



Pareto Corporation Q2 2007 Report

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 July 31, 2007, summarizes the significant factors affecting the consolidated operating results, financial condition, liquidity and cash flows of Pareto for the quarter and six month period ended June 30, 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, 2006, which are prepared in accordance with Canadian GAAP. Additional information relating to Pareto, including the Annual Information Form dated March 29, 2007, can be found at the Company's website at www.pareto.ca and on SEDAR at 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 and income taxes) and pro forma revenue; measures 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. The items required to reconcile between EBITDA and net earnings are amortization of capital assets, amortization of intangible and other assets, net interest and finance charges, share-based compensation and income taxes all of which are clearly identified on the Company's Statement of Operations and Retained Earnings.

Pro forma revenue is calculated by including the revenue of businesses acquired since the end of the prior year comparative period in the Company's revenue for the corresponding period as if the acquired business was acquired at the beginning of the comparative period.

Management uses other non-GAAP financial measures, including net debt (long-term debt and capital lease obligations 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 clients in a wide range of industries. All of Pareto's operations are located in Canada. Pareto provides measurable, quantifiable services that complement its clients' marketing and sales departments. The specific products and services which Pareto offers to its clients include:

- Print management and fulfillment and distribution of in-store point of sale/point of purchase materials.
- Direct marketing.
- Retail sales and merchandising.
- Design, production and coordination of consumer promotions.
- Corporate events and incentive travel management.
- Outsourced sales and marketing program management.
- Customer loyalty programs.
- Channel sales and employee training and incentive programs.

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Pareto sells its products and services, other than channel sales and employee 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 print management, direct mail, consumer promotions, corporate events and customer loyalty programs. For example, in a retail application the Company sells 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.

Retail sales and merchandising as well as outsourced sales and marketing program management 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 sales and 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 channel sales and employee incentive programs, and in particular the Elevate business, 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 Elevate 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. In that regard, the acceptance and use of Aeroplan Miles in the Canadian marketplace is anticipated to be a significant contributor to the success of the Company's Elevate business.

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.

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Operating Results for the quarter ended June 30:

	2007	2006	\$ Change	% Change
Revenue	\$ 24,347,041	\$ 13,036,822	\$ 11,310,219	87%
Operating and administrative expenses	21,994,494	11,800,529	10,193,965	86%
	\$ 2,352,547	\$ 1,236,293	\$ 1,116,254	90%
Amortization of capital assets	\$ 114,771	\$ 76,107	\$ 38,664	51%
Amortization of intangible assets and deferred costs	90,216	62,671	27,545	36%
Interest and finance charges, net	110,951	(31,632)	142,583	451%
Share-based compensation	119,832	71,407	48,425	68%
	435,770	178,553	257,217	144%
Earnings before income taxes	1,916,777	1,057,740	859,037	81%
Income taxes	646,523	344,693	301,830	88%
Net earnings	\$ 1,270,254	\$ 713,047	\$ 557,207	78%
Basic and Diluted earnings per share	\$ 0.03	\$ 0.02	\$ 0.01	50%

Operating Results for the six months ended June 30:

	2007	2006	\$ Change	% Change
Revenue	\$ 39,063,349	\$ 22,569,095	\$ 16,494,254	73%
Operating and administrative expenses	35,894,109	20,568,255	15,325,854	75%
	\$ 3,169,240	\$ 2,000,840	\$ 1,168,400	58%
Amortization of capital assets	\$ 217,070	\$ 147,537	\$ 69,533	47%
Amortization of intangible assets and deferred costs	180,433	125,609	54,824	43%
Interest and finance charges, net	185,546	1,763	183,783	10,424%
Share-based compensation	184,357	137,876	46,481	34%
	767,406	412,785	354,621	86%
Earnings before income taxes	2,401,834	1,588,055	813,779	51%
Income taxes	784,036	528,856	255,180	48%
Net earnings	\$ 1,617,798	\$ 1,059,199	\$ 558,599	53%
Basic and Diluted earnings per share	\$ 0.04	\$ 0.03	\$ 0.01	33%

