

## **Pareto Corporation**

### **Management's Discussion and Analysis of Results of Operations and Financial Position**

Management's Discussion and Analysis of Results of Operations and Financial Position ("MD&A") of Pareto Corporation ("the Company" or "Pareto"), dated March 26, 2008, summarizes the significant factors affecting the consolidated operating results, financial condition, liquidity and cash flows of Pareto for the year ended December 31, 2007. All amounts are in Canadian dollars. This MD&A should be read in conjunction with consolidated annual financial statements for the year ended December 31, 2007, which are prepared in accordance with Canadian GAAP. Additional information relating to Pareto, including the Annual Information Form dated March 26, 2007, can be found at the Company's website at [www.pareto.ca](http://www.pareto.ca) and on SEDAR at [www.sedar.com](http://www.sedar.com).

#### **Forward-looking Statements**

The Company and its representatives periodically make written and spoken forward-looking statements, including those contained in this 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.

#### **Non-GAAP Measures**

In this discussion and analysis, management uses "EBITDA" (earnings before amortization, net interest and finance charges, share-based compensation, income taxes, gain on acquisition and non-controlling interest); a measure not defined under Canadian generally accepted accounting principles ("GAAP"), to discuss Pareto's operating performance. The Company cautions readers that measures adjusted to a basis other than GAAP do not have standardized meaning and are unlikely to be comparable to similar measures used by other companies. EBITDA is presented as a supplemental figure for discussion because management believes it provides useful information regarding operating performance.

Management uses other non-GAAP financial measures, including net debt (long-term debt plus acquisition notes payable, less cash), EBITDA margin and cash interest expense.

The Company's non-GAAP financial measures, particularly EBITDA, are measures used by investors, financial analysts and lenders, who may use EBITDA and other non-GAAP financial measures to value the Company and assess the Company's ability to service its debt.

#### **Business Overview**

Pareto is a marketing services company that provides marketing execution services to its clients. Pareto provides measurable, quantifiable services that complement and support its clients' marketing and sales departments. The Company endeavors to sell, to each client, as many of its operational services and products as possible and while the Company markets a number of distinct "solutions", most client projects typically involve contributions from several of Pareto's service offerings. The specific products and services which Pareto offers to its clients include:

- Design, production and fulfillment of in-store marketing materials.
- Design and production of direct marketing materials.
- Corporate events.
- Incentive programs.
- Outsourced marketing program management.

Pareto sells its products and services, other than incentive programs which are based on reward unit resale (described in more detail below), either on a project or deliverable fixed fee basis or on a time and materials basis. Pareto services typically sold on a fixed fee basis include design, production and fulfillment of in-store marketing materials and direct marketing services and, corporate events. For example, the Company may sell finished goods (such as in-store signage and direct mail) bundled with a management system (which may include web or data management and distribution) for a fixed price per unit. The value proposition to the client in these circumstances is reduced cost and the benefits of Pareto's management system in terms of reduced cycle times, program effectiveness, and data availability. Profitability in the project or deliverable fixed fee business model is driven by Pareto's success in accurately projecting its costs in pricing products and services and by effective project management.

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Outsourced marketing program management and field services are typically sold on a time and materials basis. In this application Pareto often acts as the client's representative. The Company's personnel are positioned as an extension of, and support for, the client's sales or marketing department. In addition to offering support, Pareto adds value in these situations through program management where it administers and manages an ongoing marketing program to specified objectives. These services may also be sold on a fixed fee basis. In the time and materials based business model profitability is driven by establishing appropriate billing rates for services rendered, and by ensuring that each billable employee is engaged in an appropriate level of billable activity.

Certain incentive programs are based upon the resale of reward units at prices in excess of the cost of the unit to Pareto. Profitability in this business model is dependent on the successful achievement by Pareto's clients of the sales and other business objectives for which the reward units are used as an incentive as well as the number of participants registered in the program. This drives the volume of reward units resold by the Company. These programs are also characterized by significant start-up costs incurred to put the program into place and to sign up participants. As revenues directly reflect our clients' sales volume, the timing of those revenues trends toward the end of the year, as client companies are working to ensure they meet their annual sales targets and accordingly offer attractive incentives to their sales channel during this time. The attractiveness of the reward units resold is also a factor in the overall performance and growth potential of the Company's loyalty and incentive business.

Pareto's focus is on the details of marketing programs, utilizing technology to drive efficient and effective marketing execution. The Company provides value to its clients by sourcing, designing and coordinating the many elements that go into delivery a successful campaign, event or loyalty program. In all of Pareto's businesses it is critical that the Company have and retain the highest quality of personnel having the capabilities and expertise required to deliver the services and products required by Pareto's clients. Personnel development and retention is a key focus of Pareto management and the Company believes that its personnel systems and processes are a key component of its achievements in terms of growth and profitability to date.

