



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

**March 18, 2009**

# Pareto Corporation

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

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Management's Discussion and Analysis of Results of Operations and Financial Position ("MD&A") of Pareto Corporation ("the Company" or "Pareto"), dated March 18, 2009, summarizes the significant factors affecting the consolidated operating results, financial condition, liquidity and cash flows of Pareto for the year ended December 31, 2008. All amounts are in Canadian dollars. This MD&A should be read in conjunction with consolidated financial statements for the period ended December 31, 2008, which are prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). Additional information relating to Pareto, including the Annual Information Form dated March 26, 2008, 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-recurring expenses), a measure not defined under Canadian GAAP, to discuss 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 debt (capital lease obligation, acquisition notes payable, and bank indebtedness), 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'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 of a successful campaign, event or loyalty program. 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 products and services which Pareto offers to its clients can be grouped into four core offerings:

- ❖ Retail promotions, including design, production and fulfillment of in-store marketing materials.
- ❖ Field merchandising services.
- ❖ Direct marketing.
- ❖ Incentive programs, including events.

# Pareto Corporation

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

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Pareto sells its products and services, other than select 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.

Additionally, Pareto provides outsourced marketing program management to select key customers. 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.

Outsourced marketing program management and field merchandising services are typically sold on a time and materials basis. 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.

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 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 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 two to three years in length. Long-term contracts allow Pareto to develop and execute longer-term performance improvement and cost reduction programs, and achieve a more seamless interaction with the client personnel. We have been shifting our focus towards more strategic relationships, and away from opportunistic or reactive business. We are striving to build enterprise-wide relationships.

# Pareto Corporation

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

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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.

### Comment on Current Global Economic Conditions

The current global financial market downturn has resulted in some of the world's best known financial institutions disappearing, as well as significant erosion of stock market values, and severe restrictions on credit availability. The volatile and uncertain economic environment presents many companies with new business challenges, not the least of which is communicating the impact of the current economic environment to its shareholders.

Pareto has not seen a significant impact on its operations thus far as a result of the global financial crisis. The Company's customer base includes blue chip clients that are fairly diversified and poses minimal credit risk. Since this economic downturn began, the Company has not experienced any collection problems on accounts receivable.

Pareto provides marketing execution services that are designed to produce measurable results and help our clients sell more. While overall marketing budgets are often reduced during economic downturns, it is services like advertising or branding that tend to be viewed as being most dispensable. Our retail promotion and field merchandising solutions are designed to influence consumers' decisions at the point of sale and provide measurable sales lift. Our customers are telling us these services are becoming more important during tough economic times and in some cases spending is being increased in these areas. These two core business areas represented approximately two thirds of the Company's revenues in 2008.

Pareto provides incentive solutions, encompassing loyalty programs and event management. This area of the business is the most susceptible to economic downturns, when this type of spending may be seen as expendable in times of cost cutting pressures. Given the long lead times on some of these projects, we are seeing reductions in spending for 2009 yet at the same time are seeing commitments being made for 2010. Pareto provides outsourced managed services to a customer in the automotive sector. While our relationships and service levels are strong, this sector has been hit particularly hard by the global financial crisis. Together these two components of the business represented less than 15% of the total in 2008.

The Company has spent the last year implementing a business management system allowing us to monitor costs, profitability by project and resource requirements. The Company believes it is able to adjust internal resources quickly by shifting them to areas of growth. The Company has completed a thorough review of its cost base and has made material reductions in 2009 to its selling, general and administrative costs and reduced certain service offerings where profitability was not sufficient. Strategically, we believe this has led to stronger focus on our four core offerings.

The Company has a strong balance sheet and management believes the Company is underleveraged. Bank indebtedness at year end was \$655 thousand and there is considerable capacity on its line of credit, which allows for up to \$9 million of borrowing. This line of credit is secured against accounts receivable, and carries no financial covenants or adverse economic change language.

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.

The Company will continue to monitor market activity and trends in our industry, in order to be able to react in a timely fashion should we see a decline in the level of new business activity.

# Pareto Corporation

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

For a more complete analysis of risks faced by the Company, and additional comments on the global economic environment, please refer to the section "Risks and Uncertainties".