Revenue

During the second quarter of 2007, Pareto generated \$24.3 million of revenues, up from \$13.0 million in 2006, an 87% increase. The inclusion of the operations of the SourceLink Canada business acquired in August 2006 and the Secom Plus business acquired in October 2006 was the primary driver of the increase though significantly increased corporate event revenues also significantly contributed to growth. On a pro forma basis, assuming the above acquisitions completed in 2006 had occurred on January 1, 2006, overall organic revenue increased by 34%, driven by strong growth in Secom and corporate events. As previously mentioned the Company's second quarter corporate event revenues were positively impacted by the

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completion of a number of biannual events. Excluding corporate events pro forma organic revenue increased by 17% driven by Secom and retail revenue growth.

For the six month period ended June 30, 2007, revenues increased by 73% or \$16.5 million to \$39.1 million from \$22.6 million in the same period last year. Once again, the inclusion of the 2006 acquisitions completed after June 30, 2006 was the primary reason for growth. On a proforma basis, revenues for the period increased by 20% led by strong growth in Secom, corporate events and print management services. Excluding corporate events proforma revenues increased by 15% on a year to date basis.

Operating and Administrative Expenses

For the quarter, operating and administrative expenses increased 86% or \$10.2 million to \$22.0 million from \$11.8 million in the prior year. Operating and administrative expenses include project, selling, general, administrative and facilities costs. The increase in operating and administrative expenses resulted from the inclusion of the expenses of the businesses acquired after June 30, 2006 and was consistent with the 87% increase in revenues for the quarter.

On a year to date basis, operating and administrative expenses increased by 75% to \$35.9 million compared to \$20.6 million last year. This percentage increase exceeded the corresponding revenue increase of 73% as a result of higher the average operating costs percentage incurred in the first quarter of 2007 compared to last year.

EBITDA

In Q2 2007, the Company generated \$2.4 million of EBITDA (see "Non-GAAP Measures" above) compared to \$1.2 million in 2006, an increase of 90%. The growth in EBITDA only marginally outpaced the growth in revenues of 87% as the inclusion of higher margin revenues derived from businesses acquired in 2006 was offset by the impact of lower margin corporate event revenues in the quarter. EBITDA as a percentage of revenue represented 9.7% in 2007 up from 9.5% in 2006.

For the six month period ended June 30, 2007 EBITDA totaled \$3.2 million, up 58% from 2006. EBITDA as a percentage of revenue of 8.1% was lower than the 8.9% recorded in the first six months of 2006 and behind the rate achieved in the second quarter of 2007 due to the lower EBITDA margin rate achieved in the first quarter of 2007.

Amortization, Interest and Share-based Compensation

For the quarter, amortization, interest and share-based compensation increased by 144% or \$257,217 over the same period in 2006. Each of the components of the total increased with the primary driver being increased interest and finance charges. Net interest and finance charges increased by \$142,583 as a result of the inclusion of interest costs on capital lease obligations taken on by the Company as part of the acquisition of SourceLink Canada in August 2006 and the loss of interest income derived in the first six months of 2006 subsequent to the Company's March 2006 private placement. Amortization of capital assets increased by 36% as a result of capital assets acquired by the Company since June 30, 2006. The acquisition of Secom Plus by the Company in October 2006 led to increased amortization of both capital assets and intangible assets. The Company expects both capital asset and intangible asset amortization to increase in 2007 due the full year effect of the acquisitions and capital assets acquired and further capital expenditures in 2007. Share-based compensation expense increased by 68% resulting from stock options and restricted stock units issued by the Company since June 30, 2006. Similar factors affected these costs for the six month period ended June 30, with total amortization, interest and share-based compensation expenses increasing 86% during the period compared to last year.

Income Taxes

Income tax expense in the second quarter of 2007 represented 34% of earnings before tax compared to 33% in Q2 2006. The overall tax rate increased as a result of higher amounts of non deductible items for tax purposes such as share based compensation. For the six month period, the overall tax rate remained consistent at 33%. At June 30, 2007 the Company has approximately \$3.2 million of future income tax assets still to be utilized. Going forward, the Company expects to incur a long term effective tax rate of approximately 37%.