Pareto is managed and operated as a single business. The Company endeavors to sell, to each client, as many of its operational services and products as possible and while the Company markets a number of distinct "solutions", in reality a particular project typically involves contributions from several service offerings. Senior management also participates directly in the sales and delivery of products and services to the Company's clients. Accordingly, the Company has determined that it is not practical to prepare and provide meaningful profitability information for individual components of Pareto's business, nor is it meaningful to present a measure of profitability for the business, which includes all direct costs incurred in respect of sales and operational execution other than EBITDA.

Pareto endeavors to enter into long-term contracts with its clients in order to deliver the most cost effective outsourcing of the client's marketing execution as possible. Customer contracts are often annual with certain contracts being 2 to 3 years in length. Long-term contracts allow Pareto to develop and execute longer-term performance improvement and cost reduction programs. The contracts also allow Pareto to achieve a seamless interaction with the client personnel and have been shifting our focus towards more strategic relationships, and away from opportunistic or reactive business. We are striving to build enterprise-wide relationships.

Competition in the marketing industry is intense, and competitors range from small, owner-managed companies to diversified multinational agency groups. While the industry is highly fragmented overall, the trend for many years has been towards consolidation. While many companies may provide services which are similar to the Company's, Pareto's focus on marketing execution as opposed to strategy is often a differentiator. As such, the Company often acts as a complement to, rather than in competition with, existing client marketing and agency resources.

While marketing services may be exposed to risk in an economic downturn, our retail customers may actually increase spending during such a downturn to promote consumer spending. The Company has been fairly resilient to previous downturns in economic cycles. All of the Company's operations are located in Canada with minimal purchasing done outside of Canada and as such, the Company has minimal exposure to changes in currency.

**Pareto Corporation****Management's Discussion and Analysis of Results of Operations and Financial Position****Operating Results for the year ended December 31:**

	2007	2006	\$ Change	% Change
Revenue	\$ 74,340,013	\$ 51,080,008	\$ 23,260,005	46%
Operating and administrative expenses	67,486,077	48,330,272	19,155,805	40%
	\$ 6,853,936	\$ 2,749,736	\$ 4,104,200	149%
Amortization of capital assets	\$ 556,864	\$ 361,174	\$ 195,690	54%
Amortization of intangible assets	211,111	118,599	92,512	78%
Amortization of deferred costs	188,124	149,751	38,373	26%
Interest and finance charges, net	431,404	82,617	348,787	422%
Gain on acquisition	-	(192,042)	192,042	100%
Share-based compensation	480,623	134,210	346,413	258%
	1,868,126	654,309	1,213,817	186%
Earnings before income taxes	4,985,810	2,095,427	2,890,383	138%
Income taxes	1,855,313	545,632	1,309,681	240%
Net earnings	\$ 3,130,497	\$ 1,549,795	\$ 1,580,702	102%
Basic and Diluted earnings per share	\$ 0.07	\$ 0.04	\$ 0.03	75%

**Operating Results for the fourth quarter ended December 31:**

	2007	2006	\$ Change	% Change
Revenue	\$ 20,931,405	\$ 18,194,436	\$ 2,736,969	15%
Operating and administrative expenses	17,847,845	18,153,590	(305,745)	(2%)
	\$ 3,083,560	\$ 40,846	\$ 3,042,714	-
Amortization of capital assets	\$ 204,239	\$ 132,643	\$ 71,596	54%
Amortization of intangible assets and deferred costs	128,585	80,070	48,515	60%
Interest and finance charges, net	110,762	68,391	42,371	62%
Gain on acquisition	-	(63,458)	(63,458)	-
Share-based compensation	170,502	(73,622)	244,124	-
	614,088	144,024	470,064	326%
Earnings before income taxes	2,469,472	(103,178)	2,572,650	-
Income taxes	1,032,987	(129,427)	1,162,414	-
Net earnings	\$ 1,436,485	\$ 26,249	\$ 1,410,236	-
Basic and Diluted earnings per share	\$ 0.03	\$ -	\$ 0.03	-

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#### **Full Year Results**

##### Revenue

In 2007, the Company generated \$74.3 million of revenue compared to \$51.1 million in 2006, an increase of \$23.2 million or 46%. The increase was driven primarily by the inclusion of the operations of the SourceLink Canada business acquired in August 2006 and the Secom Plus business acquired in October 2006. On a pro forma basis, assuming the above acquisitions completed in 2006 had occurred on January 1, 2006, overall organic revenue growth of \$9.5 million or 15% was achieved, driven mainly by growth in field services of \$4.1 million, print management of \$2.2 million, outsourced program management and incentives of \$1.5 million, and corporate events of \$2.7 million, offset by declines in direct marketing. In fact, on a proforma basis, the direct marketing operation of SourceLink Canada declined in 2007 by \$1.0 million or 9% due to the loss of business previously provided to other agencies which are competitors of Pareto. Excluding the SourceLink acquisition, organic revenue growth was \$10.5 million or 19%. Strongest growth was achieved in the field services business, which included a large non recurring customer project that accounted for approximately \$5 million or 7% of this organic growth. While this particular project is non recurring, a number of new projects have already been sold to replace this business.

