193
Selling and administration	2,591,201	2,113,542
	3,052,394	2,342,735
	(94,924)	(1,960,414)
Amortization of capital assets	194,060	110,068
Amortization of intangible assets	22,208	–
Interest and finance charges	162,076	14,178
Unsuccessful acquisition costs	–	279,941
Loss on disposal of assets	–	24,597
Restructuring expenses	–	47,354
Writedown of goodwill	–	242,000
	378,344	718,138
Loss before income taxes	(473,268)	(2,678,552)
Income taxes (Note 6)		
Current (recovery)	–	(5,123)
Future (recovery)	(10,500)	(31,000)
	(10,500)	(36,123)
Net loss for the year	$ (462,768)	$ (2,642,429)
Deficit, beginning of year	$ (2,642,429)	$ –
Deficit, reallocated to share capital (Note 5(b))	2,642,429	–
Deficit, end of year	$ (462,768)	$ (2,642,429)
Basic and fully diluted loss per share (Note 7)	$ (0.017)	$ (0.14)
Basic and fully diluted weighted average number of common shares outstanding	26,654,873	18,408,857

The accompanying notes and summary of significant accounting policies are integral parts of these financial statements.

Pareto Corporation
Consolidated Statements of Cash Flows

For the years ended December 31	2002	2001
Cash provided by (used in):		
Operating activities		
Net loss for the year	$ (462,768)	$ (2,642,429)
Items not involving cash:		
Amortization of capital assets	194,060	110,068
Amortization of intangible assets	22,208	–
Amortization of deferred finance costs	48,541	–
Non-cash interest expense	29,000	–
Writedown of goodwill	–	242,000
Loss on disposal of assets	–	24,597
Expenses settled by share issuance	–	26,500
	(168,959)	(2,239,264)
Changes in non-cash operating accounts (Note 8)	(748,725)	40,877
	(917,684)	(2,198,387)
Investing activities		
Capital asset additions	(44,820)	(85,659)
Acquisitions, net of cash acquired	(1,233,315)	(65,866)
	(1,278,135)	(151,525)
Financing activicties		
Bank indebtedness	(458,405)	43,282
Payment of acquisition notes payable	(270,000)	(110,000)
Issuance of long-term debt	1,350,000	30,000
Repayment of long-term debt	(30,000)	–
Additions to deferred finance costs	(50,000)	–
Issuance of shares	1,200,000	3,725,700
Share issue costs	(23,727)	(176,630)
	1,717,868	3,512,352
Increase (decrease) in cash for the year	$ (477,951)	$ 1,162,440
Cash and cash equivalents, beginning of year	1,163,440	1,000
Cash and cash equivalents, end of year	$ 685,489	$ 1,163,440

Supplementary cash flow disclosures (Note 8)

The accompanying notes and summary of significant accounting policies are integral parts of these financial statements.

Pareto Corporation
Summary of Significant Accounting Policies
December 31, 2002 and 2001

Nature of business
Pareto Corporation ("the Company" or "Pareto") is incorporated under the laws of Ontario. Pareto is a Canadian marketing services company, which provides marketing solutions through the delivery of print management, event management, digital and project management marketing services.

On July 3, 2002, the legal name of the Company was changed to Pareto Corporation from Caxton Group Inc. Caxton Group Inc. was the result of the amalgamation of Alouettes 1974 Capital Inc., a public capital pool company listed on the Canadian Venture Exchange, and Caxton Group Inc. referred to in note 1(e).

Basis of consolidation
The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries from the effective date of their acquisition by the Company, with intercompany transactions and balances eliminated upon consolidation.

Accounting estimates
The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amount of revenues and expenses during the reporting period. Actual results could differ from management's best estimates as additional information becomes available in the future.

Cash and cash equivalents
Cash and cash equivalents include cash and deposits with short terms to maturity.

Work in progress and inventory
Work in progress and inventory are carried at the lower of cost and net realizable value, and are recorded on a project-specific basis.

