



## Consolidated Financial Statements

For the quarter ended June 30, 2009

# Pareto Corporation

## Consolidated Balance Sheets

As at	June 30 2009 (unaudited)	December 31 2008 (audited) – note 3
<b>Assets</b>		
<b>Current assets</b>		
Accounts receivable	\$ 13,794,240	\$ 16,460,617
Inventories (note 4)	2,135,379	1,746,355
Prepaid expenses	689,221	466,040
Current future income tax assets	44,181	38,167
	<u>16,663,021</u>	<u>18,711,179</u>
<b>Loans receivable and other assets (note 5)</b>	<b>1,512,679</b>	<b>1,299,045</b>
<b>Long-term future income tax assets</b>	<b>263,345</b>	<b>258,209</b>
<b>Capital assets (note 6)</b>	<b>3,284,534</b>	<b>3,340,697</b>
<b>Intangible assets (note 7)</b>	<b>1,237,935</b>	<b>1,343,493</b>
<b>Goodwill (note 8)</b>	<b>21,058,577</b>	<b>21,058,577</b>
	<u>\$ 44,020,091</u>	<u>\$ 46,011,200</u>
<b>Liabilities and Shareholders' Equity</b>		
<b>Current liabilities</b>		
Bank indebtedness (note 9)	\$ 2,140,682	\$ 654,573
Accounts payable and accrued liabilities	9,071,510	12,032,039
Dividends payable	645,147	1,717,246
Deferred revenue	1,942,839	2,023,252
Income taxes payable	776,425	983,915
Current portion of capital lease obligations (note 10)	582,503	314,275
Current portion of lease inducements (note 11)	42,482	42,482
	<u>15,201,588</u>	<u>17,767,782</u>
<b>Long-term future income tax liabilities (note 3)</b>	<b>337,982</b>	<b>194,192</b>
<b>Long-term capital lease obligations (note 10)</b>	<b>-</b>	<b>395,004</b>
<b>Deferred lease inducements (note 11)</b>	<b>321,501</b>	<b>342,742</b>
<b>Total liabilities</b>	<u><b>15,861,071</b></u>	<u><b>18,699,720</b></u>
<b>Shareholders' equity</b>		
Share capital (note 12(b))	16,604,987	16,501,855
Contributed surplus (note 12(f))	1,795,348	1,492,547
Retained earnings and accumulated other comprehensive income (note 3)	9,758,685	9,317,078
<b>Total shareholders' equity</b>	<u><b>28,159,020</b></u>	<u><b>27,311,480</b></u>
	<u>\$ 44,020,091</u>	<u>\$ 46,011,200</u>

The accompanying notes are an integral part of these consolidated financial statements

# Pareto Corporation

## Consolidated Statements of Operations and Retained Earnings

	Three months ended June 30 (unaudited)		Six months ended June 30 (unaudited)	
	2009	2008 (note 3)	2009	2008 (note 3)
<b>Revenue</b>	\$ 17,048,569	\$ 20,853,852	\$ 33,231,565	\$ 37,307,022
<b>Operating and administrative expenses</b>	<b>14,914,809</b>	18,859,644	<b>29,686,678</b>	34,133,736
	<b>2,133,760</b>	1,994,208	<b>3,544,887</b>	3,173,286
Amortization of capital assets	156,955	158,638	324,005	317,590
Amortization of intangible assets	52,778	52,777	105,557	105,555
Interest expense	51,382	171,045	96,368	285,635
Interest income	(26,005)	(6,585)	(58,582)	(14,182)
Share-based compensation (note 12(f))	231,274	193,811	420,933	401,591
	<b>466,384</b>	569,686	<b>888,281</b>	1,096,189
Earnings before income taxes	1,667,376	1,424,522	2,656,606	2,077,097
Income taxes (note 13)	593,413	462,904	925,873	658,706
<b>Net earnings and comprehensive income for the period</b>	<b>1,073,963</b>	961,618	<b>1,730,733</b>	1,418,391
Retained earnings, beginning of period (note 3)	9,329,881	7,940,323	9,317,078	7,877,806
Dividends declared	(645,159)	-	(1,289,126)	-
Excess price paid over carrying value on repurchase of common shares		(135,841)		(530,097)
<b>Retained earnings, end of period</b>	<b>\$ 9,758,685</b>	\$ 8,766,100	<b>\$ 9,758,685</b>	\$ 8,766,100
Basic and diluted earnings per share (note 14)	\$ 0.02	\$ 0.02	\$ 0.04	\$ 0.03
<b>Weighted average number of common shares outstanding:</b>				
Basic	42,970,815	42,897,760	42,950,981	43,234,245
Diluted	45,209,205	44,735,332	45,017,411	44,965,913

The accompanying notes are an integral part of these consolidated financial statements

# Pareto Corporation

## Consolidated Statements of Cash Flows

	Three months ended		Six months ended	
	June 30 (unaudited)		June 30 (unaudited)	
	2009	2008 (note 3)	2009	2008 (note 3)
<b>Operating activities</b>				
Net earnings for the period	\$ 1,073,963	\$ 961,618	\$ 1,730,733	\$ 1,418,391
Items not involving cash:				
Amortization of capital assets	156,955	158,638	324,005	317,590
Amortization of intangible assets	52,778	52,777	105,557	105,555
Amortization of lease inducement (note 11)	(10,620)	-	(21,241)	-
Non-cash interest	(20,599)	-	(48,384)	-
Share-based compensation (note 12 (f))	231,274	193,811	420,933	401,591
Future income tax provision (notes 3 and 13)	178,619	405,816	132,640	611,877
	<b>1,662,370</b>	<b>1,772,660</b>	<b>2,644,243</b>	<b>2,855,004</b>
Changes in non cash operating accounts (note 15)	<b>(704,820)</b>	<b>(956,077)</b>	<b>(1,209,261)</b>	<b>(1,807,226)</b>
	<b>957,550</b>	<b>816,583</b>	<b>1,434,982</b>	<b>1,047,778</b>
<b>Investing activities</b>				
Capital asset additions	<b>(208,320)</b>	(431,812)	<b>(267,841)</b>	(484,271)
Proceeds from lease inducement (note 11)	-	-	-	-
Loans receivable and other assets	<b>(190,250)</b>	-	<b>(190,250)</b>	(550,000)
Acquisitions, net of cash (note 8 (a))	-	(66,668)	-	(3,066,668)
	<b>(398,570)</b>	<b>(498,480)</b>	<b>(458,091)</b>	<b>(4,100,939)</b>
<b>Financing activities</b>				
Dividends paid	<b>(643,977)</b>	-	<b>(2,361,223)</b>	-
Repayment of capital lease obligations	<b>(51,407)</b>	(69,426)	<b>(126,777)</b>	(136,978)
Repayment of Loan Receivables	<b>25,000</b>	-	<b>25,000</b>	-
Issuance of shares	-	12,500	-	12,500
Share issue costs	-	-	-	(2,051)
Repurchase of common shares	-	(265,451)	-	(1,026,430)
	<b>(670,384)</b>	<b>(322,377)</b>	<b>(2,463,000)</b>	<b>(1,152,959)</b>
<b>Increase (Decrease) in cash for the period</b>	<b>(111,404)</b>	<b>(4,274)</b>	<b>(1,486,109)</b>	<b>(4,206,120)</b>
<b>(Bank Indebtedness)/Cash, beginning of period</b>	<b>(2,029,278)</b>	<b>(4,570,137)</b>	<b>(654,573)</b>	<b>(368,291)</b>
<b>(Bank Indebtedness)/Cash, end of period</b>	<b>\$ (2,140,682)</b>	<b>\$ (4,574,411)</b>	<b>\$ (2,140,682)</b>	<b>\$ (4,574,411)</b>

The accompanying notes are an integral part of these consolidated financial statements

**1. Nature of Operations**

Pareto Corporation ("the Company" or "Pareto") is incorporated under the laws of Ontario. Pareto is a marketing services company, providing marketing solutions through the delivery, fulfillment and distribution of retail promotions; direct marketing; customer incentive and loyalty management; field merchandising; and program management services.