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Net Earnings

Year to date in 2007, the Company has generated a total of \$1.6 million of total net earnings including \$1.3 million in the second quarter of 2007. This represents a 53% (50% for the quarter) increase over 2006 as significant revenue and EBITDA increases were offset by higher amortization, interest and share-based compensation as well as higher income taxes. Net earnings as a percentage of revenue were 4.1% compared to 4.7% in 2006 (5.2% versus 5.5% for the quarter). Excluding the effect of income taxes, earnings before income taxes were 6.1% of revenue in 2007 compared to 7.0% in 2006 (7.9% versus 8.1% for the quarter).

Earnings per Share

In the second quarter of 2007, basic and diluted earnings per share increased to \$0.03 from \$0.02, an increase of 50%. This rate of increase was lower than the corresponding 78% increase in net earnings. The weighted average number of diluted shares outstanding increased by 1% over 2006 as dilution resulting from common shares, options and restricted stock units issued was offset by common shares repurchased for cancellation. On a six month basis basic and diluted earnings per share increased to \$0.04 from \$0.03, an increase of 33%. This rate of increase was also lower than the corresponding 53% increase in net earnings as a result of the increase in the weighted average diluted shares outstanding of 8%. This increase resulted from two private placements completed in 2006 and the shares issued pursuant to the acquisition of Secom Plus in October 2006, offset by shares repurchased for cancellation during the year and the effect of the decrease in the Company's share price compared to the same period last year.

Financial Outlook

The Company expects the second quarter of 2007 will be the Company's largest revenue quarter in 2007 and as has been the case in the last two years and for third quarter revenues to be considerably less than second quarter revenues.

The Company expects to achieve EBITDA margins in the range of 10% for the year and has established a long-term EBITDA margin target of 15% of revenue.

Liquidity and Capital Resources

Financial Position

	June 30, 2007	December 31, 2006	\$ Change	% Change
Cash	\$ 129,667	\$ 5,020,127	\$ (4,890,460)	(97%)
Acquisition notes payable	66,667	1,450,000	(1,383,333)	(95%)
Long-term debt	415,990	665,992	(250,002)	(38%)
Long-term capital leases	1,126,194	1,256,355	(130,161)	(10%)
Total debt	1,608,851	3,372,347	(1,763,496)	(52%)
Total net cash (debt) position	(1,479,184)	1,647,780	(3,126,964)	(189%)
Shareholders' equity	24,802,685	23,736,606	1,066,079	5%
Total capitalization	\$ 26,281,869	\$ 22,088,826	\$ 4,193,043	19%
Working capital position	\$ 3,837,976	\$ 4,134,294	\$ (286,318)	(7%)

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Net debt: Shareholders' equity	0.06:1	n/a
Net debt: Total Capitalization	0.06:1	n/a
Net debt: EBITDA	0.41:1	n/a
Total debt: EBITDA	0.41:1	1.23:1

Pareto's sources of short-term liquidity include cash provided by operating activities and a \$9.0 million operating line of credit (increased from \$5.5 million in July 2007) secured by a general security agreement over the assets of Pareto and its subsidiaries, and which is repayable on demand.

The Company has long-term subordinated debt with a principal amount of \$0.4 million outstanding as at June 30, 2007. In July 2007, the Company repaid the debt in full.

Management considers the Company's capital resources adequate to meet the Company's operating, capital expenditure, and financing requirements. The Company is continuing to explore 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.

The Company's balance sheet and financial flexibility presents a number of options. One is the ability to realize greater efficiencies with our suppliers, for example seeking more favourable pricing in exchange for faster payment. The Company may also utilize available cash for share repurchases under its previously filed Normal Course Issuer Bid should the Board determine it to be in the best interests of the Company. Alternatively the Company may also fund internal start-up ventures, as has been done in the past with Pareto Dialogue and Elevate. The Company may also use its current resources to finance acquisitions. In the long term we do not intend to maintain unnecessarily high cash balances.