In 2007 the Company's mix of revenues by business model was as follows:

- Fixed fee basis - \$44.5 million or 60% ( \$33.7 million or 66% in 2006)
- Time and materials basis - \$20.8 million or 28% (\$11.3 million or 22% in 2006)
- Resale of reward units - \$9.0 million or 12% (\$6.1 million or 12% in 2006)

##### Operating and Administrative Expenses

In 2007, the Company incurred \$67.5 million in operating and administrative expenses compared to \$48.3 million in 2006, an increase of \$19.2 million or 40%. Operating and administrative expenses include direct project costs, wages and salaries, facilities costs, and selling, general, and administrative costs. The increase in operating and administrative expenses resulted from the inclusion of the expenses of the businesses acquired during 2006

Direct project costs decreased as a percentage of revenue by 7% in 2007 as compared to the prior year due to a change in mix of revenues and operating efficiencies recognized as the integration efforts of the 2006 acquisitions began. Wages and salaries, as a percentage of revenue, remained flat compared to the prior year due mainly to a change in mix of sales as a significant percentage of the revenue growth was derived from field services and outsourced program management which are labour based services. Facilities costs and selling, general and administrative costs declined as a percentage of sales by 17% as these infrastructure costs were reduced and are spread over a larger revenue base. Included in 2006 operating and administrative expenses, were approximately \$1.2 million of costs incurred by the Company to reduce its infrastructure costs, including facilities closures and staffing reductions.

##### EBITDA

In 2007, the Company generated \$6.9 million of EBITDA (see "Non-GAAP Measures") compared to \$2.7 million in 2006, an increase of \$4.1 million or 149%. EBITDA as a percentage of revenue represented 9.2% in 2007 compared to 5.4% in 2006. This increase in percentage is due to economies of scale as fixed infrastructure costs are spread over a larger revenue base, the elimination of \$1.2 million of infrastructure reduction costs incurred in 2006 and greater efficiencies realized as integration efforts of acquisitions have begun and operating efficiencies are realized.

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#### Amortization, Interest and Share-based Compensation

In 2007, the Company incurred amortization, interest and share-based compensation expenses of \$1.9 million compared to \$0.9 million in 2006, an increase of \$1.0 million or 121%. This increase was driven primarily by increased net interest and finance costs, increased amortization of capital and intangible assets and share-based compensation. Interest and finance charges increased by \$0.3 million due to the inclusion of a full year of capital lease financing costs acquired with SourceLink acquisition in 2006 and interest paid on operating line of credit whereas interest income was earned in 2006 on cash balances. Capital asset and intangible asset amortization increased by \$0.3 million resulting from the full year inclusion of the acquisitions completed during 2007 and amortization related to the capital assets acquired in 2006. Share-based compensation expense increased by \$0.4 million or 258% reflecting the impact of the options and restricted stock units granted as part of the Company's plans as well as those granted for incentive purposes in 2007 for the hiring of three new senior executives.

#### Gain on Acquisition

As set out in note 4(b) of the Company's annual consolidated financial statements, the Company realized a gain of \$0.2 million in 2006 related to the acquisition of SourceLink Canada. The gain resulted from the fair value of the net assets recognized exceeding the purchase price of the business.

#### Income Taxes

In 2007, the Company incurred income tax expenses of \$1.9 million compared to \$0.5 million in 2006, an increase of \$1.3 million or 240%. In 2007 income taxes represented 37% of earnings before tax compared to 26% in 2006. Total tax expense increased due to a reduction of future income tax assets due to reduced income tax rates enacted (\$0.3 million), non-deductible expenses (\$0.2 million), offset somewhat by reductions in tax liabilities recorded in prior years no longer required (\$0.2 million). The \$1.9 million of income tax expense will be settled by a reduction of future income tax assets, with minimal charge to current income taxes. At December 31, 2007 the Company has \$1.7 million of future income tax assets still to be utilized, with approximately \$1.0 million expected to be utilized in 2008. The Company expects to incur an effective tax rate of approximately 34% in 2008.