Deferred finance costs
Deferred finance costs are amortized on a straight-line basis over the term of the related indebtedness.

Capital assets
Capital assets are recorded at cost, less accumulated amortization. Amortization is provided as follows:

Computer software	Straight-line over 1 to 5 years
Computer hardware	30% declining balance
Furniture and fixtures	20% declining balance
Leasehold improvements	Straight-line over lease term

Goodwill and intangible assets
Goodwill represents the consideration paid for acquisitions in excess of the fair market value of the net identifiable assets acquired. The carrying value of the goodwill is assessed at least annually by comparing it to its fair value.

In 2001, the Company adopted the recommendations of CICA Handbook Section 1581 – *Business Combinations* and Section 3062 – *Goodwill and Other Intangible Assets*.

Intangible assets consist of the value of the Company's acquired customer contracts and the related customer relationships. In the marketing services industry, these are typically long-term in nature. These intangible assets are amortized using the straight-line method over an estimated useful life of 10 years.

Income taxes
The liability method is used for determining income taxes. Under this method, future tax assets and liabilities are adjusted to reflect changes in tax rates and laws in the period such changes are enacted, resulting in adjustments to the current period's consolidated statement of operations.

Revenue recognition
For print management and event management services, revenues are recognized on a completed project basis. Costs incurred in advance of a project's completion are reflected as work in progress. Customer billings in advance of a project's completion are recorded as deferred revenue. For digital and project management marketing services, revenues are recognized as services are rendered.

Stock-based compensation
Effective January 1, 2002, the Company adopted the recommendations of CICA Handbook Section 3870 – *Stock-based Compensation and Other Stock-based Payments*. This section requires that direct awards of stock and liabilities based on the price of common stock be measured at fair value at each reporting date, with the change in fair value reported in the statements of income, and encourages, but does not require, the use of the fair value method for all other types of stock-based compensation plans. None of the Company's plans qualify as direct awards of stock or as plans that create liabilities based on the price of the Company's stock and, as a result, the implementation of the section has no impact on the consolidated financial statements.

The Company did not issue any stock options to consultants during the year. The Company has chosen not to use the fair value method to account for stock-based employee compensation plans, but to disclose pro forma information for options granted after January 1, 2002. The Company records no compensation expense when options are issued to employees. Any consideration paid by employees on the exercise of the options is credited to capital stock.

Government assistance
Government assistance, consisting of investment and other tax credits, is recorded using the cost reduction method. Such government assistance is recorded where there is reasonable assurance that investment and other tax credits will be realized.

Financial instruments
Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest rate, currency or credit risks arising from its financial instruments. Fair values of financial instruments approximate carrying values.

Foreign currencies
Monetary assets and liabilities denominated in foreign currencies are translated at the exchange rates in effect as of the balance sheet date. Revenue and expense items are translated at the exchange rates prevailing on the date the transactions occur.

1 Business Combinations

a) On November 19, 2002, the Company acquired all of the issued and outstanding shares of Bridge Sales and Marketing Inc., subsequently renamed Pareto Solutions Inc. (“Solutions”), for total consideration of $500,000, comprised of a $360,000 promissory note payable in 36 equal monthly instalments of $10,000 and 700,000 special warrants with a fair value of $0.20 per special warrant at the date of the acquisition. Solutions was acquired for its expertise in integrated marketing project management, and its assets and liabilities were distributed to the previous owner prior to the closing of the acquisition. This acquisition was accounted for as a purchase with the $500,000 of consideration and $30,000 in transaction costs allocated as follows: $499,300 to goodwill, $50,000 to intangible assets, and $19,300 to future income tax liability.

b) Effective May 31, 2002, the Company acquired all of the issued and outstanding shares of Naylor Event Management Inc. (“Naylor”) for consideration of $3,250,000, comprised of $2,025,000 cash, $612,500 of notes payable, and 3,062,500 common shares with a fair value of $0.20 per share at the date of the acquisition. In addition, potential cash consideration of up to $1,100,000 may be payable based on Naylor’s future operating results. This acquisition was accounted for as a purchase and the results of operations of the acquired company have been included in the consolidated statement of operations and deficit from the effective date of acquisition. The closing date of the transaction was August 1, 2002 and, accordingly, the Company has recorded $29,000 of imputed interest during the year.