Operating activities

For the quarter operating activities generated \$1.0 million of cash flow compared to a utilization of \$1.3 million of cash flow in 2006, an improvement of \$2.3 million. The increase was driven by the increase in net earnings and a significant increase in the non-cash expenses deducted from net earnings. Most notably future income taxes increased by approximately \$564,000 as a result of utilization of the Company's future tax asset acquired in the acquisition of SourceLink Canada. Though changes in non-cash working capital accounts utilized \$1.2 million of cashflow in the quarter, this represented an improvement of \$1.0 over the same period in 2006. The utilization in Q2 2007 resulted from an increase in accounts receivable coupled with a decrease in deferred revenue offset by increases in accounts payable and a reduction in inventory and work in progress. Both the decrease in deferred revenue and decrease in inventory and work in progress relate to project work done in Q1 2007 in advance of the Corporation's second quarter. The Company's days sales outstanding measured on a quarterly basis stood at 51 days at June 30, 2007 and 64 days measured on a year to date basis. This compares to 76 days on both a quarterly and year to date basis at March 31, 2007 and 86 days and 99 days respectively at June 30, 2006.

On a year to date basis operating activities utilized \$1.4 million of cash flow compared to a utilization of \$4.9 million in 2006 cash flow, an improvement of \$3.5 million. The improvement resulted from a \$1.3 million improvement in operating activities before changes in non-cash working capital accounts and a \$2.2 million improvement in non-cash working capital accounts. The increase in operating activities before changes in non-cash working capital accounts was once again driven by increased net earnings and increased future income tax expense. The utilization in changes in non-cash working capital accounts in 2007 primarily resulted from increases in accounts receivable and reductions in accounts payable and deferred revenue. The improvement over 2006 resulted from smaller increases in accounts receivable and less significant reductions in accounts payable and deferred revenue.

Investing activities

In the second quarter of 2007, Pareto's investing activities utilized \$0.5 million of cash flow, down from \$1.1 million in the same period of 2006, with almost all of the total 2007 cashflow utilization resulting from capital asset expenditures. On a year to date basis, investing activities decreased to \$0.8 million from \$1.2 million with capital asset expenditures representing the majority of the activities in 2007. In the second quarter of

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2006 investing activities included \$0.7 million expended pursuant to the acquisition of Trajectory. The capital expenditures undertaken in 2007 primarily related to leasehold improvements and machinery and equipment.

Financing activities

Pareto's financing activities utilized approximately \$442,000 of cash flow in Q2 2007. The Corporation reduced debt by \$289,000 and utilized \$225,000 to repurchase common shares of the Company pursuant to its normal course issuer bid. This compares to debt reduction of \$460,000 and share repurchases of \$72,000 in Q2 2006. On a year to date basis, financing activities utilized \$2.7 million of cash flow compared to generating \$6.8 million in the same period of 2006. In 2007, the Company reduced debt by \$1.8 million and expended \$1.1 million on common share repurchases. This compares to \$7.2 million of cash flow generated in Q1 2006 resulting from the net proceeds from share issuances. The Company may expend further funds to repurchase common shares in 2007.

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
Long-term debt	\$ 415,990	\$ 415,990	\$ -	\$ -	\$ -
Capital leases	1,126,194	262,537	863,657	-	-
Acquisition notes payable	66,667	66,667	-	-	-
Operating leases	5,413,365	986,114	1,383,754	1,044,666	1,998,831
Total contractual obligations	\$ 7,022,216	\$ 1,731,308	\$ 2,247,411	\$ 1,044,666	\$ 1,998,831

In May 2006, the Company acquired the assets of Trajectory Business Performance Inc. ("TBPI"). As part of the purchase, potential future consideration of up to \$450,000 was potentially payable by the Company based on the performance of TBPI through 2008. In June 2007, the Company amended the purchase agreement pursuant to which the potential future consideration has been cancelled.