### Operating Results for the year ended December 31:

	2008	2007	\$ Change	% Change
Revenue	\$ 77,164,336	\$ 74,340,013	\$ 2,824,323	4%
Operating and administrative expenses <sup>(1)</sup>	69,109,895	67,486,077	1,623,818	2%
EBITDA <sup>(2)</sup>	\$ 8,054,441	\$ 6,853,936	\$ 1,200,505	18%
	10.4%	9.2%	1.2%	
Amortization of long-term assets	\$ 1,045,708	\$ 956,099	\$ 89,609	9%
Non-recurring expenses <sup>(1)</sup>	182,391	-	182,391	0%
Interest and finance charges, net	427,381	431,404	(4,023)	-1%
Share-based compensation	815,643	480,623	335,020	70%
	2,471,123	1,868,126	602,997	32%
Earnings before income taxes	5,583,318	4,985,810	597,508	12%
Income taxes	2,024,038	1,855,313	168,725	9%
Net earnings	\$ 3,559,280	\$ 3,130,497	\$ 428,783	14%
Basic and Diluted earnings per share	\$ 0.08	\$ 0.07	\$	

<sup>(1)</sup> Operating and administration expenses exclude non-recurring expenses totaling \$182,391 for costs incurred during the third quarter by the Company for its substantial issuer bid announced August 7, 2008 and subsequently terminated on September 18, 2008.

<sup>(2)</sup> See "Non-GAAP Measures"

# Pareto Corporation

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

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

	2008	2007	\$ Change	% Change
Revenue	\$ 21,730,884	\$ 20,931,405	\$ 799,479	4%
Operating and administrative expenses	18,621,596	17,847,845	773,751	4%
EBITDA <sup>(2)</sup>	\$ 3,109,288	\$ 3,083,560	\$ 25,728	0%
	14.3%	14.7%	(0.4%)	
Amortization of long-term assets	\$ 280,117	\$ 332,824	\$ (52,707)	-16%
Interest and finance charges, net	37,074	110,762	(73,688)	-66%
Share-based compensation	210,838	170,502	40,336	23%
	528,029	614,088	(86,059)	-14%
Earnings before income taxes	2,581,259	2,469,472	111,787	5%
Income taxes	998,939	1,032,987	-34,048	-3%
Net earnings	\$ 1,582,320	\$ 1,436,485	\$ 145,835	10%
Basic and Diluted earnings per share	\$ 0.04	\$ 0.03	\$	

<sup>(2)</sup> See "Non-GAAP Measures"

### Year-end and Fourth Quarter Results

#### Revenue

In the fourth quarter of 2008, the Company generated \$21.7 million of revenue compared to \$20.9 million in 2007, an increase of \$0.8 million or 4%. Revenue increased this quarter in the field merchandising business, up \$1.2 million or 56% over the previous year, in the retail promotion business, up \$0.3 million or 4% over the previous year, and in the managed services business, up \$0.2 million or 6%. Revenue was flat to prior year in our direct marketing business, and decreased in the incentives business, down \$0.9 million or 14% over the previous year.

Increased revenues from the field merchandising business and the retail promotion business were driven primarily by new business that we have won as well as increasing volume with our existing clients. Our retail promotion and field merchandising solutions are designed to influence consumers' decisions at the point of sale and provide measurable sales lift. Some customers have indicated that these services are becoming more important during tough economic times which is evidenced by this quarter's results. The incentives business decline was due mainly to one of our customers within the automotive sector cancelling a \$0.8 million incentive-based travel program originally scheduled for the fourth quarter and reduced programs within our managed service business this quarter. While event revenue was decreased due to this cancellation, overall program margins were maintained as significant planning efforts had been completed and additional resources were required to manage the cancellation.

# Pareto Corporation

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

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The fourth quarter of 2007 was an unusually high quarter. As we disclosed in the third quarter of 2007, our revenue was impacted by several large projects underway in Q3 would not be completed until Q4, meaning all the revenue would be recognized in Q4 while the costs were split over both quarters. As a result, Q4/07 revenues and EBITDA margins received a boost. Instead of just comparing quarters, therefore, it is useful to look at our results for the second half of 2008, compared to the second half of 2007. On that basis, total revenues of \$39.9 million in the second half of 2008 were up by 13% over the same period in 2007. And EBITDA of \$4.9 million was 32% above 2007 levels. Combined EBITDA margin for the 6-month period was 12.2% in 2008, compared to 10.4% in 2007.

In 2008, revenues increased by 4% or \$2.8 million to \$77.1 million from \$74.3 million in the same period last year. Revenue increased in retail promotion business, up \$1.7 million or 8% over the previous year, in the field merchandising business, up \$0.3 million or 2% over the previous year, and in program management services, up \$0.9 million or 12% over the previous year, offset by a decrease in incentive services, down \$0.1 million or 1% from the previous year.