A summary of the net assets acquired and consideration given is as follows:

Cash and short-term investments	$ 1,179,345
Other current assets	2,310,957
Capital assets	66,705
Intangible assets	370,000
Current liabilities	(3,591,614)
Future income tax liability	(142,820)
Net identifiable assets acquired	192,573
Purchase consideration:	
Cash	2,025,000
Notes payable	612,500
Transaction costs (net of imputed interest of $29,000)	439,429
	3,076,929
Share capital issued (3,062,500 common shares)	612,500
	3,689,429
Excess of purchase price consideration allocated to goodwill	$ 3,496,856

Cash amounts totaling up to $1,100,000 are payable based on the achievement by Naylor of certain earnings thresholds consistent with the current year. Should these levels be obtained, additional cash consideration would be earned in future years as follows: 2003 – $430,000; 2004 – $335,000; and 2005 – $335,000.

1 Business Combinations *(continued)*

c) On August 24, 2001, the Company acquired all of the issued and outstanding shares of The Campbell Group Ltd. for a purchase price of $974,352, which consisted of $300,000 in cash paid at closing, $110,000 in the form of a promissory note maturing in November 2001, $250,000 in the form of a promissory note maturing on August 25, 2002 and 628,724 common shares with a value of $0.50 per share.

A summary of the net assets acquired and consideration given is as follows:

Current assets	$	1,209,505
Capital assets		75,590
Bank indebtedness		(368,084)
Current liabilities		(1,255,302)
Net assets acquired (deficiency)		(338,291)
Purchase consideration:		
Cash		300,000
Notes payable		360,000
Transaction costs		20,743
		680,743
Share capital issued (628,724 common shares)		314,362
		995,105
Excess of purchase price consideration allocated to goodwill	$	1,333,396

d) On April 6, 2001, the Company acquired all of the issued and outstanding shares of Tone Interactive Inc. for a purchase price of $600,000, which consisted of $150,000 in cash and 900,000 common shares with a value of $0.50 per share.

A summary of the net assets acquired and consideration given is as follows:

Current assets	$	623,865
Capital assets		589,191
Bank indebtedness		(47,038)
Current liabilities		(624,897)
Future income tax liability		(152,000)
Net assets acquired		389,121
Purchase consideration:		
Cash		150,000
Transaction costs		31,121
		181,121
Share capital issued (900,000 common shares)		450,000
		631,121
Excess of purchase price consideration allocated to goodwill	$	242,000

1 Business Combinations *(continued)*

As at December 31, 2001, the Company performed an assessment of the carrying value of the goodwill relating to the acquisition of Tone Interactive Inc. and determined the goodwill amount to be not recoverable. Accordingly, a writedown of goodwill in the amount of $242,000 was recorded in 2001.

e) On December 31, 2001, Caxton Group Inc. ("old Caxton") amalgamated with Alouettes 1974 Capital Inc. ("Alouettes") to form a new company carrying the same name, Caxton Group Inc. ("new Caxton"). As a result of the amalgamation, each issued common share and stock option of old Caxton was converted into one new Caxton common share and one new Caxton stock option and each issued common share of Alouettes was converted into one new Caxton common share.

This transaction resulted in the former shareholders of old Caxton owning 85% of new Caxton. Accordingly, the amalgamation has been treated for accounting purposes as an acquisition of Alouettes by old Caxton, referred to as a reverse take-over. Application of reverse take-over accounting results in the following:

i) Old Caxton is deemed to be the acquirer for accounting purposes; its assets and liabilities are included in the balance sheet at their carrying values.

ii) The balance sheet combines the assets and liabilities of Alouettes as an acquisition under the purchase method. The results of operations of Alouettes have been included in the consolidated statement of operations and deficit from the date of the deemed acquisition. The net assets acquired, prior to amalgamation, at fair value are as follows:

