



**Pareto Corporation**

**Third Quarter Report  
For The Nine Months Ended September 30, 2003**

## To Our Shareholders:

I am very pleased to report our third quarter results for 2003. Pareto was once again able to deliver a record quarter, in which our Company improved on our previous quarters' success. Pareto achieved record levels of revenue, EBITDA and net income in the quarter and on July 1<sup>st</sup> saw an important step in the future of Pareto as the Company relocated to new office space, thereby integrating all of our operations in one location.

In Q3 Pareto achieved almost \$4.9 million of revenues compared to \$3.4 million last, a 43% increase. EBITDA increased to \$304,000 and net income improved to \$204,000. All of these amounts are the highest our Company has ever achieved in a quarter. Our continued focus on improving profitability is showing as net income for the nine months ended September 30, 2003 represents a \$705,000 improvement over the same period last year.

Improving the financial position of our Company is another key goal for us and we have continued to due that. During Q3 we reduced our debt levels by \$105,000 for a total reduction for the year so far of \$970,000 as a result of our improved profitability and operational cashflow.

Our goal for 2003 was to strengthen the Company and build a platform to enable future growth. I am excited at the progress we have made so far this year on all fronts including attracting top notch employees and developing stronger relationships with our clients, both old and new.

We are committed to building a strong profitable business which will be the dominate player in the Canadian marketplace. To this end, we have and will continue over the next several years to invest in the people and capabilities needed to reach our goal. This is a long term project.

We have accomplished much to date in 2003, but there is much more to be done.

Thank you for your support.

A handwritten signature in blue ink, appearing to read 'K Shapansky', with a long, sweeping horizontal stroke extending to the right.

Kerry Shapansky  
President & Chief Executive Officer

## Consolidated Summary Financial Information

For periods ended September 30  
(Unaudited)

	Three Months		Nine Months	
	2003	2002	2003	2002
Revenues	\$ 4,889,182	\$ 3,408,648	\$ 12,653,697	\$ 6,849,867
Gross Profit	1,487,720	923,914	3,886,306	1,782,744
EBITDA	304,161	139,964	663,347	(229,507)
Net income (loss) for the period	204,883	21,686	283,129	(442,843)
Basic and fully diluted earnings (loss) per common share	\$ 0.006	\$ 0.001	\$ 0.009	\$ (0.016)
Basic weighted average number of common shares outstanding	32,172,748	29,374,081	32,112,686	26,707,414
Fully diluted weighted average number of common shares outstanding	32,822,581	29,412,176	32,971,019	26,707,414

# Pareto Corporation

## Management's Discussion and Analysis

The following discussion focuses on Pareto Corporation's (the "Company or "Pareto") operating results for the three months and nine months ended September 30, 2003 and 2002, and the financial condition as at September 30, 2003. This analysis should be read in conjunction with the consolidated interim financial statements presented in this interim report and the annual audited financial statements for the year ended December 31, 2002.

### *Operating Results*

#### *Three Months Ended September 30, 2003 Compared to Three Months Ended September 30, 2002:*

The Company's revenue was \$4,889,182 in the quarter compared to \$3,408,648 reported in the third quarter of 2002. This represents an organic growth rate of 43% for the quarter. Revenue growth was achieved in all divisions of the Company, lead by a very strong performance in the Print/Retail division. The quarterly growth resulted from both new client wins and extended relationships with existing clients.

During the third quarter of 2003, the Company's revenues derived from customers in a broad mix of industries with significant contributions from customers in the retail, food and beverage, pharmaceutical and technology sectors. All of the Company's operations are in Canada; however 4% (2002 – 11%) of the quarter's revenues were earned from customers based in the United States.

The Company achieved a gross profit percentage of 30% in the quarter compared to 27% gross profit in 2002 and 30% achieved in the second quarter of 2003. The overall gross profit percentage was achieved consistently over the Company's divisions and falls within the company's expected range of 27% to 30%.

Operating expenses excluding depreciation totaled \$1,183,561 for the quarter compared to \$783,950 in 2002. The increased size of the Company drove this increase in operating expenses. Operating expenses in the quarter represented 24% of revenues compared with 23% last year.