#### Net earnings

In 2007, the Company generated \$3.1 million of net earnings compared to \$1.5 million in 2006, an increase of \$1.6 million or 102%. This increase is the result of revenue growth of \$0.7 million, improved EBITDA margins of \$1.0 million and the elimination of non-recurring costs in 2006 of \$1.2 million partially offset by an increase in the effective tax rate in 2007 of \$0.6 million and an increased percentage of revenue amortization, interest and share based costs of \$0.7 million. In 2007, net earnings as a percentage of revenue was 4.2% compared to 3.0% in 2006. Excluding the effect of income taxes, earnings before income taxes was 6.7% of revenue in the year compared to 4.1% in 2006.

#### Earnings per share

Pareto's basic and diluted earnings per share in 2007 were \$0.07 versus \$0.04 for both measures in 2006. The increase in net income of 102% translated into a 75% increase in diluted earnings per share due to the 9.0% increase in number of diluted shares outstanding in the year. The weighted average number of diluted shares outstanding increased as a result of the full year impact of a 5.7 million share private placement completed in 2006, the shares issued on exercise of stock options, offset by the 1,862,127 shares repurchased for cancellation during the year.

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#### **Fourth Quarter Results**

##### Revenue

In the fourth quarter of 2007, the Company generated \$20.9 million of revenue compared \$18.2 million in 2006, an increase of \$2.7 million or 15%. The increase was due entirely to organic growth as the operations of the SourceLink Canada and the Secom Plus businesses were acquired before the prior year fourth quarter. This growth was driven mainly by growth in outsourced program management and incentives (\$2.8 million), and corporate events (\$0.2 million), offset by declines in print management (\$0.5 million) and field services (\$0.5 million).

##### Operating and Administrative Expenses

In the fourth quarter of 2007, the Company incurred operating and administrative expenses of \$17.8 million compared to \$18.2 million in 2006, a decrease of \$0.3 million or 2%. Included in 2006, were approximately \$1.2 million of costs incurred by the Company to reduce its infrastructure including facilities closures and staffing reductions. Adjusting the prior year numbers for this non-recurring item, operating and administrative expenses increased \$0.9 million or 5%. Operating and administrative expenses include direct project costs, wages and salaries, facilities costs, and selling, general and administrative costs. Costs decreased as a percentage of revenue in 2007 as compared to the prior year due to a change in mix of revenues and economies of scale as these infrastructure costs are spread over a significantly larger revenue base.

##### EBITDA

In the fourth quarter of 2007, the Company generated \$3.1 million of EBITDA compared to \$0.0 million in 2006. Adjusting for the impact of the \$1.2 million non-recurring expenses recorded in 2006, EBITDA increased \$1.9 million or 158%. EBITDA as a percentage of revenue represented 14.7% in 2007 from 6.8% in 2006, after adjusting for the impact of \$1.2 million of non-recurring expenses. This increase in percentage is due to mix of revenues and economies of scale as fixed infrastructure costs are spread over a larger revenue base.

##### Income Taxes

In the fourth quarter of 2007, the Company incurred income tax expense of \$1.0 million compared to an income tax recovery of \$0.1 million in 2006, an increase of \$1.1 million. Income tax expense represented 42% of earnings before tax this quarter compared to a full year effective tax rate of 37%. This increase in percentage is due to tax expenses of approximately \$0.4 million resulting from a reduction of future income tax assets due to reduced income tax rates enacted by the federal government this quarter.

##### Net earnings

In the fourth quarter 2007, the Company generated \$1.4 million of net earnings compared to nil in 2006, an increase of \$1.4 million. This increase is the result of 149% EBITDA growth offset by an increase in the effective tax rate in 2007. Net earnings as a percentage of revenue was 6.9% in the fourth quarter of 2007 compared to 0.1% in 2006. Excluding the effect of income taxes, earnings before income taxes was 11.8% of revenue in the fourth quarter compared to -0.6% in 2006.

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#### Liquidity and Capital Resources

##### Financial Position

	Dec 31, 2007	Dec 31, 2006	\$ Change	% Change
Cash	\$ -	\$ 5,020,127	\$ (5,020,127)	100%
Bank Indebtedness	368,291		(368,291)	
Acquisition notes payable	3,066,668	1,450,000	(1,616,668)	
Long-term debt	-	665,992	665,992	
Long-term capital leases	990,945	1,256,355	265,410	
Total debt	4,425,904	3,372,347	(1,053,557)	(31%)
Total net (debt) cash position	(4,425,904)	1,646,780	(6,073,684)	(368%)
Shareholders' equity	25,702,273	23,736,606	1,965,667	8%
Total capitalization	\$ 30,128,177	\$ 22,088,826	\$ (8,039,351)	(36%)
Working capital position	\$ 1,445,121	\$ 4,134,294	\$ (2,689,173)	(65%)
Net debt:Shareholders' equity	0.17:1	n/a		
Net debt:Total Capitalization	0.15:1	n/a		
Total debt:EBITDA	0.6:1	1.2:1		

Pareto's sources of short-term liquidity include cash provided by operating activities and a \$9 million operating line of credit secured by a general security agreement over the assets of Pareto and its subsidiaries, and which is repayable on demand.