Cash and cash equivalents	$	435,998
Current liabilities		(62,935)
Net assets acquired		373,063
Consideration attributed to the common shares issued	$	373,063

2 Capital Assets

	2002					
		Cost		Accumulated Amortization		Net Book Value
Computer software	$	582,034	$	240,621	$	341,413
Computer hardware		161,422		101,936		59,486
Furniture and fixtures		214,889		113,633		101,256
Leasehold improvements		44,275		13,190		31,085
	$	1,002,620	$	469,380	$	533,240

2 Capital Assets *(continued)*

	2001		
	Cost	Accumulated Amortization	Net Book Value
Computer software	$ 535,841	$ 83,144	$ 452,697
Computer hardware	62,687	13,927	48,760
Furniture and fixtures	83,350	8,600	74,750
Leasehold improvements	43,965	4,397	39,568
	$ 725,843	$ 110,068	$ 615,775

3 Goodwill and Intangible Assets

	2002		
	Cost	Accumulated Amortization	Net Book Value
Goodwill	$ 5,332,983	$ –	$ 5,332,983
Intangible assets – customer relationships	420,000	22,208	397,792
	$ 5,752,983	$ 22,208	$ 5,730,775

	2001		
	Cost	Accumulated Amortization	Net Book Value
Goodwill	$ 1,333,396	$ –	$ 1,333,396
Intangible assets – customer relationships	–	–	–
	$ 1,333,396	$ –	$ 1,333,396

4 Long-term Debt

	2002	2001
Bank credit facility (a)	$ 1,000,000	$ –
Term loan (b)	350,000	–
Supplier loan (c)	–	30,000
	1,350,000	30,000
Less current portion	300,000	30,000
	$ 1,050,000	$ –

4 Long-term Debt *(continued)*

a) The bank credit facility bears interest at a rate of prime plus 2.5%, payable monthly, with monthly principal repayments of $25,000 commencing in January 2003. The credit facility agreement provides for potential principal repayments based on Available Cash Flow as defined in the agreement, commencing in 2004. The facility is secured by a general security agreement over the assets of the Company and its subsidiaries and matures in December 2005. The Company also has a revolving line of credit of up to $250,000 bearing interest at a rate of prime plus 2%, payable monthly. No amount was drawn under the line of credit as at December 31, 2002.

b) Pursuant to a loan agreement dated January 31, 2002, the Company entered into a term facility in the amount of $870,000 with a director of the Company. The facility is unsecured and bears interest at 8.75% per annum payable quarterly, and matures in April 2004. Subsequent to December 31, 2002, the Company amended the loan agreement, reducing the maximum amount available under the facility to $350,000.

c) Loan due to supplier, non-interest bearing, unsecured, no fixed terms of repayment.

Principal repayments on long-term debt are as follows:

2003	$	300,000
2004		650,000
2005		400,000
	$	1,350,000

5 Share Capital

a) Authorized
Unlimited common shares
Unlimited special shares issuable in series

b) Issued common shares

	Number of Shares		Amount
Balance, December 31, 2001	22,311,581	$	4,713,995
Shares issued pursuant to Naylor acquisition	3,062,500		612,500
Shares issued pursuant to private placement (i)	6,000,000		1,200,000
Shares issued for services	332,000		114,200
Shares issued for term loan fee	350,000		70,000
Deficit reallocated to share capital (ii)	–		(2,642,429)
Share issue cost	–		(23,727)
Balance, December 31, 2002	32,056,081	$	4,044,539

i) On August 1, 2002, the Company issued 6,000,000 common shares pursuant to a private placement at an issue price of $0.20 per common share for gross proceeds of $1,200,000.

ii) On June 26, 2002, the shareholders of Pareto approved a reduction in the stated capital of the Company by reducing the stated capital of the common shares by $2,642,429 and reducing the company's deficit by an equal amount.