**2. Significant Accounting Policies**

**Basis of Consolidation**

These financial statements include the accounts of Pareto Corporation and all of its wholly-owned subsidiaries consisting of Pareto Inc., Pareto Retail Services Inc. and Secom Plus Inc. Inter-company transactions and balances are eliminated upon consolidation.

**Use of Estimates**

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

**Accounts Receivable**

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 accounts receivable is impaired include whether a customer is in bankruptcy, under administration or if payments are in dispute. The offsetting expense is recognized in earnings within operating expenses. When an accounts receivable for which an impairment allowance had been recognized becomes uncollectible in a subsequent period, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against operating expenses in earnings.

**Financial 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.

Gains and losses related to financial assets and financial liabilities classified as held for trading are recorded in earnings in the period in which they arise. The Company designates financial assets and financial liabilities as held for trading if it is acquired or incurred principally for the purpose of selling or repurchasing in the near term.

If a financial asset is classified as available-for-sale, the cumulative unrealized gain or loss is recognized in accumulated other comprehensive income and recognized in earnings upon sale or other-than-temporary impairment. The Company assesses whether a financial asset is other-than-temporarily impaired by assessing whether there is a significant or prolonged decline in fair value and objective evidence of impairment exists such as financial difficulty, breach or default of contracts, probability of bankruptcy or other financial reorganization.

The Company applies trade date accounting for its purchases and sales of financial assets.

**2. Summary of Significant Accounting Policies (continued)**

**i. Transaction Costs**

Transaction costs directly attributable to financial assets and liabilities that are not classified as held-for-trading are included in the amortized cost of the related asset or liability and recognized in earnings through the effective interest method. Transaction costs related to held-for-trading financial assets and liabilities are expensed as incurred.

**ii. Derivative Financial Instruments**

All derivative financial instruments are measured at fair value, even when they are part of an effective hedging relationship. An embedded derivative is a component of a hybrid instrument that also includes a non-derivative host contract, with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. If certain conditions are met, an embedded derivative is bifurcated from the host contract and accounted for as a derivative in the consolidated balance sheet, and measured at fair value.

The Company does not enter into derivative financial instruments for trading or speculative purposes.

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

**Inventories**

Inventories include work in progress, finished goods and loyalty reward units. Work in progress includes costs incurred on non-manufacturing projects for which revenue has not yet been recognized for accounting purposes. Finished goods inventory includes total costs incurred for print materials that the company holds for future distribution under its fulfillment and distribution client agreements. Loyalty reward units include the cost of units purchased that the company holds for resale under its incentive service agreements. Inventory is carried at the lower of cost and net realizable value. The cost of work in progress inventory and loyalty reward units is determined through specific identification by project and includes direct costs and labour. The cost of finished goods inventory is determined using the retail method of accounting.

**Capital Assets**

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

Computer software	Straight-line over 1 to 8 years
Computer hardware	30% declining balance
Furniture and fixtures	20% declining balance
Leasehold improvements	Straight-line over lease term

**Intangible Assets**

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.

**2. Summary of Significant Accounting Policies (continued)**

**Impairment of Long Lived Assets**

The Company monitors events and changes in circumstances which may require an assessment of the recoverability of its long lived assets. The Company assesses recoverability using estimated undiscounted future operating cash flows expected from the use and eventual disposition of the asset. If the carrying amount of an asset is not recoverable, an impairment loss is recognized in operations, measured by comparing the carrying amount of the asset to its fair value.

**Goodwill**

Goodwill represents the consideration paid for acquisitions in excess of the fair market value of the net identifiable assets acquired. Goodwill is carried at cost, less impairment losses, if any.

The Company uses a two-step impairment test on an annual basis, or when significant business changes have occurred that may have had an adverse impact on the fair value of the goodwill. 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.

When the fair value is in excess of its carrying amount, the goodwill is not considered impaired, and the second step of the impairment test is not necessary. An impairment loss is recognized when the carrying amount of the goodwill exceeds its fair value. It is not reversed in the event that the fair value subsequently increases.

**Income Taxes**

The liability method is used for determining income taxes. Under this method, future income tax assets and liabilities are determined based on deductible or taxable temporary differences between financial statement basis and tax basis of assets and liabilities measured at the rates expected to apply when the differences are realized. Future tax assets and liabilities are adjusted to reflect changes in tax rates and laws in the period such changes are substantially enacted, resulting in adjustments to that period's earnings. A valuation allowance is recorded against future tax assets for amounts that are not more likely than not to be realized. Tax reserves are established for uncertain tax positions based on management's best estimates.

**2. Summary of Significant Accounting Policies (continued)**

**Revenue Recognition**

Revenue is recognized when the service is performed, in accordance with terms of the contractual arrangement and upon completion of the earnings process as follows: for print management when delivered to the client or fulfillment agency, direct marketing when delivered to the client's distribution agency, event management when the event is completed, fulfillment and distribution upon shipment to the client, and customer incentive and loyalty management services when delivered to the client or its agent. Costs incurred in advance of a project's completion are reflected as work in progress. Customer receipts in advance of a project's completion are recorded as deferred revenue. For program management and field merchandising services, revenues are recognized as services are rendered.

The Company has arrangements to provide multiple products and services to certain of its customers. The Company has accounted for the activities within such arrangements as separate accounting units based on the relevant revenue recognition criteria for each revenue type described above. These arrangements include delivered items with stand-alone value, and undelivered items with objective and reliable evidence of fair value where delivery is probable and substantially controlled by the vendor.

Revenue from sales of third party services is recorded net of costs when the Company is acting as an agent between the customer and the vendor and recorded gross when the Company is a principal to the transaction. Several factors are considered to determine whether the Company is an agent or a principal, including whether the Company is the primary obligor to the customer, has inventory risk or adds meaningful value to the service. Consideration is also given to whether the Company was involved in the selection of the vendor's service, has latitude in establishing the sales price or has credit risk.

**Earnings per Share**

Basic earnings per share are determined using the weighted average number of common shares outstanding during the year. Diluted earnings per share are determined using the weighted average number of common shares outstanding during the year, plus the effects of potential dilutive common shares outstanding during the year. This method requires that diluted earnings per share be calculated, using the treasury stock method, as if all potential common shares had been issued at the later of the beginning of the year or the date of issuance of the dilutive instrument, and that the funds obtained thereby be used to repurchase common shares of the Company at the average fair value of the common shares during the year.