Management considers the Company's capital resources adequate to meet the Company's operating, capital expenditure, and financing requirements. However, the Company may consider acquisition opportunities. Depending on the size of an acquisition, the Company may need to secure external capital, in the form of debt or share equity, to finance the acquisition.

##### Operating activities

In 2007, Pareto's operating activities generated \$0.6 million of cash flow compared to utilizing \$1.1 million of cash flow in 2006, an increase of \$1.7 million. Operating activities before changes in non-cash operating accounts generated \$6.5 million of cash flow in 2007 compared to \$2.6 million in 2006, an increase of \$3.9 million. Non-cash operating accounts utilized \$5.9 million of cash flow in 2007 compared to \$3.7 million in 2006, a decrease of \$2.2 million. This decline is due to a reduced cash flow as accounts receivable increased by \$4.9 million and deferred revenue decreased by \$0.7 million. The Company's days sales outstanding measured on a quarterly basis stood at 70 days at December 31, 2007 compared to 62 days at December 31, 2006, due in part to significant cash transactions received immediately after year end resulting from the timing of the holiday season.

##### Investing activities

In 2007, Pareto's investing activities, comprised of capital asset additions and acquisition costs, utilized \$2.2 million of cash flow, down from \$5.9 million in 2006, a reduction of \$3.7 million. In 2007 capital asset additions incurred totaled \$2.1 million compared to \$0.9 million in 2006, and increase of \$1.2 million. The increased capital expenditures were related primarily to leasehold improvements and new equipment purchases for the new retail production and distribution facility in Richmond Hill which opened in August 2007 as well investments in technology enhancements to our management information system. In 2007, the Company had no acquisitions compared to \$4.9 million in 2006, an increase of \$4.9 million. The Company anticipates its capital asset requirements in 2008 will be significantly reduced from the 2007 levels, returning closer to the levels incurred in 2006.

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#### Financing activities

In 2007, Pareto's financing activities utilized \$3.8 million of cash flow compared to generating \$6.9 million in 2006. In 2007, \$1.4 million was utilized for payment of outstanding acquisition notes payable from the Secom Plus Inc. and Trajectory Business Performance Inc. prior year acquisitions, \$0.7 million utilized for repayment of long term debt, \$0.3 million utilized for repayment of capital lease obligations and \$2.0 million utilized to repurchase 1.9 million common shares of the Company pursuant to its normal course issuer bid, offset somewhat by \$0.4 million of cash received from the repayment of loans receivable. The Company intends to expend further funds to repurchase common shares in 2008. At December 31, 2007, the Company had approximately 1.3 million shares remaining available to purchase under the current normal course issuer bid.

#### **Contractual Obligations**

The following table provides a summary of Pareto's contractual obligations under various debt and lease agreements:

	Payments due by period				
	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
Capital leases	\$ 990,945	\$ 281,666	\$ 709,279	\$ -	\$ -
Acquisition notes payable	3,066,668	3,066,668	-	-	-
Operating leases	5,139,110	861,520	1,865,637	828,634	1,583,319
Total contractual obligations	\$ 9,196,723	\$ 4,209,854	\$ 2,574,916	\$ 828,634	\$ 1,583,319

#### **Off Balance Sheet Arrangements**

In October 2006, the Company acquired the shares of Secom Plus Inc. ("Secom"). As part of the purchase, additional cash consideration of \$2.0 million will be payable to the previous owners in October 2008 based on the satisfaction of remaining conditions precedent to payment.

#### **Outstanding Share Data**

At March 26, 2008 an unlimited number of common shares were authorized and 43,038,648 (December 31, 2007 - 43,994,648) common shares were outstanding. The Company has 1,904,168 options currently outstanding to acquire common shares pursuant to its Option Plan of which 429,440 are exercisable. The Company also has 1,515,952 restricted stock units currently outstanding, all convertible to common shares on a one to one basis. See note 13 to the consolidated financial statements for further information on the Company's share capital.