In October 2006, the Company acquired the shares of Secom Plus Inc. ("Secom"). As part of the purchase, potential future consideration of up to \$5.0 million may be payable by the Company based on the performance of Secom through 2007. As previously indicated, the Company expects the maximum future consideration amount of \$5.0 million will become payable in 2008.

Outstanding Share Data

At June 30, 2007, an unlimited number of common shares were authorized and 44,726,875 (44,871,875 at July 31, 2007) common shares were outstanding. The Company had 1,804,168 options (1,659,168 at July 31, 2007) outstanding to acquire common shares of which 502,778 (369,445 at July 31, 2007) were exercisable. The Company also has 1,369,285 restricted stock units currently outstanding, all convertible to common shares on a one to one basis. See note 4 to the consolidated financial statements for further information on the Company's share capital.

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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.

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 quarter Pareto generated revenues from one client representing greater than 10% of revenues (30%). In the second quarter of 2006 two clients represented greater than 10% of revenues (20% and 19% respectively). For the six month period one client represented greater than 10% of revenues (31%) (2006: three clients – 22%, 22%, 12% 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 33% of consolidated assets at June 30, 2007. 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.

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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.

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 1 to the 2006 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 2006, 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 June 30, 2007.

Recent Accounting Developments

The Canadian Institute of Chartered Accountants (CICA) has published three new accounting standards: Section 3855 "Financial Instruments – Recognition and Measurement", Section 3865 "Hedges" and Section 1530 "Comprehensive Income" that are effective for fiscal periods beginning on or after October 1, 2006. These accounting standards introduce new requirements for the recognition and measurement of financial instruments, the application of hedge accounting and the reporting of comprehensive income that are designed to harmonize Canadian accounting standards with US and International Financial Reporting Standards. The new standards will require the presentation of a separate statement of comprehensive income. Derivative financial instruments will be recorded in the balance sheet at fair value and the changes in fair value of derivatives designated as cash flow hedges will be reported in comprehensive income.

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The Corporation does not expect these new accounting pronouncements to have a significant impact on its financial statements.

Internal Control over Financial Reporting

Internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. Management has not assessed the design of internal controls over financial reporting for operating units acquired during 2006. While management is not aware of any material deficiency in the design of such internal controls in these acquired units, such a material deficiency may exist.

There have been no changes in the Corporation's internal control over financial reporting that occurred during the second quarter of 2007, the most recently completed interim period, that have materially affected or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

Seasonality

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 with respect to corporate event revenues, 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.

Pareto Corporation**Management's Discussion and Analysis of Results of Operations and Financial Position****Summary of Quarterly and Annual Results**

Year Ended					
December 31, 2007	March 31	June 30	September 30	December 31	Total

Quarterly information:

Revenue	\$ 14,716,308	\$24,347,041			
EBITDA ¹	816,693	2,352,547			
Net earnings	347,544	1,270,254			
Basic and diluted earnings per share ²	0.01	0.03			

Year Ended					
December 31, 2006	March 31	June 30	September 30	December 31	Total

Quarterly information:

Revenue	\$ 9,532,273	\$ 13,036,822	\$ 10,316,477	\$18,194,436	\$51,080,008
EBITDA ¹	764,547	1,236,293	708,050	40,846	2,749,736
Net earnings	346,152	713,047	464,347	26,249	1,549,795
Basic and diluted earnings per share ²	0.01	0.02	0.01	0.00	0.04

Annual Information:

Total assets					44,807,361
Total long-term financial liabilities					3,372,347
Cash dividends declared					0.00

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

Year Ended						
December 31, 2005	March 31	June 30	September 30	December 31		Total

Quarterly information:

Revenue	\$	9,141,811	\$15,278,951	\$10,645,812	\$17,884,195	\$52,950,769
EBITDA ¹		458,366	1,520,915	1,006,194	2,521,112	5,506,587
Net earnings		322,430	868,860	528,130	1,255,612	2,975,032
Basic and diluted earnings per share ²		0.01	0.02	0.01	0.03	0.08