**Stock-based Compensation**

The compensation cost for options granted to employees and officers is determined using the fair value method. The fair value of the options at the grant date is estimated using the Black-Scholes option pricing model, and recognized over the vesting period of the options as an expense, using the graded vesting method with a corresponding amount included in equity as contributed surplus. Any consideration received by the Company on the exercise of stock options is credited to share capital and the contributed surplus component of the stock-based compensation is transferred to share capital upon the issuance of shares.

**Long-term Incentive Plans**

Eligible employees, consultants, directors and officers of the Company participate in a long-term incentive plan, being restricted stock units (RSUs). Compensation cost for RSUs granted is recorded as an expense with a corresponding increase in contributed surplus. Compensation cost is measured based on the common share price on the grant date and recognized over the vesting period using the straight-line method.

**2. Summary of Significant Accounting Policies (continued)**

**Foreign Currencies**

Monetary assets and liabilities denominated in foreign currencies are translated at the exchange rates in effect as of the balance sheet date.

Revenue and expense items are translated at the exchange rates prevailing on the date the transactions occur. The results of foreign currency translation are recognized in net earnings.

**3. Changes in Accounting Policies**

**a) New Accounting Policies**

**Goodwill and Intangible Assets** – In February 2008, the CICA issued Handbook Section 3064, Goodwill and Intangible Assets, replacing the existing guidance on goodwill and other intangible assets and research and development costs. The standard is effective for interim and annual financial statements for fiscal years beginning on or after October 1, 2008. The new standard established revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets and provides guidance for the treatment of various preproduction and start-up costs, and requires that these costs be expensed as incurred.

The Company applied the new accounting standard retrospectively at the beginning of its current fiscal year, with restatement of prior periods. Certain assets, notably, start-up and other deferred costs previously included on the Company's balance sheet as Deferred Costs prior to the Company's current fiscal year no longer meet the new recognition or measurement criteria and the definition of an asset were removed from the consolidated balance sheets in accordance with CICA Handbook Section 1506, Accounting Changes. The balance of any such Deferred Costs as at the beginning of the Company's 2008 fiscal year was reflected as a charge to opening retained earnings.

**Net Earnings Impact** – For the three months ending June 30, 2008, the implementation of the new standard resulted in an increase the Company's pre-tax net earnings of \$35,086, a decrease to future income taxes of \$11,578. For the six months ending June 30, 2009, the implementation of the new standard resulted in an increase to the Company's pre-tax net earnings of \$74,875, a decrease to future income taxes of \$24,709.

**Balance Sheet Adjustments** – The impact on balances as at December 31, 2008 was a non-cash reduction of \$118,490 to opening retained earnings (\$245,825 at January 1, 2008 and \$ 192,905 at April 1, 2008), a \$159,838 reduction in deferred costs and a \$41,348 reduction in long-term future income tax liabilities

**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.

**3. Changes in Accounting Policies (continued)**

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.

**Business Combinations and Minority Interest** - In October of 2008, the CICA issued Handbook Section 1582, Business Combinations (CICA 1582), concurrently with Handbook Sections 1601, Consolidated Financial Statements (CICA 1601), and 1602, Non-controlling Interests (CICA 1602). CICA 1582, which replaces Handbook Section 1581, Business Combinations, establishes standards for the measurement of a business combination and the recognition and measurement of assets acquired and liabilities assumed. CICA 1601, which replaces Handbook Section 1600, carries forward the existing Canadian guidance on aspects of the preparation of consolidated financial statements subsequent to acquisition other than non-controlling interests. CICA 1602 establishes guidance for the treatment of non-controlling interests subsequent to acquisition through a business combination. These new standards are effective for the Company's interim and annual consolidated financial statements commencing on September 1, 2011 with earlier adoption permitted as of the beginning of a fiscal year. The Company is assessing the impact of the new standards on its consolidated financial statements.

**4. Inventories**

	June 30 2009	December 31 2008
Work in progress	\$ 1,520,402	\$ 623,226
Finished goods	94,454	73,129
Loyalty reward units	520,523	1,050,000
	<b>\$ 2,135,379</b>	<b>\$ 1,746,355</b>

There have been no write downs of inventory recognized as an expense in the period. There are no inventories pledged as security for liabilities.

**Pareto Corporation**  
**Notes to Consolidated Financial Statements**  
June 30, 2009

**5. Loans Receivable and Other Assets**

	June 30 2009	December 31 2008
Employee loans receivable (a)	\$ 225,000	\$ 250,000
Employee loan receivable (b)	236,250	236,250
Employee loan receivable(c)	188,500	188,500
Convertible debenture (d)	672,679	624,295
Convertible debenture (e)	190,250	-
	<b>1,512,679</b>	<b>1,299,045</b>

- (a) In May 2006, the Company issued loans totalling \$250,000 to executives of the Company for the purchase of 192,308 common shares of the Company. During 2009, \$25,000 was repaid to the Company. The loan is carried at the carrying amount of \$225,000 which approximates its fair value. The loan bears interest at Prime Rate plus ½% with interest payable quarterly. The loans are repayable on May 16, 2011. The loans are full recourse and the Company has received a pledge of the purchased common shares as security for the loans.
- (b) 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.
- (c) 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.
- (d) On February 26, 2008 the Company provided financing in the amount of \$550,000 to PeerSet Inc. ("Peerset"), formerly Ontogenix Inc., in return for a three year convertible debenture. The debenture bears an annualized interest rate of 16% of the principal, compounded annually. Interest shall be due and payable upon prepayment or repayment of the debenture. The Company has the option to convert the principal and any outstanding interest into equity securities at any time upon a material business change event and/or liquidity event. A material business change event occurs if Peerset becomes insolvent, its board is reduced in size to two or fewer members, or Peerset is in default of any of the terms of the debenture. A liquidity event means an initial public offering or change of control. If converted, ownership is expected to be treated on a cost basis. The debenture is secured by a general security agreement over all the present and future assets of Peerset.

At June 30, 2009, the carrying amount of the loan includes \$122,679 of accrued interest from the issue date of February 26, 2008 and approximates fair value calculated based on the present value of estimated cash flows at current interest rates.

**Pareto Corporation**  
**Notes to Consolidated Financial Statements**  
June 30, 2009

**5. Loans Receivable and Other Assets (continued)**

- (e) On April 7, 2009, the Company provided an additional loan in the amount of \$190,250 (“First Tranche Debenture”) to Peerset in return for a two year convertible debenture. In accordance with the terms of the Subscription Agreement, a second amount of \$190,250 would be payable in the future upon satisfaction of certain performance criteria and shall have terms and conditions substantially similar to the First Tranche Debentures, including the maturity date thereof. Subsequent to the quarter ended June 30, 2009, this second amount of \$190,250 was loaned to Peerset in return for a convertible debenture. The debenture bears an annualized interest rate of 12% of the principal, compounded annually. Interest shall be due and payable upon prepayment or repayment of the debenture. The Company has the option to convert the principal and any outstanding interest into equity securities at any time upon a material business change event and/or liquidity event. A material business change event occurs if Peerset becomes insolvent, its board is reduced in size to two or fewer members, or Peerset is in default of any of the terms of the debenture. A liquidity event means an initial public offering or change of control. If converted, ownership is expected to be treated on a cost basis. The debenture is secured by a general security agreement over all the present and future assets of Peerset.