5 Share Capital *(continued)*

Pre-amalgamation shares of old Caxton

Balance, December 31, 2000	10,000	1,000
Shares issued for cash	9,950,000	1,225,700
Shares issued for services	215,000	26,500
Shares issued for acquisition of Tone	900,000	450,000
Shares issued for acquisition of Campbell	628,724	314,362
Shares issued pursuant to conversion of special shares (i)	7,142,857	2,500,000
Share issue cost	–	(28,546)
Balance, December 31, 2001	18,846,581	$ 4,489,016

i) During the year 7,142,857 special shares were issued pursuant to a private placement. These shares were convertible into common shares on a one-for-one basis. Prior to the amalgamation, the special shares were converted into common shares.

Pre-amalgamation shares of Alouettes

Balance, December 31, 2000	1,850,000	265,000
Shares issued pursuant to private placement	1,300,000	260,000
Share issue cost	–	(26,000)
Shares issued upon exercise of stock options	315,000	63,000
Balance, December 31, 2001	3,465,000	$ 562,000

Amalgamation

Share capital is comprised of the number of issued shares of Alouettes and the stated capital of old Caxton	3,465,000	$ 4,489,016
Shares issue upon the reverse take-over (Note 1(e))	18,846,581	373,063
Amalgamation cost	–	(148,084)
Balance, December 31, 2001	22,311,581	$ 4,713,995

5 Share Capital *(continued)*

c) Stock options

The Company has a stock option plan (the "Plan") for employees, consultants, directors and officers of the Company. Pursuant to the Plan, a total of 3,000,000 of the Company's common shares have been reserved for issue. One-third of granted options vest on each of the anniversary dates of the grant.

The following stock options were granted under the Plan:

	Number of Options		Weighted Average Exercise Price
Options outstanding, December 31, 2000	–	$	–
Granted in 2001	1,913,000		0.35
Options outstanding, December 31, 2001	1,913,000	$	0.35
Granted in 2002	2,038,571		0.25
Cancelled in 2002	(961,285)		0.35
Options outstanding, December 31, 2002	2,990,286	$	0.28
Options exercisable, December 31, 2002	320,571	$	0.35
Options exercisable, December 31, 2001	–	$	–

As at December 31, 2002, the Company had the following options outstanding pursuant to the Plan:

Number of Options	Exercise Price Per Share		Expiry Date
580,000	$	0.35	March 31, 2006
381,715	$	0.35	November 30, 2006
658,571	$	0.35	February 15, 2007
790,000	$	0.20	August 1, 2007
580,000	$	0.20	November 4, 2007

The compensation cost for the 2,038,571 options granted to employees and directors during 2002, determined using the fair value method would have increased the Company's net loss for 2002 by $50,630. This amount would have changed the Company's loss per share for 2002 to ($0.019). The fair value of share options was estimated using the Black-Scholes option-pricing model with the following assumptions:

Dividend yield	0%
Expected volatility	40%
Risk-free interest rate	3.50% to 4.75%
Expected option life	2 to 4 years

5 Share Capital *(continued)*

d) Special warrants

Pursuant to the acquisition of Solutions, the Company issued 700,000 special warrants. The special warrants are convertible upon exercise into common shares of the Company for no further consideration in six tranches, exercisable every six months beginning May 19, 2003. The fair value of the special warrants at the date of issuance was $140,000.

e) Escrow common shares

i) Pursuant to an Escrow Agreement with the former shareholders of Campbell, the 628,724 common shares issued on the acquisition (Note 1(c)) will be released during 2003 provided specific revenue targets are met.

ii) Pursuant to an Escrow Agreement with the CDNX, the founders of Alouettes and certain shareholders of old Caxton were required to place a total of 8,705,000 shares in escrow. Of the 8,705,000 shares, 10% were released from escrow in February 2002 and 15% of the 8,705,000 shares will be released every six months thereafter. As at December 31, 2002, 6,528,750 of these shares remain in escrow.