Annual Information:

Total assets						31,917,953
Total long-term financial liabilities						1,667,996
Cash dividends declared						0.00

Year Ended						
December 31, 2004	March 31	June 30	September 30	December 31		Total

Quarterly information:

Revenue	\$	6,811,555	\$ 7,389,411	\$ 7,588,106	\$16,956,135	\$38,745,207
EBITDA ¹		498,256	564,206	684,888	1,655,428	3,402,778
Net earnings		431,446	424,206	436,662	1,193,753	2,486,067
Basic and diluted earnings per share ²		0.01	0.01	0.01	0.03	0.07

Annual Information:

Total assets						24,966,769
Total long-term financial liabilities						1,948,576
Cash dividends declared						0.00

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

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

Pareto Corporation Consolidated Balance Sheets

June 30, 2007
(unaudited)

December 31, 2006

	June 30, 2007 (unaudited)	December 31, 2006
Assets		
Current assets		
Cash	\$ 129,667	\$ 5,020,127
Accounts receivable	13,824,355	12,399,746
Inventory and work in progress	2,461,297	2,457,361
Other current assets	662,240	540,698
Current future income tax assets	2,063,293	2,903,293
	19,140,852	23,321,225
Loans receivable	852,917	616,667
Long-term future income tax assets	1,122,826	850,590
Deferred costs	491,572	513,708
Capital assets	2,226,998	1,722,298
Goodwill and intangible assets	17,700,652	17,782,873
	\$ 41,535,817	\$ 44,807,361
Liabilities and Shareholders' Equity		
Current liabilities		
Accounts payable and accrued liabilities	\$ 12,597,166	\$ 14,059,056
Current portion of deferred revenue	1,737,708	2,607,264
Income taxes payable	102,068	275,091
Current future income tax liabilities	120,740	131,225
Current portion of acquisition notes payable	66,667	1,350,000
Current portion of long-term debt	415,990	500,000
Current portion of capital lease obligations	262,537	264,295
	15,302,876	19,186,931
Long-term future income tax liabilities	566,599	625,772
Long-term debt	-	165,992
Long-term capital lease obligations	863,657	992,060
Long-term acquisition notes payable	-	100,000
Total liabilities	16,733,132	21,070,755
Shareholders' equity		
Share capital	17,345,326	17,176,172
Contributed surplus	419,732	268,895
Retained earnings	7,037,627	6,291,539
Total shareholders' equity	24,802,685	23,736,606
	\$ 41,535,817	\$ 44,807,361

These financial statements have not been reviewed by the Company's external auditors.

The accompanying significant accounting policies and notes are an integral part of these statements.

Pareto Corporation

Consolidated Statements of Operations and Retained Earnings

For the quarter ended June 30 (unaudited)

	Three Months		Six Months	
	2007	2006	2007	2006
Revenue	\$24,347,041	\$13,036,822	\$39,063,349	\$22,569,095
Operating and administrative expenses	21,994,494	11,880,529	35,894,109	20,568,255
	2,352,547	1,236,293	3,169,240	2,000,840
Amortization of capital assets	114,771	76,107	217,070	147,537
Amortization of intangible assets and deferred costs	90,216	62,671	180,433	125,609
Interest and finance charges, net	110,951	(31,632)	185,546	1,763
Share-based compensation	119,832	71,407	184,357	137,876
	435,770	178,553	767,406	412,785
Earnings before income taxes	1,916,777	1,057,740	2,401,834	1,588,055
Income taxes	646,523	344,693	784,036	528,856
Net earnings for the period	1,270,254	713,047	1,617,798	1,059,199
Retained earnings, beginning of period	5,911,606	5,755,716	6,291,539	5,409,564
Excess price paid over carrying value on repurchase of common shares	(144,233)	(49,329)	(871,710)	(49,329)
Retained earnings, end of period	\$ 7,037,627	\$ 6,419,434	\$ 7,037,627	\$ 6,419,434
Basic and diluted earnings per share	\$ 0.03	\$ 0.02	\$ 0.04	\$ 0.03
Average number of common shares outstanding:				
Basic	44,515,164	43,716,300	44,649,180	40,537,939
Diluted	45,804,244	45,409,834	45,645,608	42,310,443

These financial statements have not been reviewed by the Company's external auditors.
The accompanying significant accounting policies and notes are an integral part of these statements.