The Peerset debentures have been classified as held-to-maturity. Management deemed the value of the conversion right to be insignificant at the date of issue and at June 30, 2009 based on an assessment of the conversion rights and term to expiry

**6. Capital Assets**

June 30, 2009	Cost	Accumulated Amortization	Net book Value
Computer software	\$ 1,773,847	\$ 1,048,702	\$ 725,145
Computer hardware	1,095,195	684,604	410,591
Furniture and fixtures	1,993,458	940,296	1,053,162
Leasehold improvements	1,651,605	555,969	1,095,636
	<b>\$ 6,514,105</b>	<b>\$ 3,229,571</b>	<b>\$ 3,284,534</b>

December 31, 2008	Cost	Accumulated Amortization	Net Book Value
Computer software	\$ 1,710,804	\$ 956,603	\$ 754,201
Computer hardware	979,647	628,825	350,822
Furniture and fixtures	1,934,797	841,622	1,093,175
Leasehold improvements	1,621,015	478,516	1,142,499
	<b>\$ 6,246,263</b>	<b>\$ 2,905,566</b>	<b>\$ 3,340,697</b>

**7. Intangible Assets**

Intangible assets – customer relationships	Cost	Accumulated Amortization	Net book Value
<b>Balance at June 30, 2009</b>	<b>\$ 2,111,106</b>	<b>\$ 873,171</b>	<b>\$ 1,237,935</b>
Balance at December 31, 2008	\$ 2,111,106	\$ 767,613	\$ 1,343,493

**Pareto Corporation**  
**Notes to Consolidated Financial Statements**  
June 30, 2009

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**8. Goodwill**

Balance at December 31, 2007	\$ 19,058,577
Acquisition of Secom Plus Inc.	2,000,000
<b>Balance at December 31, 2008 and June 30, 2009</b>	<b>\$ 21,058,577</b>

On October 3, 2006, the Company acquired all of the outstanding shares of Secom Plus Inc. (“Secom”) a Montreal based retail sales and merchandising company for initial consideration of \$5,000,000, comprised of \$3,250,000 in cash, \$1,250,000 of acquisition notes payable, and 450,450 common shares with a fair value of \$500,000 at that date. Additional contingent consideration of \$3,000,000 and additional transaction costs of \$12,429 were recorded in 2007 and paid in 2008.

Additional contingent consideration of \$2,000,000 was recorded and paid in 2008 based on the satisfaction of remaining conditions precedent. The acquisition was accounted for as a purchase.

**9. Bank Indebtedness**

At June 30, 2009, the Company has a line of credit available in the amount of \$9,000,000 (December 31, 2008 – \$9,000,000) secured by a general security agreement over the assets of the Company. The line of credit bears interest at prime plus 1.0% and is repayable on demand. As at June 30, 2009, the prime rate was 2.25% (3.5% as of December 31, 2008).

On August 6, 2009, the Company has agreed to a new credit facility with a major Canadian chartered bank. The credit facility is comprised of a three year term loan in the amount of up to \$15 million and a line of credit in the amount of \$10 million. The term loan bears interest at an annual rate starting at banker’s acceptance rate plus 3.25% and is repayable in quarterly installments starting at an annual rate of 10% of the amount drawn. Pareto expects to repay any funds borrowed under the credit facility using internally generated cash flow. The term facility will be drawn upon to fund the Company’s substantial issuer bid described in note 22 of up to \$10 million and to fund the purchase of capital asset purchase commitments of \$2million. The line of credit bears interest at an annual rate equal to prime rate plus 1% and is repayable in monthly interest-only payments. The line of credit will be used initially to repay funds borrowed on the company’s existing line of credit and subsequently for operating purposes.

**10. Capital Lease Obligations**

The current leases bear interest at rates between 10% and 12% and carry expiry dates between 2009 and 2011, but will be fully paid off in Q3 of 2009 in connection with the purchase of additional capital assets. The Company will utilize the new credit facilities described in note 9 to fund the payment.

**Pareto Corporation**  
**Notes to Consolidated Financial Statements**  
June 30, 2009

**11. Deferred Lease Inducements**

During the year ended December 31, 2008 the Company received various lease inducements under two of its 10 year lease agreements. In accordance with CICA EIC-21 "Accounting for Lease Inducements by the Lessee", the Company adopted the recommended balance sheet presentation as well as the amortization of the lease inducements over the term of the lease as a reduction to rental expense.

	Leasehold improvement allowance paid by landlord	Rent holiday	Total
Cost	\$ 227,285	\$ 197,130	\$ 424,415
Amortization	(13,259)	(25,932)	(39,191)
Balance at December 31, 2008	214,026	171,198	385,224
Amortization	(11,363)	(9,878)	(21,241)
Balance at June 30, 2009	\$ 202,663	\$ 161,320	\$ 363,983
Less: Current portion	22,729	19,753	42,482
	\$ 179,934	\$ 141,567	\$ 321,501

**12. Share Capital**

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

	Number of Shares	Amount
Balance, December 31, 2007	43,994,648	\$ 16,872,129
Shares issued on exercise of stock options	250,000	128,109
Shares repurchased for cancellation	(1,313,500)	(496,332)
Shares issue costs	-	(2,051)
<b>Balance, December 31, 2008</b>	<b>42,931,148</b>	<b>\$ 16,501,855</b>
<b>Shares issued on redemption of restricted stock units</b>	<b>79,333</b>	<b>103,132</b>
<b>Balance, June 30, 2009</b>	<b>43,010,481</b>	<b>\$ 16,604,987</b>

- c) Stock options

The Company has a stock option plan (the "Plan") for employees, consultants and officers of the Company and was amended in May 2007. Pursuant to the amended Plan, the lesser of 10 per cent of the outstanding and 3,500,000 common shares of the Company have been reserved for issue.

In addition, subject to regulatory approval, the Company grants options which are not included under the Plan to new employees as an incentive of employment. Currently, there are no options awaiting regulatory approval. One-third of granted options vest on each of the anniversary dates of the grant and expire after five years.