Our retail promotion business increase was driven by both new customers as well as increasing volumes with our existing customers. The field merchandising business increase was driven by new business that we have won to replace a large non-recurring project completed during the second quarter 2007. Program management service revenue increased due mainly to new customer wins late in 2007. The incentive services business decrease was primarily attributable to one of our customers within the automotive sector cancelling a total of \$1.5 million in incentive based travel scheduled for the second half of the year. While event revenue was decreased due to this cancellation, overall program margins were maintained as significant planning efforts had been completed and additional resources were required to manage the cancellation.

In 2008 the Company's mix of revenues by business model was as follows:

- ❖ Fixed fee basis - \$ 47.9 million or 62% ( \$44.5 million or 60% in 2007)
- ❖ Time and materials basis - \$20.8 million or 27% (\$20.8 million or 28% in 2007)
- ❖ Resale of reward units - \$8.4 million or 11% (\$9.0 million or 12% in 2007)

We are operating in seriously challenging economic times. While overall marketing budgets are often reduced during economic downturns, it is services like advertising or branding that are typically seen as being most dispensable. Our retail promotion and field merchandising solutions are designed to influence consumers' decisions at the point of sale and provide measurable sales lift. It is management's belief and feedback from our customers indicates that these services are becoming more important during difficult economic times and in some cases spending is being increased in these areas. However, management recognizes that Pareto is not immune to the troubles being experienced in the broader economy. We are closely monitoring the volume of activity of each of our clients. While our visibility into the future is weaker than normal, as it is for all businesses, we remain optimistic that we have chosen the correct strategic path. Our view at this time is that we have a very good opportunity to grow our revenues in 2009. And we believe we can, once again, grow EBITDA faster than revenue.

### Operating and Administrative Expenses

In the fourth quarter of 2008, the Company incurred \$18.6 million in operating and administrative expenses compared to \$17.8 million in 2007, an increase of \$0.8 million or 4%. As a percentage of revenue, operating and administrative expenses represented 86% in the fourth quarter of 2008 as compared to 85% in the same period last year. Operating and administrative expenses include direct project costs, wages and salaries, facilities costs, and selling, general, and administrative costs.

# Pareto Corporation

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

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Expenses increased as a percentage of revenue in the fourth quarter due to mix of services sold and reduced customer pricing from a material customer contract renegotiation offset somewhat by improved operating efficiencies and , procurement savings. Facilities costs and selling, general and administrative costs declined as a percentage of revenue by 2% in 2008 when compared to the prior year due to organizational savings realized with the integration of acquisitions which have reduced facility charges and reduced redundant administrative costs.

In 2008, operating and administrative expenses increased by 2% to \$69.1 million compared to \$67.5 million in the same period last year. As a percentage of revenue, operating and administrative expenses represented 90% in 2008 as compared to 91% in 2007.

Direct project costs declined as a percentage of revenue by 1% in 2008 as compared to the prior year. This improvement is due to the mix of services sold, improved efficiencies and procurement savings. Wages and salaries remained unchanged as a percentage of revenue in 2008 when compared to the prior year. Improved margins have been seen as our costs are spread over higher volumes. The loss of small, low margin customers and the implementation of our Business Management System process have improved both direct material usage and labour efficiencies during 2008. Additionally, a procurement process has been undertaken whereby, similar to our customers pushing us for ways to save costs, we have asked our suppliers to reduce costs. The resulting savings have been recognized providing reduced costs over the previous year.

Facilities costs and selling, general and administrative costs declined as a percentage of revenue by 1% in 2008 when compared to the prior year due to organizational savings realized with the integration of acquisitions which have reduced facility charges and eliminated redundant administrative costs.

Our revenues are smoother in 2008 than in the past. In 2007, we experienced two very low quarters, 1<sup>st</sup> and 3<sup>rd</sup> each with approximately \$14 million in revenues, and two very high quarters, 2<sup>nd</sup> and 4<sup>th</sup> with \$24 million and \$21 million respectively. In 2008, our quarterly revenues were \$17 million, \$21 million, \$18 million and \$22 million respectively. This smoothing has been driven by an increasing proportion of clients signing ongoing service contracts rather than working on a project basis. This has allowed us to optimize our resource levels and increase our staff utilization rates.

We have worked to take costs out of the business. To some extent, this has been a consistent goal of management for the past two years. But in recent months we have undertaken a more focused effort to squeeze savings opportunities out of the business. As a result, we have found material cost reductions. We continue to strive for ways to ensure SG&A remains at an appropriate level.

### EBITDA

In the fourth quarter of 2008, the Company generated \$3.1 million of EBITDA (see "Non-GAAP Measures"), equal to the value in 2007. EBITDA as a percentage of revenue represented 14.3% in 2008 compared to 14.7% in 2007.