Earnings before interest, taxes, depreciation, amortization and other charges (EBITDA as defined by the Company) improved by 117% from \$139,964 in 2002 to \$304,160 for 2003 as higher revenues and improved gross profit margin resulted in improved EBITDA. EBITDA in the quarter represented 6.2% of revenues compared to 4.2% in 2002. The Company expects EBITDA, as a percentage of revenues will improve as the revenue base grows relative to the Company's operating cost structure.

Amortization increased by \$31,932 for the quarter, as compared to 2002 and was primarily a result of amortization of intangible assets acquired in 2002 and the amortization of capital assets acquired as part of the Company's office relocation. Effective July 1, 2003, the Company has consolidated all of its office locations into a single new location.

During the quarter Interest and finance charges decreased by 71% from \$65,993 in the third quarter of 2002 to \$19,050 in 2003. The reduction results from charges incurred in 2002 which did not incur in 2003 as a result of the debt repaid by the Company earlier in 2003.

The Company generated net income \$204,883 in the third quarter of 2003 compared to a net income of \$21,686 for the third quarter of 2002. This improvement was as a result of strong revenue growth and the improvement in the Company's EBITDA margin.

On a per share basis, the Company earned \$0.006 per share on both a basic and diluted basis compared to an income of \$0.001 in the same period last year. The diluted weighted average number of shares outstanding increased from 29.4 million in 2002 to 33.0 million in 2003 primarily as a result of shares issued pursuant to the acquisition of Event and the private placement completed by the Company in August 2002.

As at September 30, 2003 the Company had \$533,977 of cash and equivalents compared to \$685,489 as at December 31, 2003, a decrease of \$151,512.

Cash inflow derived from operations for the quarter was \$322,087 compared to cash outflow of \$496,062 for the third quarter of 2002. This improvement was as a result of the Company's improved profitability and continued improvement in cash flow generated from changes in the Company's non-cash operating accounts. Changes in non-cash operating accounts resulted in a cash inflow of \$32,986 in the third quarter of 2003 versus an outflow of \$607,866 in 2002. The inflow was primarily a result of improved cash flow management and an increase in deferred revenue relating to projects to be completed in the future within the Event division.

Investing activities included the purchase of \$304,176 of capital assets versus \$732 in 2002. The capital assets purchased in the third quarter of 2003 relate primarily to furniture and leasehold improvements acquired as part of the Company's office relocation in July 2003. In 2002 investing activities included an outflow of \$638,011 related to the acquisition of Event.

The Company's financing activities in third quarter of 2003, resulted in the reduction of the Company's total debt by \$105,000 including retiring accrued acquisition notes payable by \$30,000 and reducing senior bank term debt by \$75,000. This compares to total inflows of \$30,167 in 2002.

***Nine Months Ended September 30, 2003 Compared to Nine Months Ended September 30, 2002:***

The Company's revenue for nine months ended September 30, 2003 was \$12,653,697, 85% higher than the \$6,849,867 reported in the September 30, 2002. The significant growth in revenue is due to the organic business growth coupled with inclusion of the financial results of Event which was acquired effective May 31, 2002. On a pro forma basis, including the results of Event from January 1, 2002, revenue for the nine months ended September 30, 2003 grew by over \$2.5 million representing an pro forma organic growth rate of 25%. For the nine months 4% (2002 – 8%) of the Company's revenue were earned from customers based in the United States.

The Company achieved a gross profit percentage of 31% in the nine months compared to 26% gross profit in 2002. The overall gross profit percentage was achieved consistently over the Company's divisions. Going forward company expects gross profit to represent 27% to 30% of revenues.

Operating expenses excluding depreciation totaled \$3,222,959 for the nine months ended September 30, 2003 compared to \$2,012,251 in 2002. This increase is related to business growth and the inclusion of the operating expenses of Event. Operating expenses as a percentage of revenues in this period were 25% compared to 29% last year.

EBITDA improved from a loss of \$229,507 in 2002 to earnings of \$663,347 for 2003 as higher revenues and improved gross margin percentage resulted in positive EBITDA. This improvement in EBITDA of \$892,854 represents an EBITDA margin of 15% on the incremental revenue from 2002 to 2003.