**Pareto Corporation**  
Notes to Consolidated Financial Statements  
June 30, 2009

**12. Share Capital (continued)**

Stock option transactions under the Plan, including options issued as incentives, during the period are as follows:

	Number of Options Outstanding	Weighted Average Exercise Price
Options outstanding, December 31, 2007	1,904,168	\$ 1.02
Granted in 2008	424,521	0.68
Exercised in 2008	(250,000)	0.39
Forfeited in 2008	(5,000)	1.05
Options outstanding, December 31, 2008	2,073,689	\$ 1.03
<b>Granted in 2009</b>	<b>797,630</b>	<b>0.50</b>
<b>Exercised in 2009</b>	<b>-</b>	<b>-</b>
<b>Forfeited in 2009</b>	<b>(152,110)</b>	<b>0.99</b>
<b>Options outstanding, June 30, 2009</b>	<b>2,719,209</b>	<b>\$ .87</b>

	Number of Options Exercisable	Weighted Average Exercise Price
Options exercisable, December 31, 2008	751,938	\$ 1.11
<b>Vested in 2009</b>	<b>337,781</b>	<b>1.15</b>
<b>Forfeited in 2009</b>	<b>(71,665)</b>	<b>1.01</b>
<b>Options exercisable, June 30, 2009</b>	<b>1,018,054</b>	<b>\$ 1.13</b>

The range of exercise prices for options outstanding and exercisable options at June 30, 2009 are as follows:

Exercise Price	Number Outstanding	Weighted Average Contractual Life	Number Exercisable	Weighted Average Contractual Life
\$0.52 - \$0.75	1,166,708	4.52	0	0
\$0.76 - \$1.00	109,167	0.47	109,167	0.88
\$1.01 - \$1.25	1,303,334	2.91	768,887	1.10
\$1.26 - \$1.53	140,000	1.83	140,000	1.49
	<b>2,719,209</b>	<b>3.44</b>	<b>1,018,054</b>	<b>1.13</b>

**12. Share Capital (continued)**

d) Restricted stock units:

The Company has a long-term incentive plan (LTIP) for employees, consultants, directors and officers of the Company which was amended in May 2007. Pursuant to the amended 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. RSUs are convertible into common shares on a one-to-one basis at a price equal to the common share value when granted. Restricted stock units are redeemable upon the third anniversary of the date of grant.

In addition, subject to regulatory approval, the Company grants restricted stock units which are not included under the LTIP to new employees as an incentive of employment. Currently there are no restricted stock units awaiting regulatory approval.

At June 30, 2009, 1,190,952 restricted stock units were outstanding pursuant to the LTIP (993,285 at December 31, 2008) and 833,333 restricted stock units were outstanding outside of the LTIP as issued as incentives (833,333 at December 31, 2008). The fair value of a restricted stock unit granted in 2008 and 2007 was estimated to equal the market price of a Pareto common share on the date of grant.

Restricted stock unit transactions including RSU's issued under the Plan and RSU's issued as incentives, during the period are as follows:

	Number of RSU's Outstanding
RSU's outstanding, December 31, 2007	1,515,952
Granted in 2008	333,333
Forfeited in 2008	(22,667)
RSU's outstanding, December 31, 2008	1,826,618
<b>Granted in 2009</b>	<b>300,000</b>
<b>Redeemed in 2009</b>	<b>(79,333)</b>
<b>Forfeited in 2009</b>	<b>(23,000)</b>
<b>RSU's outstanding, June 30, 2009</b>	<b>2,024,285</b>

e) Share-based compensation:

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

	<b>2009</b>	<b>2008</b>
Dividend yield	0%	0%
Expected volatility	60.17% to 64.18%	52.30% to 60.73%
Risk-free interest rate	1.38% to 1.60%	2.22% to 2.94%
Expected option life	3 to 4 years	2 to 4 years

**Pareto Corporation**  
Notes to Consolidated Financial Statements  
June 30, 2009

**12. Share Capital (continued)**

f) Contributed surplus

In the six months ending June 30, 2009, \$420,933 (2008 - \$401,591 )of share based compensation was added to contributed surplus with \$103,132 (2008 - \$128,109) of contributed surplus reallocated to share capital as a result of restricted stock units exercised in the period.

**13. Income Taxes**

	Three months ended June 30		Six months ended June 30	
	2009	2008	2009	2008
Provision for income taxes consists of:				
Current	\$ 414,794	\$ 57,088	\$ 793,233	\$ 46,829
Future (note 3)	178,619	405,816	132,640	611,877
	\$ 593,413	\$ 462,904	\$ 925,873	\$ 658,706

**14. Earnings Per Share**

The table below contains the data used to calculate the Company's diluted earnings per share:

	Three months ended June 30		Six months ended June 30	
	2009	2008	2009	2008
Net earnings (note 3)	\$ 1,073,963	\$ 961,618	\$ 1,730,733	\$ 1,418,391
Weighted average number of common shares outstanding	42,970,815	42,897,760	42,950,981	43,234,245
Stock options	175,747	103,102	82,495	106,457
Restricted stock units	2,062,643	1,734,470	1,983,935	1,625,211
Weighted average number of diluted common shares outstanding	45,209,205	44,735,332	45,017,411	44,965,913
	\$ 0.02	\$ 0.02	\$ 0.04	\$ 0.03

The calculation of the dilutive impact of the exercise of options excludes those securities considered anti-dilutive because their exercise price exceeded the average market price of Pareto's common shares during the period (2009 - \$0.58), meaning their inclusion would increase diluted earnings per share. In 2009, 1,509,622 stock options were excluded because their effect would be anti-dilutive.

**Pareto Corporation**  
Notes to Consolidated Financial Statements  
June 30, 2009

**15. Supplementary Cash Flow Information**

	Three months ended		Six months ended	
	2009	June 30 2008	2009	June 30 2008
<b>Changes in non-cash operating accounts:</b>				
Accounts receivable	\$ (186,984)	\$ 15,905	\$ 2,666,377	\$ 743,739
Inventory and work in progress	74,165	1,967,717	(389,024)	240,930
Prepaid expenses	18,736	(7,858)	(223,181)	80,183
Accounts payable and accrued liabilities	(344,724)	(1,456,058)	(2,975,530)	(2,695,145)
Income taxes payable	(515,167)	15,344	(207,490)	(20,713)
Deferred revenue	249,154	(1,491,127)	(80,413)	(156,220)
	<b>\$ (704,820)</b>	<b>\$ (956,077)</b>	<b>\$ (1,209,261)</b>	<b>\$ (1,807,226)</b>
<b>Supplemental cash flow information:</b>				
Interest paid	\$ 51,382	\$ 171,045	\$ 96,368	\$ 285,635
Income taxes paid	929,961	-	1,000,723	-

**16. Commitments**

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

2009	\$ 432,487
2010	858,191
2011	814,027
2012	647,020
2013	661,722
2014 and thereafter	2,569,632

At June 30, 2009 Pareto has capital asset purchase commitments that are due within the next quarter totalling \$1,505,497.

**17. Related Party Transactions**

The company has no related party transactions other than the loans receivable described in note 5.

**Pareto Corporation**  
**Notes to Consolidated Financial Statements**  
June 30, 2009

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**18. Segmented Information**

The Company provides marketing solutions through the delivery of print management, direct marketing, event management, program management, customer incentive and loyalty management, fulfillment and distribution services and field merchandising. In the opinion of management, the Company carries on business in one operating segment.

During the six month period ending June 30, 2009, one customer represented greater than 10% of the Company's revenue being 25% (2008 – 23%). Amounts due from this customer accounted for 16% of accounts receivable as at June 30, 2009 (December 31, 2008 – 24%). All of the Company's operations are located in Canada.

**19. Capital Management**

The Company's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and sustain future development of the business. The Company defines capitalization to include the total of bank indebtedness, acquisition notes payable, capital lease obligation and shareholders' equity.