In 2008, the Company generated \$8.1 million of EBITDA, compared to \$6.9 million in 2007. EBITDA as a percentage of revenue represented 10.4% in 2008 compared to 9.2% in 2007. EBITDA has improved as a percentage of revenue due to improved mix of business, greater efficiencies realized from integration of acquisitions and operational improvements.

# Pareto Corporation

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

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### Amortization, Interest, Share-based Compensation and Non-recurring expenses

In the fourth quarter of 2008, the Company incurred amortization, interest and share-based compensation expenses of \$0.5 million compared to \$0.6 million in 2007, a decrease of \$0.1 million or 14%. This decrease was driven primarily by a reduced amortization of long-term assets and reduced interest expenses offset by increased share-based compensation expense. Interest and finance charges decreased this quarter as compared to the prior year as a result of lower debt balances and interest income on other investments. Long-term asset amortization decreased due to amortization related to other assets that were fully amortized. Share-based compensation expense increased by 23% reflecting the impact of the options and restricted stock units granted for incentive purposes in 2007 for the hiring of three new senior executives.

In fiscal 2008, total amortization, interest and share-based compensation expenses increased \$0.6 million or 32% compared to the previous year. This increase was driven primarily by one-time non-recurring costs totaling \$0.2 million resulting from the Substantial Issuer Bid the Company announced on August 7, 2008 and subsequently terminated on September 18, 2008. Additionally, share-based compensation expense increased by \$0.3 million or 70% reflecting the impact of the options and restricted stock units granted under the Company's plans as well as those granted for incentive purposes in 2007 for the hiring of three new senior executives. Capital asset amortization increased slightly due to amortization related to capital assets acquired in 2007 and 2008. Interest and finance charges remained comparable to the prior year.

### Income Taxes

In the fourth quarter of 2008, the Company incurred income tax expenses of \$1.0 million, equal to 2007. Income taxes represented 39% of earnings before tax compared to 42% in 2007. For the year, the overall tax rate represented 36% of earnings before tax compared to 37% in 2007. This reduction is due to reduced corporate tax rates in 2008. The Company expects to incur an effective tax rate of approximately 35% during 2009.

### Net earnings

In the fourth quarter of 2008, the Company generated \$1.6 million of net earnings compared to \$1.4 million in 2007, an increase of \$0.2 million. In 2008, net earnings of \$3.6 million represented a 14% increase compared to \$3.1 million in the previous year. This increase is the result of increased revenues and improved EBITDA margins, offset somewhat by increased amortization, interest and share-based compensation costs. Excluding the tax-effected impact of the non-recurring substantial issuer bid expenses, net earnings totaled \$3.7 million for the year. Net earnings as a percentage of revenue was 7.3% for the fourth quarter compared to 6.9% in 2007 and 4.6% for the year compared to 4.2% in 2007. Excluding the effect of income taxes, earnings before income taxes were 11.9% of revenue for the quarter compared to 11.8% in 2007, and 7.2% of revenue for the year compared to 6.7% in 2007.

### Earnings per share

Basic and diluted earnings per share in the fourth quarter of 2008 were \$0.04 versus \$0.03 in 2007. For the year, basic and diluted earnings per share were \$0.08 versus \$0.07 in 2007.

# Pareto Corporation

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

### Liquidity and Capital Resources

#### Financial Position

	December 31, 2008	December 31, 2007	\$ Change	% Change
Bank Indebtedness	654,573	368,291	286,282	78%
Acquisition notes payable	--	3,066,668	(3,066,668)	-100%
Capital lease obligation	709,279	990,945	(281,666)	-28%
Total debt	1,363,852	4,425,904	(3,062,052)	-69%
Shareholders' equity	27,429,969	25,702,273	1,727,696	7%
Total capitalization	\$ 28,793,821	\$ 30,128,177	\$ (1,334,356)	-4%
Working capital position	\$ 943,396	\$ 1,445,121	\$ (501,219)	-35%

Debt:Shareholders' equity	0.05:1	0.17:1
Debt:Total Capitalization	0.05:1	0.15:1
Debt:EBITDA	0.2:1	0.6:1

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.

The Company seeks to maintain a balance between the higher returns that might be possible with the leverage afforded by higher borrowing levels and the security afforded by a sound capital position. The Company's target is to create value for its shareholders over the long-term through increases in share value.

In July 2007, the Company commenced a normal course issuer bid to acquire up to 2,235,000 common shares through the facilities of the Toronto Stock Exchange. Purchases are made at market prices with a maximum of 400,000 shares being purchased in any 30 day period. The shares are cancelled as purchased. The normal course issuer bid terminated on July 11, 2008 with a total of 2,210,727 shares repurchased. The Company considers its shares to be undervalued, and a buy-back program is consistent with the Company's goal of creating long-term value for its shareholders.