Pareto Corporation

Consolidated Statements of Cash Flows

For the quarter ended June 30 (unaudited)

	Three Months		Six Months	
	2007	2006	2007	2006
Operating activities				
Net earnings for the period	\$ 1,270,254	\$ 713,047	\$ 1,617,798	\$1,059,199
Items not involving cash:				
Amortization of capital assets	114,771	76,107	217,070	147,537
Amortization of intangible assets and deferred costs	90,216	59,390	180,433	125,609
Non-cash interest and finance charges	3,281	3,281	6,562	6,562
Share-based compensation	119,832	71,407	184,357	137,876
Future income tax provision	541,761	(22,267)	498,106	(35,430)
	2,140,115	900,965	2,704,326	1,441,353
Changes in non cash operating accounts	(1,181,058)	(2,211,897)	(4,054,556)	(6,384,965)
	959,057	(1,310,932)	(1,350,230)	(4,943,612)
Investing activities				
Capital asset additions	(502,507)	(359,850)	(721,770)	(462,012)
Other asset additions	17,141	(27,845)	(59,304)	(81,526)
Acquisitions, net of cash acquired	(23,334)	(675,695)	(23,334)	(675,695)
	(508,700)	(1,063,390)	(804,408)	(1,219,233)
Financing activities				
Repayment of acquisition notes payable	(100,000)	(335,000)	(1,383,333)	(335,000)
Repayment of long-term debt	(125,001)	(125,001)	(250,002)	(250,002)
Repayment of capital lease obligations	(64,371)	-	(130,161)	-
Issuance of shares	72,501	85,770	110,500	8,095,136
Share issue costs	-	(1,000)	-	(671,972)
Repurchase of common shares	(225,780)	(71,990)	(1,082,826)	(71,990)
	(442,651)	(447,221)	(2,735,822)	6,766,172
Increase (decrease) in cash for the period	7,706	(2,821,543)	(4,890,460)	603,327
Cash and cash equivalents, beginning of period	121,961	8,503,797	5,020,127	5,078,927
Cash and cash equivalents, end of period	129,667	5,682,254	129,667	5,682,254

These financial statements have not been reviewed by the Company's external auditors.
The accompanying significant accounting policies and notes are an integral part of these statements.

Pareto Corporation

Notes to Consolidated Financial Statements

June 30, 2007 (unaudited)

1. Interim financial information

These interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and use the same accounting policies and methods used in the preparation of the Company's most recent annual consolidated financial statements. However, all disclosures required for annual financial statements have not been included in these financial statements. These interim consolidated financial statements should therefore be read in conjunction with the company's most recent annual consolidated financial statements. The financial information as at June 30, 2007 and for the three and six-month periods ended June 30, 2007 is unaudited.

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. Business Combinations

In 2006, the company acquired certain operating assets and liabilities of Trajectory Business Performance Inc. The consideration included cash, acquisition notes payable, common share purchase warrants and contingent consideration based on future operating results. The acquisition was accounted for a purchase. In 2007, the company paid \$23,334 of additional cash consideration and amended the purchase agreement under which the contingent future consideration and the common share purchase warrants were cancelled.

4. Share capital

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

- b) Issued common shares:

	Number of Shares	Amount
Balance, December 31, 2006	45,058,204	\$ 17,176,172
Shares issued pursuant to private placements (i)	225,000	236,250
Shares issued on exercise of stock options	408,571	144,020
Shares repurchased for cancellation	(964,900)	(211,116)
Balance, June 30, 2007	44,726,875	\$ 17,345,326

- (i) In April 2007, Pareto issued 225,000 common shares pursuant to a private placement at an issue price of \$1.05 per common share for gross proceeds of \$236,250. The company issued a loan in the amount of \$236,250 to an executive of the company pursuant to the placement.