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#### Non-GAAP Earning Measures

The following is a quantitative reconciliation of EBITDA to net earnings:

	Year Ending December 31, 2007	Year Ending December 31, 2006
Net earnings	\$ 3,130,497	\$ 1,549,795
Income Taxes	1,855,313	545,632
Amortization of capital assets	556,864	361,174
Amortization of intangible assets and deferred costs	399,235	268,350
Interest and financing charges	431,404	82,617
Gain on acquisition	-	(192,042)
Share-based compensation	480,623	134,210
EBITDA	<u>\$ 6,853,936</u>	<u>\$ 2,749,736</u>

#### Transactions with Related Parties

- (a) In April 2007, the Company issued a loan totalling \$236,250 to an executive of the Company for the purchase of 225,000 common shares of the Company. The loan is carried at the carrying amount of \$236,250 which approximates its fair value. The loan bears interest at Prime Rate plus ½% with interest payable quarterly. The loan is repayable on April 4, 2012. The loan is full recourse and the Company has received a pledge of the purchased common shares as security for the loans.
- (b) In May 2006, the Company issued loans totalling \$866,667 to executives of the Company. The loans were carried at the carrying amount of \$866,667 which approximates the fair value. The loans bear interest at Prime Rate plus ½% with interest payable quarterly. The loans are repayable on May 16, 2011. During 2007, loans totalling \$366,667 were repaid. During 2006, loans totalling \$250,000 were repaid. The loans are full recourse, and the Company has received pledges of the purchased common shares as security for the loans.

During 2007, \$46,873 (2006 - \$32,036) of interest was received pursuant to these loans.

#### 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, and operating results may be affected in a material adverse manner.

##### Access to Capital Resources

While the Company expects to generate positive cash flow from operations, the Company may raise capital to fund its future growth, either from the incurrence of 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.

The incurrence of 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.

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#### Competition

The marketing services industry is highly competitive. The Company has competition in all major markets in which it does business from competitors that range from large multinational agencies 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 and creative capabilities and reputation, management, personal relationships, quality and reliability of service, and expertise in particular niche areas of the marketplace. As the Company continues to expand through strategic acquisitions or organic growth, this may reduce the number of competitors in the market, however the success achieved may be a springboard for other companies to enter the market, therefore the competitive landscape is ever fluctuating and difficult to predict.

#### Dependence Upon a Limited Number of Clients

Although the Company has a significant number of clients, a relatively small number of them contribute the majority of the Company's revenue and gross profit. During the year Pareto generated revenues from one client represented greater than 10% of revenues (30%). In 2006 two clients represented greater than 10% of revenues (23% and 17% respectively). The Company's dependence on a limited number of clients may increase in the future, should the Company continue to achieve improved relationships with key clients and succeed in providing new services to them.

The Company endeavors to reduce the risk of key client dependence by entering into multi-year contractual arrangements with its key clients and by developing multiple relationships within the client organization. The Company also reduces the risk of key client dependence by winning new clients through strategic acquisitions and internal growth.

#### Credit Risk

Accounts receivable represented 37% of consolidated assets at December 31, 2007 (2006 – 27%). The Company mitigates its credit risk with respect to accounts receivable by dealing with large, creditworthy clients and also by billing whenever possible in advance of the provision of services.

#### Dependence on Key Personnel

The Company's success is dependent on the leadership of a number of key executive and management personnel. If any of these key individuals leave the Company, the relationships they have with certain of the Company's clients could be lost. In addition, the Company's ability to generate revenue is dependent upon 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, and 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 towards consolidating their marketing services providers so that one firm provides these services to 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 supplier. To the extent that Pareto loses revenue as a result of this trend, the Company's business, financial condition and operating results may be affected in a material adverse manner.

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#### **Critical Accounting Estimates**

##### Overview

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates that affect the amounts reported and disclosed in the consolidated financial statements. Management bases estimates on historical experience and various other assumptions that are believed to be reasonable in the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. On an ongoing basis, management evaluates its estimates. However, actual results could differ from estimated results. The Company's significant accounting policies are included in note 2 to the 2007 consolidated financial statements. Management believes the following critical accounting policy involves the most significant judgments and estimates used in the preparation of the Company's consolidated financial statements.

##### Goodwill and Intangible Assets

Goodwill and intangible assets represent the Company's most significant 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. For the fourth quarter of 2007, the Company completed the annual assessment and found no impairment of goodwill. Intangible assets consist of the value of the Company's acquired customer relationships. In the marketing services industry, these are typically long-term in nature, and therefore customer relationship assets are amortized on a straight-line basis over an estimated useful life of 10 years. If impairment losses related to goodwill and intangible assets were to be recognized in future periods, the losses could have a material adverse impact on the Company's results of operations and financial position.

#### **Financial Instruments and Other Instruments**

Pareto engages in transactions in foreign currencies, most commonly involving the U.S. dollar and the euro. From time to time, Pareto will use currency forward contracts to fix the exchange rate for known future transactions. No such contracts were outstanding at December 31, 2007.