Amortization increased by \$99,024 for the first nine months of 2003, as compared to 2002. This increase resulted from the inclusion of amortization of intangible assets acquired in 2002, the inclusion of the amortization of capital assets of Event and amortization of the capital assets of the new office location.

Income for the nine month period was reduced by \$100,000 as during the second quarter of 2003, the Company recorded a \$100,000 loss on the termination of the lease for the Company's office space. Effective July 1, 2003, the Company has consolidated all of its' office locations into a single new location.

Interest and finance charges increased nominally from \$89,451 in the first nine months of 2002 to \$90,031 in 2003.

The Company recorded net income \$283,129 for the nine month period ended September 30, 2003 compared to a net loss of \$422,843 for the same period in 2002, an improvement of \$705,972. This improvement was as a result of the profitability growth in all divisions of Pareto as well as the inclusion of Event.

On a per share basis, the Company earned \$0.009 per share on both a basic and diluted basis compared to a loss of \$0.016 in the same period last year. The diluted weighted average number of shares outstanding increased from 26.87 million in 2002 to 33.0 million in 2003 primarily as a result of shares issued pursuant to the acquisition of Event and the private placement completed by the Company in August 2002.

Cash flow derived from operations for the nine months was \$1,169,356 compared to a cash outflow of \$873,486 for the same period of 2002. This improvement was as a result of the Company's improved profitability and improvement in the cashflow generated from changes in non-cash operating accounts which resulted in a cash inflow of \$672,818 in 2003 versus an outflow of \$617,361 in 2002.

In 2003, the Company has purchased \$349,618 of capital assets compared to capital asset purchases of \$32,708 in 2002 as a result of the increase in the third quarter of this year. In 2002, the investing activities included an outflow of \$2,497,444 relating to the acquisition of Event and inflow for sale of securities of \$575,000 versus nil in 2003.

The Company's financing activities for the nine month period in 2003, included retiring total debt by \$971,250 compared to the issuance of \$1,224,095 of debt in the same period in 2002. The total debt reduction in 2003 included the reduction of acquisition notes payable by \$396,250, repayment of a shareholder loan of \$350,000 and reducing senior term debt by \$225,000. In 2002 the Company also issued 6,000,000 common shares which resulted in net proceeds of \$1,177,173.

The Company did not pay any dividends in the nine month period ended September 30, 2003 and does not currently anticipate paying any dividends in the foreseeable future.

# Pareto Corporation

## Consolidated Balance Sheets

September 30,  
2003  
(unaudited)

December 31,  
2002  
(audited)

### ASSETS

#### Current

Cash and equivalents	\$	533,977	\$	685,489
Accounts receivable		4,880,558		2,458,341
Income and other taxes recoverable		19,595		748,336
Work in progress		985,706		149,321
Inventory and other current assets		188,917		62,553

**6,608,753**                      4,104,040

#### Deferred finance costs

**38,625**                              71,459

#### Capital assets

**700,950**                              533,240

#### Goodwill

**5,699,275**                              5,730,775

**\$ 13,047,603**                      **\$ 10,439,514**

### LIABILITIES AND SHAREHOLDERS' EQUITY

#### Current

Accounts payable and accrued liabilities	\$	2,773,092	\$	3,145,043
Deferred revenue		4,757,711		997,580
Current portion of long-term debt		300,000		300,000
Current portion of acquisition notes payable		426,250		426,250

**8,257,053**                              4,868,873

#### Future income tax liability

**180,650**                              272,620

#### Acquisition notes payable

**130,000**                              526,250

#### Long-term debt

**475,000**                              1,050,000

**9,042,703**                              6,717,743

#### Shareholders' equity

Share capital (Note 3)		4,067,939		4,044,539
Special warrants		116,600		140,000
Deficit		(179,639)		(462,768)

**4,004,900**                              3,721,771

**\$ 13,047,603**                      **\$ 10,439,514**

The accompanying summary of significant accounting policies is an integral part of these financial statements.