On August 7, 2008 the Company announced that its Board of Directors authorized an offer to repurchase ("the Offer") for cancellation up to \$11 million worth of its common shares, at a price of \$1.00 per share, through a substantial issuer bid. This represented up to 11 million common shares or approximately 26% of the Company's approximately 42.7 million total issued and outstanding common shares. An issuer bid circular containing full details of the offer and procedures for tendering common shares was filed on SEDAR and mailed to shareholders on August 14, 2008.

# Pareto Corporation

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

---

On September 18, 2008, the Company announced the termination of the Offer as the conditions had not been satisfied. The substantial issuer bid circular dated August 14, 2008 specified that Pareto could terminate the Offer if, among other things, the S&P/TSX Composite Index (the "Index") declined by an amount in excess of 10%, as measured from the close of business on August 6, 2008. On September 17, 2008 the Index had declined 11.7% since August 6, 2008. The Board of Directors of Pareto determined that proceeding with the bid under the market conditions would not be in the best interests of Pareto shareholders. Pareto then notified the depositary appointed under the Offer of the withdrawal of the Offer, and instructed the depositary to cease accepting deposits of common shares and to promptly return all deposited shares to the tendering shareholders.

On November 20, 2008, the Company declared a special cash dividend of \$0.04 per issued and outstanding share payable on January 15, 2009, to shareholders of record at the close of business on December 31, 2008.

Subsequent to year end, the Company announced the initiation of an ongoing quarterly dividend of \$0.015 per share, commencing in the first quarter of 2009 payable on April 15, 2009 to shareholders of record at March 31, 2009.

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.

There were no changes in the Company's approach to capital management during the period. The Company currently has no externally imposed capital restrictions.

### Operating activities

Given the global economic situation arising in the latter part of 2008, cash flow from operating activities in the fourth quarter provides some insight into the liquidity of the Company. The Company continues to generate strong cash flows from operations despite the challenging environment. In the fourth quarter of 2008, operating activities generated \$4.4 million of cash flow compared to a generation of \$4.6 million of cash flow in 2007, a decrease of \$0.2 million. Operating activities before changes in non-cash operating accounts generated \$2.1 million of cash flow in 2008 compared to \$2.9 million in 2007, a decrease of \$0.8 million. This decrease is due mainly to income taxes. In 2007, capital losses were available to offset all cash income taxes. By the fourth quarter of 2008, all capital losses had been utilized and the Company was in a taxable position. As a result, additional cash taxes of \$1.0 million were recorded in the fourth quarter. Non-cash operating accounts generated \$2.3 million of cash flow in 2008 compared to generating \$1.7 million in 2007, an increase of \$0.4 million.

In 2008, operating activities generated \$7.2 million of cash flow compared to a generation of \$0.6 million of cash flow in 2007, an increase of \$6.8 million. Operating activities before changes in non-cash operating accounts generated \$6.5 million of cash flow for both 2008 and 2008. Non-cash operating accounts generated \$0.7 million of cash flow in 2008 compared to utilizing \$5.9 million in 2007, an increase of \$6.6 million.

Our accounts receivable balance showed a decrease during the year to \$16.5 million from \$17.3 million at December 31, 2007. This figure represents an average Days Sales Outstanding of 70 days compared to 75 days at December 31, 2007. While this marks an improvement of 5%, it is still above the level we are targeting. However, the aging schedule is better than it has ever been at Pareto. The percentage of receivables that are more than 60 days old reached a new low this year. The significance of this is not related to the risk of bad debts. Our clients are mostly large, stable organizations. Our focus is in the area of managing our working capital. We have begun implementing a plan to improve cash management, with some early success, and we believe there is further leverage available.

# Pareto Corporation

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

### Investing activities

In 2008, investing activities utilized \$6.3 million of cash flow compared to \$3.6 million for the previous year. In 2008, \$0.7 million was utilized on capital additions, \$0.3 million resulting from leasehold improvements incurred as the field service division moved into a new facility during the third quarter and the remaining \$0.4 million on maintenance capital requirements. In 2008, cash from lease inducements was received totaling \$0.2 million relating to the new field service facility lease. In 2008, cash utilized for investments included \$0.5 million of cash flow for a strategic investment loan to PeerSet Inc. (formerly Ontogenix Inc), a technology company focused in online marketing, and \$0.2 million for an employee loan for the purchase of shares. The investment loan consists of a three year convertible debenture bearing interest at a rate of 16%, accrued annually. If converted, ownership would be treated on a cost basis. The loan was funded out of existing cash resources. In 2008, \$5.0 million was utilized for payment of outstanding acquisition notes payable from the Secom Plus Inc. acquisition in the prior year compared to \$1.4 million in 2007. The Company anticipates its capital asset requirements in 2009 will be slightly less than the 2008 levels.