#### **Subsequent events**

On February 27, 2008, the Company announced a strategic investment in Ontogenix Inc, a technology company focused in online marketing. The Company invested \$550,000 in a three year convertible debenture bearing interest at a rate of 16%, accrued annually. When converted, ownership would equate to less than 20%. The investment was funded out of existing cash resources.

#### **Disclosure Controls and Procedures**

The Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the company's disclosure controls and procedures and concluded that such controls and procedures were effective at the reasonable assurance levels as of December 31, 2007 and in respect of the year ending. Due to inherent limitations, the company's disclosure controls and procedures do not guarantee timely communication of all material events to the certifying officers and projections of any evaluation of effectiveness of such controls and procedures to future periods are subject to the risk that controls may become inadequate due to changes in conditions, or deterioration in the degree of compliance with the Company's policies and procedures.

## **Pareto Corporation**

### **Management's Discussion and Analysis of Results of Operations and Financial Position**

#### **Internal Control over Financial Reporting**

The Chief Executive Officer and Chief Financial Officer have designed a system of internal control over financial reporting which provides reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with the generally accepted accounting principles.

During the year ended December 31, 2007, there were no substantive changes in the nature of the company's policies or procedures that have materially affected, or are reasonably likely to materially affect, the company's system of internal control over financial reporting. The Company is continuing with its efforts in formalizing and documenting various elements of its system of internal control over financial reporting in preparation for the evaluation of the operating effectiveness of its internal control system within the timelines to be prescribed by the Canadian Securities Administrators.

#### **Recent Accounting Developments**

Effective January 1, 2007, the Company adopted Sections 1530 "Comprehensive Income", 3251 "Equity", 3855 "Financial Instruments – Recognition and Measurement", 3861 "Financial Instruments – Disclosure and Presentation" and 3865 "Hedges" issued by the Canadian Institute of Chartered Accountants.

In accordance with the transitional provisions in these new standards, these policies were adopted retroactively without restatement of prior year figures. The adoption of these policies has no material change to the prior year figures. The methods by which the Company determines the fair value of its financial instruments have also not changed as a result of adopting this standard.

Financial Assets and Financial Liabilities – Under the new standards, all financial instruments are classified into one of the following five categories: held for trading, held to maturity investments, loans and receivables, available for sale financial assets and other financial liabilities. All financial instruments, including derivatives, are included in the consolidated balance sheet and are measured at fair value except for held to maturity investments, loans and receivables and other financial liabilities which are measured at amortized cost.

Under the new standards, financial assets and financial liabilities are initially recognized at fair value and are subsequently accounted for based on their classification described below. The classification depends on the purpose for which the financial instruments were acquired and their characteristics. Except in very limited circumstances, the classification is not changed subsequent to initial recognition. Transaction costs are recognized immediately in income or are capitalized, depending upon the nature of the transaction and the associated product.

Upon adoption of these new standards, the Company's significant financial asset and liabilities are classified as follows:

Cash (Bank indebtedness)	Held for trading
Accounts receivable	Loans and receivables
Loans receivable	Loans and receivables
Accounts payable and accrued liabilities	Other financial liabilities
Acquisition notes payable	Other financial liabilities

Held for trading – financial assets and financial liabilities that are purchased and incurred with the intention of generating profits in the near term are classified as held for trading. These instruments are accounted for at fair value with the change in the fair value recognized in net earnings.

Available for sale – financial assets classified as available for sale are carried at fair value with the changes in fair value recorded in other comprehensive income. Gains and losses realized on disposal of available for sale financial assets, which are calculated on an average cost basis, are recognized in earnings.

## **Pareto Corporation**

### **Management's Discussion and Analysis of Results of Operations and Financial Position**

Held to maturity – Securities that have a fixed maturity date, where the Company intends and has the ability to hold to maturity, are classified as held to maturity and accounted for at amortized cost using the effective interest rate method.

Loans and receivables – Loans and receivables are accounted for at amortized cost using the effective interest rate method.

Other financial liabilities – Other financial liabilities are recorded at amortized cost using the effective interest rate method, and include all liabilities, other than derivatives.

#### **Future Accounting Policy Changes**

Financial Instruments Disclosure and Presentation – Under CICA Handbook section 3862 “Financial Instruments - Disclosure” and section 3863 “Financial Instruments – Presentation”, disclosure requirements are revised and enhanced, while presentation requirements remain essentially unchanged. The new disclosure requirements will expand discussion around the significance of financial instruments for the Company's financial positions and performance, and the nature and extent of risk arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and how the entity manages those risks. These standards are effective for fiscal years beginning on or after October 1, 2007. The Company is currently assessing the potential impact.