# Pareto Corporation

## Consolidated Statement of Operations and Deficit

For Periods ended September 30  
(Unaudited)

	Three Months		Nine Months	
	2003	2002	2003	2002
Revenues	\$ 4,889,182	\$ 3,408,648	\$ 12,653,697	\$ 6,849,867
Direct Costs	3,401,462	2,484,734	8,767,392	5,067,123
Gross Profit	1,487,720	923,914	3,886,306	1,782,744
Expenses				
Facilities	116,860	144,497	294,236	337,979
Selling and administration	1,066,699	639,453	2,928,723	1,674,272
	1,183,559	783,950	3,222,959	2,012,251
	304,161	139,964	663,347	(229,507)
Amortization of capital assets	73,718	52,285	181,909	114,385
Amortization of intangible assets	10,500	-	31,500	-
Loss on lease termination	-	-	100,000	-
Interest and finance charges	19,050	65,993	90,031	89,451
	103,268	118,278	403,440	203,836
Income (loss) before income taxes	200,893	21,686	259,907	(433,343)
Income taxes				
Current (recovery)	-	8,460	68,748	-
Future (recovery)	(3,990)	(8,460)	(91,970)	(10,500)
	(3,990)	-	(23,222)	(10,500)
<b>Net income (loss) for the period</b>	<b>204,883</b>	<b>21,686</b>	<b>283,129</b>	<b>(422,843)</b>
Deficit, beginning of period	(384,522)	(3,086,958)	(462,768)	(2,642,429)
Deficit reallocated to share capital		2,642,429		2,642,429
<b>Deficit, end of period</b>	<b>\$ (179,639)</b>	<b>\$ (422,843)</b>	<b>\$ (179,639)</b>	<b>\$ (422,843)</b>
<b>Basic and fully diluted earnings (loss) per common share</b>	<b>\$ 0.006</b>	<b>\$ 0.001</b>	<b>\$ 0.009</b>	<b>\$ (0.016)</b>
<b>Basic weighted average number of shares outstanding</b>	<b>32,172,748</b>	<b>29,374,081</b>	<b>32,112,686</b>	<b>26,707,414</b>
<b>Diluted weighted average number of shares outstanding</b>	<b>32,822,581</b>	<b>29,412,176</b>	<b>32,971,019</b>	<b>26,867,414</b>

The accompanying summary of significant accounting policies is an integral part of these financial statements.

# Pareto Corporation

## Consolidated Statements of Cash Flow

For the periods ending September 30  
(Unaudited)

	Three Months		Nine Months	
	2003	2002	2003	2002
<b>Cash provided by (used in)</b>				
<b>Operating activities</b>				
Net income (loss) for the period	\$ 204,883	\$ 21,686	\$ 283,129	\$ (422,843)
Items not involving cash				
Amortization of capital assets	73,718	52,285	181,909	114,385
Amortization of intangible assets	10,500	23,333	31,500	23,333
Non-cash interest expense	-	14,500	-	29,000
	<u>289,101</u>	<u>111,804</u>	<u>496,538</u>	<u>(256,125)</u>
Changes in non-cash operating accounts	<u>32,986</u>	<u>(607,866)</u>	<u>672,818</u>	<u>(617,361)</u>
	<u>322,087</u>	<u>(496,062)</u>	<u>1,169,356</u>	<u>(873,486)</u>
<b>Investment activities</b>				
Purchase of capital assets	(304,176)	(732)	(349,618)	(32,708)
Sale of short-term securities	-	956,763	-	575,000
Business acquisition	-	(638,011)	-	(2,497,444)
	<u>(304,176)</u>	<u>318,020</u>	<u>(349,618)</u>	<u>(1,955,152)</u>
<b>Financing Activities</b>				
Share issue cost	-	(23,777)	-	(22,827)
Issuance of shares	-	1,200,000	-	1,200,000
Repayment of long-term debt	(75,000)	711,149	(575,000)	1,320,000
Payment of acquisition notes payable	(30,000)	(1,412,500)	(396,250)	362,500
Bank indebtedness	-	(444,705)	-	(458,405)
	<u>(105,000)</u>	<u>30,167</u>	<u>(971,250)</u>	<u>2,401,268</u>
<b>Increase (decrease) in cash for the period</b>	<b>(87,089)</b>	<b>(147,875)</b>	<b>(151,512)</b>	<b>(427,370)</b>
<b>Cash and equivalents, beginning of period</b>	<b>621,066</b>	<b>883,945</b>	<b>685,489</b>	<b>1,163,440</b>
<b>Cash and equivalents, end of period</b>	<b>\$ 533,977</b>	<b>\$ 736,070</b>	<b>\$ 533,977</b>	<b>\$ 736,070</b>

The accompanying summary of significant accounting policies is an integral part of these financial statements.