	June 30, 2009	December 31, 2008
Bank Indebtedness	\$ 2,140,682	\$ 654,573
Capital lease obligation	582,503	709,279
Total debt	2,723,185	1,363,852
Shareholders' equity	28,159,020	27,311,480
Total capitalization	\$ 30,882,205	\$ 28,675,332
Debt:Shareholders' equity	0.10:1	0.05:1
Debt:Total Capitalization	0.09:1	0.05:1
Debt: EBITDA <sup>(1)</sup>	0.3:1	0.2:1

<sup>(1)</sup> For purposes of calculating ratios EBITDA is defined as earnings before amortization, net interest and finance charges, share-based compensation, income taxes, gain on acquisition and non-recurring expenses. EBITDA is not a measure defined under Canadian generally accepted accounting principles ("GAAP") and therefore readers are cautioned 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.

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.

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.

**19. Capital Management (continued)**

On March 4, 2009, the Company initiated a quarterly cash dividend of \$0.015 per issued and outstanding share, with the inaugural dividend payable on April 15, 2009, to shareholders of record at the close of business on March 31, 2009.

On June 11, 2009, the Company initiated a quarterly cash dividend of \$0.015 per issued and outstanding share, with the inaugural dividend payable on July 15, 2009, to shareholders of record at the close of business on June 30, 2009.

On August 7, 2009 the Company announced that its Board of Directors authorized an offer to offer to purchase from shareholders for cancellation, for an aggregate purchase price of not more than \$10,000,000 in cash, up to 13,333,333 of the issued and outstanding common shares of Pareto ("Shares"), at a purchase price of not less than \$0.75 per Share and not more than \$1.00 per Share.

The Company may consider acquisition opportunities. Depending on the size of an acquisition, the Company may need to secure external capital in addition to the current credit facilities, 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.

**20. Financial Instruments**

**(a) Fair value of Financial Instruments**

At June 30, 2009, the fair value of the Company's financial instruments approximate their carrying values due to their short-term nature or because they bear interest at market rates.

**(b) Financial Risk Management**

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Company's activities.

**i. Credit Risk**

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises primarily from the Company's receivables from customers and notes receivable.

**20. Financial Instruments (continued)**

**Accounts Receivable**

The Company's exposure to credit risk is dependent upon individual characteristics of each customer. Each new customer is assessed for creditworthiness before standard payment and delivery terms and conditions are offered. The Company deals with large, credit worthy clients and bills in advance of the provision of services, whenever possible.

The Company regularly reviews the collectability of its accounts receivable and establishes an allowance for doubtful accounts based on its best estimate of any potentially uncollectible accounts. Historically, the Company has experienced minimal bad debts. As at June 30, 2009, a reserve in respect of doubtful accounts of \$109,053 was set up to cover accounts where collection is not assured.

All of the Company's accounts receivables are within Canada.

**ii. Liquidity Risk**

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company ensures, as far as possible, that it will always have sufficient liquidity to meet obligations when due and monitors cash flow requirements daily and projections weekly.

**iii. Market Risk**

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices will affect the Company's income or the value of its holding of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return on risk.

**iv. Interest Rate Risk**

The Company's principal exposure to interest rate fluctuations is limited to bank indebtedness (as described in note 10) which bears interest at floating interest rates.

Based on the Company's average debt level during the year ended June 30, 2009, the sensitivity of a 100 basis point increase in interest rates would result in an approximate decrease of \$16,000 in net after tax annual earnings.

**v. Foreign Exchange Risk**

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.

**vi. Other Market Price Risk**

The Company does not enter into commodity contracts other than to meet the Company's expected usage and sale requirements and such contracts are not settled net.

**21. Comparative Figures**

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

**22. Subsequent event**

Substantial Issuer Bid - On August 7, 2009 the Company announced that its Board of Directors authorized an offer to offer to purchase from shareholders for cancellation, for an aggregate purchase price of not more than \$10,000,000 in cash, up to 13,333,333 of the issued and outstanding common shares of Pareto ("Shares"), at a purchase price of not less than \$0.75 per Share and not more than \$1.00 per Share. The Offer will proceed by way of a "modified Dutch An issuer bid circular containing full details of the offer and procedures for tendering common shares will be filed on SEDAR and mailed to shareholders on or about August 12, 2009. The offer will expire 5:00pm (Toronto Time) on September 17, 2009 unless extended by the Company.



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

**August 6, 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 August 6, 2009, summarizes the significant factors affecting the consolidated operating results, financial condition, liquidity and cash flows of Pareto for the quarter ended June 30, 2009. 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 31, 2009, 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 a 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.

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

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 also 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 revenues over the twelve month period ending June 30, 2009.

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 June 30, 2009 was \$2,141,000 and there is considerable capacity on the Company's 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 little purchasing done outside of Canada and as such, the Company has minimal exposure to changes in currency.

# Pareto Corporation

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

### Operating Results for the quarter ended June 30:

	2009	2008	\$ Change	% Change
Revenue	\$ 17,048,569	\$ 20,853,852	\$ (3,805,283)	(18%)
Operating and administrative expenses <sup>(1)</sup>	14,914,809	18,859,644	(3,944,835)	(21%)
EBITDA <sup>(1)</sup>	\$ 2,133,760	\$ 1,994,208	\$ 139,552	7%
	12.5%	9.6%	2.9%	
Amortization of long-term assets	\$ 209,733	\$ 211,416	\$ (1,683)	(1%)
Interest expense	51,382	171,045	(119,663)	(70%)
Interest income	(26,005)	(6,585)	19,420	295%
Share-based compensation	231,274	193,811	37,463	19%
	466,384	569,687	(103,303)	(18%)
Earnings before income taxes	1,667,376	1,424,521	242,855	17%
Income taxes	593,414	462,904	130,510	28%
Net earnings	\$ 1,073,962	\$ 961,617	\$ 112,345	12%
Basic and Diluted earnings per share	\$ 0.02	\$ 0.02	\$ 0.00	

<sup>(1)</sup> See "Non-GAAP Measures"

### Operating Results for the six months ended June 30:

	2009	2008	\$ Change	% Change
Revenue	\$ 33,231,565	\$ 37,307,022	\$ (4,075,457)	(11%)
Operating and administrative expenses <sup>(1)</sup>	29,686,678	34,133,736	(4,447,458)	(13%)
EBITDA <sup>(1)</sup>	\$ 3,544,887	\$ 3,173,286	\$ 371,601	12%
	10.7%	8.5%	2.2%	
Amortization of long-term assets	\$ 429,562	\$ 423,145	\$ 6,417	2%
Interest expense	96,368	285,635	(189,267)	(66%)
Interest income	(58,582)	(14,182)	44,400	313%
Share-based compensation	420,933	401,591	19,342	5%
	888,281	1,096,189	(207,908)	(19%)
Earnings before income taxes	2,656,606	2,077,097	579,509	28%
Income taxes	925,873	658,706	267,167	41%
Net earnings	\$ 1,730,733	\$ 1,418,391	\$ 312,342	22%
Basic and Diluted earnings per share	\$ 0.04	\$ 0.03	\$ 0.01	

# Pareto Corporation

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

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### Second Quarter Results

#### Revenue

In the second quarter of 2009, the Company generated \$17.0 million of revenue compared to \$20.8 million in 2008, a decrease of \$3.8 million or 18%. Revenue decreased this quarter in our incentives business, down \$4.3 million or 55% and in the field merchandising business, down \$0.9 million or 28% over the same period last year. Revenue increased this quarter in the retail promotion business, up \$1.3 million or 30% and in managed services, up \$0.1 million over the same period last year. Revenue was flat to prior year in our direct marketing business.