6 Income Taxes

The significant components of future income tax assets and liabilities consist of the following:

	2002	2001
Future income tax assets:		
Loss carry forwards	$ 828,724	$ 748,678
Capital assets	131,919	122,994
Scientific research and experimental development pool	93,937	113,325
Non-refundable investment tax credits	3,943	–
	1,058,523	984,997
Future income tax liabilities:		
Capitalized software development costs	(167,200)	(177,700)
Intangible assets	(162,120)	
Scientific research and experimental development	–	(66,784)
	(329,320)	(244,484)
Valuation allowance	(1,001,823)	(861,513)
	$ (272,620)	$ (121,000)

6 Income Taxes *(continued)*

A reconciliation between income taxes provided at actual rates and at the basic rate of 38.6% (2001 – 41.74%) for federal and provincial taxes is as follows:

	2002	2001
Net loss before income taxes	$ (473,268)	$ (2,678,552)
Recovery of income taxes at statutory rates	$ (182,681)	$ (1,118,000)
Increase in income taxes resulting from:		
Non-deductible items and other	25,296	119,354
Writedown of goodwill	–	101,010
Change in valuation allowance	146,885	861,513
Provision for income taxes	$ (10,500)	$ (36,123)

As at December 31, 2002, the Company has non-capital losses of approximately $1,930,000 to apply against future taxable income. These losses will expire as follows: $1,762,000 in 2008 and $168,000 in 2009.

7 Loss Per Share

The loss per share figures have been calculated using the weighted average number of common shares outstanding during the fiscal year. The exercise of stock options would be anti-dilutive.

8 Supplementary Cash Flow Information

	2002	2001
Changes in non-cash operating accounts:		
Accounts receivable	$ (388,401)	$ 218,623
Income and other taxes recoverable	2,169	(142,101)
Work in progress	916,691	–
Inventory and other current assets	17,355	101,441
Accounts payable and accrued liabilities	366,871	(106,086)
Deferred revenue	(1,652,910)	–
Future income tax liability	(10,500)	(31,000)
	(748,725)	(40,877)
Supplemental cash flow information:		
Interest paid	$ 84,535	$ 14,178
Income taxes paid	–	–
Supplemental disclosure of non-cash transactions:		
Shares issued for non-cash consideration	$ 796,700	$ 790,862
Special warrants issued for non-cash consideration	140,000	–

9 Commitments

Pareto has operating lease agreements for premises, vehicles and equipment, with aggregate future annual minimum lease payments as follows:

2003	$ 340,573
2004	249,495
2005	224,585
2006	91,336
	$ 905,989

10 Related Party Transactions

i) Under the terms of a loan agreement with a director of the Company as described in Note 4(b), the Company paid the director a loan fee of $70,000 through the issuance of 350,000 common shares of the Company. In addition, the Company incurred $20,109 of interest relating to this loan during 2002.

ii) Under the private placement described in Note 5(b), $450,000 of the $1,200,000 of common shares issued by the Company were subscribed for by two directors and the chief executive officer of the Company.

iii) During 2002, the Company issued 150,000 common shares, for a value of $52,500, to a director in respect of services rendered by the director.

11 Segmented Information

The Company provides marketing solutions through the delivery of print management, event management, digital and project management marketing services. In the opinion of management, the Company carries on business in one operating segment. Revenue derived from the Company's largest customer accounted for 29% of total revenue (2001 – 24%). As at December 31, 2002, amounts due from the Company's largest customer accounted for 53% of accounts receivable (December 31, 2001 – 7%).

12 Comparative Figures

Certain comparative figures have been reclassified to conform to the current year's presentation.

Directors and Officers

Directors

J.R. Kingsley Ward
Kerry Shapansky
David Atkins
Gregory Cochrane
Brian Collins
Gordon Griffiths

Officers

Kerry Shapansky
President & Chief Executive Officer

Clint Becker
Chief Financial Officer

Amit Kanigsberg
Chief Technology Officer

Kim Naylor
President, Event Division

David Rose
President, Print Division

Corporate Information

Principal Office

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M5S 3L2

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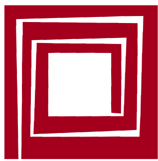

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