### Financing activities

In 2008 financing activities utilized \$1.2 million of cash flow compared to \$2.4 million in the same period last year. During the year, \$0.3 million was utilized as payment of capital lease obligations and \$1.0 million was utilized to repurchase 1.3 million common shares of the Company pursuant to its normal course issuer bid. The bid expired on July 11, 2008 and the Company purchased a total of 1.3 million shares, approximately 24,000 shares short of the total level authorized. This was offset by \$0.1 million received in 2008 for stock option purchases.

### Off- Balance Sheet Arrangements

The Company has no off-balance sheet arrangements, other than operating leases disclosed below

### Contractual Obligations

The following table provides a summary of 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	\$ 799,675	\$ 377,239	\$ 422,436	\$ -	\$ -
Operating leases	6,262,021	874,823	1,589,088	1,247,753	2,550,357
Total contractual obligations	\$ 7,061,696	\$ 1,252,062	\$ 2,011,524	\$ 1,247,753	\$ 2,550,357

### Outstanding Share Data

At March 18, 2009 an unlimited number of common shares were authorized and 42,931,148 (December 31, 2008 – 42,931,148 and December 31, 2007 – 43,994,648) common shares were outstanding. The Company has 2,073,689 options currently outstanding to acquire common shares pursuant to its Option Plan of which 751,938 are exercisable. The Company also has 1,826,618 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.

# Pareto Corporation

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

### Non-GAAP Earning Measures

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

	Year ending December 31, 2008	Year ending December 31, 2007
Net earnings	\$ 3,559,280	\$ 3,130,497
Income Taxes	2,024,038	1,855,313
Amortization of capital assets, intangible assets and deferred costs	1,045,708	956,099
Non-recurring expenses re substantial issuer bid	182,391	-
Interest and financing charges	427,381	431,404
Share-based compensation	815,643	480,623
EBITDA	\$ 8,054,441	\$ 6,853,936

### Transactions with Related Parties

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.

In September 2008, the Company issued a loan totalling \$188,500 to an executive of the Company for an initial purchase of 290,000 common shares of the Company in the open market. The loan is carried at the carrying amount of \$188,500 which approximates its fair value. The loan bears interest at Prime Rate plus ½% with interest payable quarterly. The loan is repayable on September 30, 2013. The loan is full recourse and the Company has received a pledge of the purchased common shares as security for the loans.

During 2008, \$20,559 of interest was received pursuant to the loans receivable from executives and all interest payments are current

### Risks and Uncertainties

#### Global Economic Environment and Access to Capital

The capital and credit markets have been experiencing extreme volatility and disruption. In the fourth quarter of 2008, the volatility and disruption reached unprecedented levels. The markets have exerted extreme downward pressure on stock prices and upward pressure on the cost of new debt capital and have severely restricted credit availability for most issuers. Recent events have demonstrated that business and industries throughout the world are very tightly connected to each other and may adversely affect the Company over the course of time. For example, credit contraction in financial markets may hurt the Company's ability to access credit in the event that it identifies an acquisition opportunity or some other opportunity that would require a significant investment in resources. Continued market disruptions could cause broader economic downturns, which may lead to lower demand for certain of Pareto's services and increased incidence of customers' inability to pay or timely pay for the services or products that they provide. As a result, the Company's business, financial condition, and operating results may be affected in a material adverse manner.

# Pareto Corporation

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

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The disruptions in the capital and credit markets have also resulted in higher interest rates on issuance of debt securities and increased costs under credit facilities. Continuation of these disruptions could increase Pareto's interest expense, adversely affecting their results of operations and financial position.

Pareto's access to funds under its existing credit facilities is dependent on the ability of the financial institutions that are parties to those facilities to meet their funding commitments. Those financial institutions may not be able to meet their funding commitments if they experience shortages of capital and liquidity or if they experience excessive volumes of borrowing requests within a short period of time.

Longer term volatility and continued disruptions in the capital and credit markets as a result of uncertainty, changing or increased regulation of financial institutions, reduced alternatives or failures of significant financial institutions could adversely affect Pareto's access to the liquidity needed for its businesses in the longer term. Such disruptions could require Pareto to take measures to conserve cash until the markets stabilize or until alternative credit arrangements or other funding for its business needs can be arranged.

### 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. In 2008 Pareto generated revenues from one client representing greater than 10% of revenues (27%, 2007 – 30%). The Company's current contract with this customer has a term ending July 31, 2012.