For the six month period ended June 30, 2009, revenues decreased by 11% or \$4.0 million to \$33.2 million from \$37.3 million in the same period last year. Revenue decreased in our incentives business, down \$4.2 million or 39%, in the field merchandising business, down \$1.7 million or 23% and in managed services, down \$0.2 million or 3% over the previous year. Revenue increased in the retail promotion business, up \$2.1 million or 25% over the previous year. Revenue was flat to prior year in our direct marketing business.

Increased revenues from the retail promotion business were driven by new business that we have won as well as increasing volume with our existing clients. Our retail promotion 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, as evidenced by this year's results. The field merchandising business decline was due mainly to a large \$2.5 million project undertaken during the first half of 2008 with new business in 2009 spread more evenly throughout the year. The managed services business decline in the first half of the year was due to reduced programs provided to one of our clients within the automotive sector; however, the overall customer margins have been minimally reduced this year as the reduction was not in our services but in items that, under our contract, are essentially passed through at cost.

Our incentive business is the one area of our business that has been most adversely impacted by the economic downturn. Several customers have cancelled large scale events for 2009, opting for smaller scale incentive programs or deferring until 2010. Our current year decline is due to two of our largest incentive event programs that took place in the second quarter of 2008 and did not recur this year, but given that events have large cost components together with our focus on cost reduction and improved operating efficiencies, margins have not been impacted at the same levels.

Pareto expects its incentive travel business to continue to be adversely impacted in the third quarter due to the cancellation of one of its largest event programs, but the Company is expecting improvements in revenues in all of its other offerings to more than offset. As a result, the Company expects total revenue to show a moderate increase compared to Q3 2008. Furthermore, given its ongoing success in achieving cost reduction and improved operating efficiencies, and in maintaining margins in areas where revenue has decline, the company expects third quarter EBITDA to be significantly higher than in Q3 2008, with EBITDA margins at least as high as the 12.5% recorded in Q2 2009.

In the second quarter of 2009 the Company's mix of revenues by business model was as follows:

- ❖ Fixed fee basis - \$ 2.6 million or 15% ( \$2.4 million or 12% in 2008)
- ❖ Time and materials basis - \$11.0 million or 64% (\$10.4 million or 50% in 2008)
- ❖ Resale of reward units - \$3.4 million or 20% (\$7.7 million or 37% in 2008)

#### Operating and Administrative Expenses

# Pareto Corporation

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

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In the second quarter of 2009, the Company incurred \$14.9 million in operating and administrative expenses compared to \$18.9 million in 2008, a decrease of \$4 million or 21%. As a percentage of revenue, operating and administrative expenses represented 87.5% in the second quarter of 2009 as compared to 90.4% 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.

For the six month period ended June 20, 2008, operating and administrative expenses decreased by 13% to \$29.7 million compared to \$34.1 million in the same period last year. As a percentage of revenue, operating and administrative expenses represented 89.3% in 2009 as compared to 91.5% in 2008.

Expenses decreased as a percentage of revenue in the second quarter due to mix of services sold, reduced selling, general and administrative costs resulting from cost cutting measures and improved operating efficiencies, and procurement savings.

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 second quarter of 2009, the Company generated \$2.1 million of EBITDA (see "Non-GAAP Measures"), compared with \$2.0 million in 2008, an increase of 7%. EBITDA as a percentage of revenue represented 12.5% in 2009 compared to 9.6% in 2008. This increase in percentage is due to reduced infrastructure costs, mix of revenues and greater operating efficiencies. For the six month period ended June 30, 2009, the Company generated \$3.5 million of EBITDA, compared to \$3.2 million in 2008. EBITDA as a percentage of revenue represented 10.7% in 2009 compared to 8.5% in 2008.

EBITDA percentage has improved as a percentage of revenue due to reduced infrastructure costs, mix of revenues and greater operating efficiencies.

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

In the second quarter of 2009, the Company incurred amortization, interest and share-based compensation expenses of \$0.5 million compared to \$0.6 million in 2008, a decrease of \$0.1 million or 18%. This decrease was driven primarily by interest expenses as a result of lower debt levels compared to prior year. Share-based compensation expense increased by 19% reflecting the impact of timing on vesting of options and restricted stock units granted. Amortization of long-term assets was comparable to prior year amounts.

For the six month period ended June 30, 2009, total amortization, interest and share-based compensation expenses decreased by \$0.2 million or 19% compared to the same period last year, due mainly to lower interest costs.

### Income Taxes

In the second quarter of 2009, the Company incurred income tax expenses of \$0.6 million, compared to \$0.5 million in 2008. Income taxes represented 36% of earnings before tax compared to 32% in 2008, as the prior year tax provision has been adjusted for actual tax returns completed in the current quarter. For the six month period, the overall tax rate was 35% compared to 32% in 2008. The Company expects to incur an effective tax rate of approximately 34% during 2009.

### Net earnings

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

In the second quarter of 2009, the Company generated \$1.1 million of net earnings compared to \$1.0 million in 2008, an increase of \$0.1 million. For the six month period ended June 30, 2009, net earnings of \$1.7 million represented a 22% increase compared to \$1.4 million in the same period last year. This increase is the result of improved EBITDA margins and lower interest expenses. Net earnings as a percentage of revenue was 6.3% for the second quarter compared to 4.6% in 2008. For the six month period, net earnings as a percentage of revenue was 5.2% compared to 3.8% in 2008. Excluding the effect of income taxes, earnings before income taxes were 9.8% of revenue for the quarter compared to 6.8% in 2008, and 8.0% of revenue for the six month period compared to 5.6% in 2008.

### Earnings per share

Basic and diluted earnings per share were \$0.02 for the second quarter of both 2009 and 2008. For the six month period ended June 30, basic and diluted earnings per share were \$0.04 in 2009 compared to \$0.03 in 2008.

## Liquidity and Capital Resources

### Financial Position

	June 30, 2009	December 31, 2008	\$ Change	% Change
Bank Indebtedness	\$ 2,140,682	\$ 654,573	1,486,109	227%
Capital lease obligation	582,503	709,279	(126,776)	(18%)
Total debt	2,723,185	1,363,852	1,359,333	50%
Shareholders' equity	28,159,020	27,429,969	847,540	3%
Total capitalization	\$ 30,882,205	\$ 28,793,821	\$ 2,206,873	8%
Working capital position	\$ 1,461,433	\$ 943,397	\$ 518,036	55%

Debt:Shareholders' equity	0.10:1	0.05:1
Debt:Total Capitalization	0.09:1	0.05:1
Debt:EBITDA	0.3:1	0.2:1

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.

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.