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# Pareto Corporation

## Notes to Consolidated Financial Statements

September 30, 2003  
(unaudited)

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### 1. Significant Accounting Policies

The financial statements of the Company have been prepared by management in accordance with generally accepted accounting principles in Canada for interim financial statements. The financial statements have, in management's opinion, been properly prepared using judgment within reasonable limits of materiality. These interim financial statements do not include all the note disclosures required for annual financial statements and, therefore, should be read in conjunction with the Company's audited annual financial statements for the year ended December 31, 2002. The significant accounting policies follow that of the most recently reported annual financial statements.

### 2. Accounting Estimates

The preparation of interim financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results could differ from those estimated.

### 3. Share Capital

#### (a) Authorized

Unlimited common shares  
Unlimited special shares assumable in series

#### (b) Issued common shares

	Number of Shares	Amount
Balance, December 31, 2002	32,056,081	\$ 4,044,539
Issued upon conversion of Special Warrants	116,667	23,400
Balance, September 30, 2003	<u>32,172,748</u>	<u>\$ 4,067,939</u>

#### (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 4,000,000 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.

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# Pareto Corporation

## Notes to Consolidated Financial Statements

September 30, 2003  
(unaudited)

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### 3. Share Capital (continued):

Stock option transactions under the Plan during the period are as follows:

	Number of Options	Weighted Average Exercise Price
Options outstanding, December 31, 2002	2,990,286	\$ 0.28
Granted in 2003	400,000	0.25
Cancelled in 2003	(142,000)	0.22
Options outstanding, September 30, 2003	<u>3,248,286</u>	<u>\$ 0.28</u>
Options exercisable, September 30, 2003	<u>945,428</u>	<u>\$ 0.31</u>
Options exercisable, December 31, 2002	<u>320,571</u>	<u>\$ 0.35</u>

As at September 30, 2003, the Company had the following options outstanding pursuant to the Plan:

Number of Options	Exercise Price Per share	Expiry Date
558,000	\$0.35	March 31, 2006
381,715	\$0.35	November 30, 2006
658,571	\$0.35	February 15, 2007
680,000	\$0.20	August 1, 2007
570,000	\$0.20	November 4, 2007
400,000	\$0.25	June 23, 2008

# Pareto Corporation

## Notes to Consolidated Financial Statements

September 30, 2003  
(unaudited)

### 3. Share Capital (continued)

The Company does not record compensation expense when stock options are granted to employees. Had compensation expense been determined based on the fair value at the grant dates, the net income and earnings per share amounts have been changed to the pro forma amounts indicated below:

	Three months ended September 30		Nine months ended September 30	
	2003	2002	2003	2002
Net Income - as reported	\$ 204,883	\$ 21,686	\$ 283,129	\$ (422,843)
- pro forma	185,335		223,621	(452,286)
Earnings per share – basic and diluted				
- as reported	\$ 0.006	\$ 0.001	\$ 0.009	\$ (0.016)
- pro forma	0.006	-	0.007	(0.017)

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	3.5% to 4.75%
Expected option life	2 to 4 years

#### (d) Special warrants:

Pursuant to the acquisition of Solutions, the Company issued 700,000 special warrants. The special warrants are convertible upon exercise to 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. As at September 30, 2003, 583,333 Special Warrants remain outstanding.

#### (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 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 Caxton were required to place a total of 8,705,000 shares in escrow. 10% of the 8,705,000 shares were released from escrow in February 2002 and 15% of the 8,705,000 shares will be released every six months thereafter. As at September 30, 2003, 3,917,250 of these shares remain in escrow.

### 4. Comparative Figures

Certain comparative figures have been reclassified to conform to the current period presentation.