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 36% of consolidated assets at December 31, 2008 (2007 – 37%). Accordingly, the Company could be adversely affected by the bankruptcy of a customer. 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.

# Pareto Corporation

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

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Although certain members of 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 2 to the 2008 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.

#### Valuation of Accounts Receivable

Accounts receivable is one of the Company's most significant assets. Collectability of accounts receivable is reviewed on an ongoing basis. An allowance account is used when there is objective evidence that it is impaired. The factors that are considered in determining if an account receivable is impaired include whether a customer is in bankruptcy, the age of the receivable, customer creditworthiness, and historical collection experience or if payments are in dispute. Changes in one or more assumptions could materially impact the Company's results of operation.

#### 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. Goodwill is assessed for impairment on at least an annual basis. The carrying value of the goodwill is assessed at least annually by comparing it to its fair value. To determine whether impairment has occurred, the fair value of the reporting unit is compared to its carrying amounts, including goodwill. The Company uses a present value of future cash flow approach for determining the fair value of its reporting units. Future cash flows are based on management's best estimates considering historical and expected operating plans, economic conditions and general outlook for the industry and markets in which the reporting unit operates. The discount rates used by the Company are based on an optimal debt to equity ratio and consider the risk free rate, market equity risk premium, size premium and operational risk premium for possible variations from management's projections. The terminal value is the value attributed to the reporting unit's operations beyond the projected period of growth prospects.

The Company's assumptions are affected by current market conditions which may affect expected revenues. In addition, while the Company plans to limit increases in costs, operating costs may increase more significantly than expected. The Company has made certain assumptions for the discount and terminal growth rates to reflect possible variations in the cash flows; however the risk premiums expected by market participants related to uncertainties may differ or change quickly depending on economic conditions or events.

In the fourth quarter of 2008, the Company completed the annual assessment and found no impairment of goodwill.

# Pareto Corporation

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

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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. No indicators of impairment in intangible assets were noted during the year-ended December 31, 2008.

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.

### Stock Based Compensation

Stock based compensation is accounted for in accordance with section 3870 of the CICA handbook. When equity based instruments such as stock options are issued, an estimate of fair value is derived using the Black-Scholes pricing model. The application of this pricing model requires management to estimate several variables, including the period for which the instrument is expected to be outstanding, price volatility of the Company's stock over the relevant timeframe, the determination of a relevant risk free interest rate and an assumption regarding the Company's future dividend rate policy. Changes in one or more assumptions could materially impact the value derived for these equity instruments.

### Financial Instruments and Other Instruments

Financial instruments are measured at fair value on initial recognition. After initial recognition, financial instruments are measured at their fair values, except for financial assets classified as held-to-maturity or loans and receivables and other financial liabilities, which are measured at amortized cost.

Amortized cost related to financial assets classified as held-to-maturity or loans and receivables and other financial liabilities is calculated using the effective interest method with changes recognized as income or expense in earnings.

The Company's significant financial asset and liabilities are classified as follows:

Bank indebtedness	Held for trading
Accounts receivable	Loans and receivables
Loans receivable	Loans and receivables
Other assets	Held to maturity
Accounts payable and accrued liabilities	Other financial liabilities
Acquisition notes payable	Other financial liabilities

The Company, on occasion, engages in transactions in foreign currencies, most commonly involving the US dollar and the Euro. The Company mitigates its risk by billing whenever possible in the relevant currency and, on occasion, enters into derivative instruments to manage this risk. At December 31, 2008, there are no such contracts outstanding.

### 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, 2008 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

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### Internal Control over Financial Reporting

Internal control over financial reporting has been designed, based on the framework established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”), 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 and the CFO have evaluated the effectiveness of our internal control over financial reporting using the framework designed as described above. Based on this evaluation, the CEO and CFO have concluded that internal control over financial reporting, as defined by National Instrument 52-109, was effective as at December 31, 2008.

Because of inherent limitations, internal control over financial reporting and disclosure controls can provide only reasonable assurances and may not prevent or detect misstatements. Furthermore, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

During the year ended December 31, 2008, 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.

### Recent Accounting Developments

a) New accounting policies

**Financial Instruments Disclosure and Presentation** – CICA Handbook section 3862 “Financial Instruments - Disclosure” and section 3863 “Financial Instruments – Presentation”, replace Handbook Section 3861, Financial Instruments – Disclosure and Presentations, revising and enhancing disclosure requirements to provide additional information on the nature and extent of risks arising from financial instruments to which the Company is exposed and how it manages those risks. These standards were adopted on January 1, 2008. Refer to note 21 of the audited financial statements for additional disclosures.