Pareto Corporation
Notes to Consolidated Financial Statements

June 30, 2007 (unaudited)

4. Share capital (continued)

c) Stock options

The Company has a stock option plan (the "Plan") for employees, consultants and officers of the Company. Pursuant to the Plan, a total of 3,500,000 of the Company's common shares have been reserved for issue. In addition, subject to regulatory approval, the company grants options, other than pursuant to the Plan, to new employees as an incentive of employment. One-third of granted options vest on each of the anniversary dates of the grant.

Stock option transactions during the period are as follows:

	Number of Options	Weighted Average Exercise Price
Options outstanding, December 31, 2006	1,385,516	\$ 0.67
Granted in 2007	963,334	1.09
Exercised in 2007	(408,571)	0.27
Cancelled in 2007	(136,111)	1.27
Options outstanding, June 30, 2007	1,804,168	\$ 0.35
Options exercisable, June 30, 2007	502,778	\$ 0.43
Options exercisable, December 31, 2006	864,775	\$ 0.37

The weighted average grant date fair value of the options granted in 2007 was \$0.35 (2006: \$0.41).

Pareto Corporation

Notes to Consolidated Financial Statements

June 30, 2007 (unaudited)

4. Share capital (continued)

As at June 30, 2007 the Company had the following options outstanding:

Number of Options	Exercise Price Per Share	Expiry Date
145,000	\$ 0.20	August 1, 2007
45,000	\$ 0.20	November 4, 2007
50,000	\$ 0.25	June 23, 2008
166,667	\$ 0.43	February 10, 2009
35,000	\$ 0.86	July 19, 2009
30,000	\$ 0.88	December 13, 2009
34,167	\$ 0.90	March 7, 2010
40,000	\$ 0.90	April 26, 2010
50,000	\$ 1.53	March 30, 2011
90,000	\$ 1.47	May 15, 2011
100,000	\$ 1.21	August 8, 2011
30,000	\$ 1.15	August 11, 2011
25,000	\$ 1.15	October 3, 2011
333,334	\$ 1.05	March 7, 2012
130,000	\$ 1.05	May 14, 2012
500,000	\$ 1.12	June 8, 2012

d) Restricted stock units:

The Company has a long-term incentive plan (LTIP) for employees, consultant, directors and officers of the Company. Pursuant to the LTIP, a total of 2,000,000 of the Company's common shares have been reserved for issue through the redemption of restricted stock units into common shares on a one to one basis. In addition, subject to regulatory approval, the company grants restricted stock units, other than pursuant to the LTIP, to new employees as an incentive of employment. Restricted stock units are redeemable upon the third anniversary of the date of grant. At June 30, 2007, 1,369,285 restricted stock units were outstanding (238,333 at December 31, 2006)

Pareto Corporation
Notes to Consolidated Financial Statements

June 30, 2007 (unaudited)

4. Share capital (continued)

e) Share-based compensation:

The fair value of stock options granted in 2007 was estimated using the Black-Scholes option-pricing model with the following assumptions:

Dividend yield 0%
Expected volatility 40 %
Risk-free interest rate 3.9% to 4.7%
Expected option life 2 to 4 years

The fair value of stock options granted in 2006 was estimated using the Black-Scholes option-pricing model with the following assumptions:

Dividend yield 0%
Expected volatility 40 %
Risk-free interest rate 3.9% to 4.2%
Expected option life 2 to 4 years

The fair value of restricted stock units granted in 2007 and 2006 were estimated to equal the market price of a Pareto common share on the date of grant.

In 2007, \$8,184,357 (2006: \$137,876) of share based compensation has been added to contributed surplus with \$11,579 (2006: \$80,293) of contributed surplus reallocated to share capital as a result of options exercised in the period.

5. Subsequent Event

In July 2007, the company repaid in full the long term debt of \$415,990 outstanding at June 30, 2007.