Capital Disclosures – Under CICA Handbook Section 1535 “Capital Disclosures”, the Company will disclose its objectives, policies and procedures for managing capital, any summary quantitative data about what the Company manages as capital, whether the Company has complied with any externally imposed capital requirements and, if the Company has not complied with them, any consequences of non-compliance. This standard is effective for fiscal years beginning on or after October 1, 2007. The Company is currently assessing the potential impact.

Inventories – Under CICA Handbook Section 3031 “Inventories”, effective for fiscal years beginning on or after January 1, 2008, aligns accounting for inventories under Canadian GAAP with International Financial Reporting Standards (IFRS) and provides additional guidance on the measurement and disclosure requirements for inventories. Specifically, this section requires inventories to be measured at lower of cost and net realizable value. This standard will not materially impact the Company's financial statements and will be adopted effective January 1, 2008.

International Financial Reporting Standards - In 2006, Canada's Accounting Standards Board ratified a strategic plan that will result in Canadian generally accepted account principles (Canadian “GAAP”), as used by public companies, being evolved and converged with International Financial Reporting Standards (“IFRS”) over a transitional period currently expected to be complete by 2011. The precise timing of convergence will depend on an Accounting Standards Boards “progress review” to be undertaken and released by March 31, 2008. Canadian GAAP will be converged with IFRS through a combination of two methods: as current joint-convergence projects of the United States' Financial Accounting Standards Board and the International Accounting Standards Board are agreed upon, they are expected to be adopted by Canada's Accounting Standards Board and may be introduced in Canada before the complete changeover to IFRS; and standards not subject to a joint-convergence project will be exposed in an omnibus manner for introduction at the time of the complete changeover to IFRS. The Company will convert to these new standards according to the timetable set with these new rules. The Company will closely monitor changes arising from this convergence.

**Pareto Corporation****Management's Discussion and Analysis of Results of Operations and Financial Position****SUMMARY OF QUARTERLY AND ANNUAL RESULTS**

<b>Year Ended</b>					
<b>31 December, 2007</b>	<b>Mar 31</b>	<b>Jun 30</b>	<b>Sep 30</b>	<b>Dec 31</b>	<b>Total</b>
<b>Quarterly information:</b>					
Revenue	\$ 14,716,308	\$ 24,347,041	\$ 14,345,259	\$ 20,931,405	\$ 74,340,013
EBITDA <sup>1</sup>	816,693	2,352,547	601,136	3,083,560	6,853,936
EBITDA Margin	5.5%	9.7%	4.2%	14.7%	9.2%
Net earnings	347,544	1,270,254	76,214	1,436,485	3,130,497
Basic and diluted earnings per share <sup>2</sup>	0.01	0.03	0.00	0.03	0.07
<b>Annual information:</b>					
Total assets					46,586,523
Total long-term financial Liabilities, including current portion					4,057,613
Cash dividends declared					-

<b>Year Ended</b>					
<b>31 December, 2006</b>	<b>Mar 31</b>	<b>Jun 30</b>	<b>Sep 30</b>	<b>Dec 31</b>	<b>Total</b>
<b>Quarterly information:</b>					
Revenue	\$ 9,532,273	\$ 13,036,822	\$ 10,316,477	\$ 18,194,436	\$ 51,080,008
EBITDA <sup>1</sup>	764,547	1,236,293	708,050	40,846	2,749,736
EBITDA Margin	8.0%	9.5%	6.9%	0.2%	5.4%
Net earnings	346,152	713,047	464,347	26,249	1,549,795
Basic and diluted earnings per share <sup>2</sup>	0.01	0.02	0.01	0.00	0.04
<b>Annual information:</b>					
Total assets					44,807,361
Total long-term financial liabilities, including current portion					3,372,347
Cash dividends declared					-

<sup>1</sup> EBITDA is a non-GAAP financial measure. See above under "Non-GAAP Measures".

<sup>2</sup> The quarterly figures do not add to the annual figure due to rounding and differences in weighted average diluted shares outstanding during the periods.

**Seasonality**

## **Pareto Corporation**

### **Management's Discussion and Analysis of Results of Operations and Financial Position**

Because of the project-based nature of certain of the Company's business units which recognize revenue using the completed contract method, the Company's results can be significantly impacted in a quarterly period depending on the timing of the completion of significant projects. This impact, which is particularly pronounced in the Event business, does not follow a predetermined seasonal pattern though the fourth quarter is traditionally the largest period of client spending in the marketing services industry and can cause material fluctuations in quarterly revenues, EBITDA, and net earnings.

#### **ADDITIONAL INFORMATION**

Other information relating to Pareto, including the Company's Annual Information Form, is available on SEDAR at [www.sedar.com](http://www.sedar.com).