**Capital Disclosures** –CICA Handbook Section 1535 “Capital Disclosures”, specifies the disclosure of the Company's objectives, policies and processes for managing capital, including: a description of what components of liabilities and shareholders' equity the Company defines as capital and their balances, and the nature of any externally imposed capital restrictions, how those are managed and the consequence of any non-compliance, if any. This standard was adopted on September 1, 2008. Refer to note 20 of the audited financial statements for additional disclosures.

**Inventories** – CICA Handbook Section 3031 “Inventories” was adopted on January 1, 2008 and, provides guidance on the measurement of inventories, with an expanded definition of cost, and the requirement that inventory must be measured at the lower of cost and net realizable value. In addition, the section has additional disclosure requirements, including accounting policies, carrying values, and the amount of any inventory writedowns.

The adoption of this new standard had no financial effect on the consolidated financial statements of the Company. Refer to Note 3 of the audited consolidated financial statements for additional disclosures.

# Pareto Corporation

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

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### b) Future Accounting Policy Changes

**International Financial Reporting Standards** – In February 2008, the Accounting Standards Board (AcSB) announced that Canadian GAAP for publicly accountable enterprises will be replaced by International Financial Reporting Standards ("IFRS") for fiscal years beginning on or after January 1, 2011. The transition from Canadian GAAP to IFRS will be applicable for the Company for the first quarter of 2011, at which time the Company will prepare both its fiscal 2011 and 2010 comparative financial information using IFRS.

The Company has used internal resources to understand, identify and assess the overall effort required to adopt IFRS and has met with an external consultant to proceed in 2009 preparing for the change. The Company has established a changeover plan that consists of three phases: initiation, a detailed assessment, and design and implementation. The plan will cover various areas including:

- Changes to accounting policies and implementation decisions;
- Disclosure requirements
- Changes to information systems and accounting processes
- Changes to internal control over financial reporting and disclosure controls and procedures
- Training requirements; and
- External stakeholder communications

The impact of the adoption of IFRS on the Company's financial reporting is not yet determinable. As the Company assesses the impact of adopting IFRS, it will update its MD&A disclosures quarterly to report on the progress of its IFRS changeover plan.

The Company plans to adopt IFRS according to the schedule recommended by the AcSB

**Goodwill and Intangible Assets** – Effective January 1, 2009, the Company will adopt new CICA Handbook Section 3064, Goodwill and Intangible Assets, which establish revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The new standard also provides guidance for the treatment of various preproduction and start-up costs and requires that these costs be expensed as incurred. The Company is currently evaluating the impact of the new section on its consolidated financial statements. Based on analyses to date, certain assets included on the Company's balance sheet will no longer meet the requirements of the new section, notably, start-up and other deferred costs (included in "Deferred Costs"). In first quarter 2009, the balances in these asset accounts as at December 31, 2007 – that is, at the beginning of first quarter 2008 – will be restated and included in "Retained earnings" and the results of operations of 2008 will also be restated to conform to the 2009 presentation. As at December 31, 2008, according to analyses completed to date, the impact of the recommendations of the new section on the consolidated financial statements for the first period of application consists of a \$159,838 reduction in deferred costs (\$335,956 as at December 31, 2007), a \$41,097 reduction in long-term future income tax liabilities (\$90,131 as at December 31, 2007), a \$127,084 increase in 2008 net earnings and a reduction in retained earnings at December 31, 2008 of \$118,741 (\$245,825 at January 1, 2008).

# Pareto Corporation

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

### SUMMARY OF QUARTERLY AND ANNUAL RESULTS

Year ended 31 December, 2008	Mar 31	Jun 30	Sep 30	Dec 31	Last 12 months
<b>Quarterly information:</b>					
Revenue	\$ 16,453,170	\$ 20,853,852	\$ 18,126,430	21,730,884	\$ 77,164,336
EBITDA <sup>1</sup>	1,179,078	1,994,208	1,771,867	3,109,288	8,054,441
EBITDA Margin	7.2%	9.6%	9.8%	14.3%	10.4%
Net earnings	403,853	914,954	658,152	1,582,320	3,559,280
Basic and diluted earnings per share <sup>2</sup>	0.01	0.02	0.02	0.04	0.08
<b>Annual information:</b>					
Total assets					46,171,038
Total long-term financial Liabilities, including current portion					1,363,852
Cash dividends declared					1,717,246

Year Ended 31 December, 2007	Mar 31	Jun 30	Sep 30	Dec 31	Total
<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					4,425,904
Cash dividends declared					-

# Pareto Corporation

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

Year Ended 31 December, 2006	Mar 31	Jun 30	Sep 30	Dec 31	Total
<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

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).