On March 4, 2009, the Company initiated a quarterly cash dividend of \$0.015 per issued and outstanding share, with the

# Pareto Corporation

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

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inaugural dividend payable on April 15, 2009, to shareholders of record at the close of business on March 31, 2009. On June 11, 2009, the Company declared another cash dividend of \$0.015 per issued and outstanding share, payable on July 15, 2009, to shareholders of record at the close of business on June 30, 2009.

On August 7, 2009 the Company announced that its Board of Directors authorized an offer to offer to purchase from shareholders for cancellation, for an aggregate purchase price of not more than \$10,000,000 in cash, up to 13,333,333 of the issued and outstanding common shares of Pareto ("Shares"), at a purchase price of not less than \$0.75 per Share and not more than \$1.00 per Share. The Offer will proceed by way of a "modified Dutch An issuer bid circular containing full details of the offer and procedures for tendering common shares will be filed on SEDAR and mailed to shareholders on or about August 12, 2009. The offer will expire 5:00pm (Toronto Time) on September 17, 2009 unless extended by the Company. The funds required to pay for all Shares validly deposited to the Offer will be provided through a new credit facility with a major Canadian chartered bank. The credit facility is comprised of a three year term loan in the amount of up to \$15 million and a line of credit in the amount of \$10 million. The term loan bears interest at an annual rate starting at banker's acceptance rate plus 3.25% and is repayable in quarterly installments starting at an annual rate of 10% of the amount drawn. The line of credit bears interest at an annual rate equal to prime rate plus 1% and is repayable in monthly interest-only payments. The line of credit will be used initially to repay funds borrowed on the company's existing line of credit and subsequently for operating purposes. Pareto expects to repay any funds borrowed under the credit facility using internally generated cash flow.

The Company may consider acquisition opportunities. Depending on the size of an acquisition, the Company may need to secure external capital in addition to the current credit facilities, 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 quarter. The Company currently has no externally imposed capital restrictions.

### Operating activities

The Company continues to generate strong cash flows from operations. In the second quarter of 2009, Pareto's operating activities generated \$1.0 million of cash flow compared to \$0.8 million of cash flow generated in 2008, an increase of \$0.2 million. Operating activities before changes in non-cash operating accounts generated \$1.7 million of cash flow in 2009 compared to \$1.8 million in 2008, a decrease of \$0.1 million. This decrease is due mainly to income taxes (\$0.2 million), as the Company is incurring cash taxes whereas tax losses were available during the first six months of last year. Non-cash operating accounts used \$0.7 million of cash flow in 2009 compared to utilizing \$1.0 million in 2008, an increase of \$0.3 million.

For the six month period ended June 30, 2009, operating activities generated \$1.4 million of cash flow compared to \$1.0 million of cash flow generated in 2008, an increase of \$0.4 million. Operating activities before changes in non-cash operating accounts generated \$2.6 million of cash flow in 2009 compared to \$2.9 million in 2008, a decrease of \$0.3 million, with the impact of cash taxes versus prior year losses available accounts for \$0.5 million of decrease. Non-cash operating accounts utilized \$1.2 million of cash flow in 2009 compared to \$1.8 million in 2008, a decrease of \$0.6 million.

Our accounts receivable balance showed a \$2.7 million decrease during the first six months of the year to \$13.8 million from \$16.5 million at December 31, 2008. This figure represents an average Days Sales Outstanding of 70 days compared to 75 days at December 31, 2008. This marks a trend of ongoing improvement as we continue to target receivables as an area of managing our working capital.

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### Investing activities

During the second quarter 2009, investing activities utilized \$0.4 million of cash flow, using \$0.2 million for capital asset additions and \$0.2 million as a short term loan to PeerSet Inc. ("PeerSet"), formerly known as Ontogenix Inc., compared to \$0.5 million for the same period last year. In 2008, \$0.1 million was utilized for payment of outstanding acquisition notes payable and \$0.4 million was utilized for capital asset additions.

For the six month period ended June 30, 2009, investing activities utilized \$0.5 million of cash flow, using \$0.3 million for capital asset additions and \$0.2 as a short term loan to PeerSet, compared to \$4.1 million for the same period last year. In 2008, \$3.0 million was utilized for payment of outstanding acquisition notes payable from the Secom Plus Inc. acquisition in 2006, \$0.6 million was utilized to provide financing to PeerSet, in return for a three year convertible debenture, and \$0.5 million was utilized for capital asset additions.

### Financing activities

In the second quarter of 2009 financing activities utilized \$0.7 million of cash flow compared to \$0.3 million in the same period last year. During the current quarter, \$0.1 million was utilized as payment of capital lease obligations and \$0.6 million was utilized to pay dividends, whereas \$0.3 million was utilized in the prior year for purchases of the Company's shares under a normal course issuer bid (NCIB).

For the six month period ended June 30, 2009, financing activities utilized \$2.5 million of cash flow compared to \$1.2 million in the same period last year, an increase of \$1.3 million. In 2009, \$0.1 million was utilized for payment of capital lease obligations and \$2.4 million was utilized to pay dividends. In 2008, \$0.1 million was utilized for payment of capital lease obligations and \$1.0 million was utilized to repurchase 1.3 million common shares of the Company pursuant to its NCIB.

### Off-Balance Sheet Arrangements

The Company has no off-balance sheet arrangements, other than operating leases and capital asset purchase commitments 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	\$ 582,503	\$ 582,503	\$ -	\$ -	\$ -
Capital asset purchase commitments	1,505,497	\$ 1,505,497	\$ -	\$ -	\$ -
Operating leases	5,983,079	858,121	1,569,143	1,319,807	2,236,009
Total contractual obligations	\$ 8,071,079	\$ 2,946,121	\$ 1,569,143	\$ 1,319,807	\$ 2,236,009

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

### Outstanding Share Data

At June 30, 2009 an unlimited number of common shares were authorized and 43,010,481 (December 31, 2008 – 42,931,148) common shares were outstanding. The Company has 2,719,209 options currently outstanding to acquire common shares pursuant to its Option Plan of which 1,018,054 are exercisable. The Company also has 2,024,285 restricted stock units currently outstanding, all convertible to common shares on a one to one basis. See note 12 to the consolidated financial statements for further information on the Company's share capital.

### Non-GAAP Earning Measures

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

	Quarter ending June 30, 2009	Quarter ending June 30, 2008
Net earnings	\$ 1,073,962	\$ 961,617
Income Taxes	593,414	462,904
Amortization of capital assets and intangible assets	209,733	211,416
Interest and financing charges	25,377	164,460
Share-based compensation	231,274	193,811
EBITDA	\$ 2,133,760	\$ 1,994,208

	Six months ending June 30, 2009	Six months ending June 30, 2008
Net earnings	\$ 1,730,733	\$ 1,418,391
Income Taxes	925,873	658,706
Amortization of capital assets and intangible assets	429,562	423,145
Interest and financing charges	37,786	371,453
Share-based compensation	420,933	401,591
EBITDA	3,544,877	3,173,286

### Transactions with Related Parties

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.

In March 2008, the Company received a partial repayment of \$25,000 on the loan to an executive of the Company issued on May 2006 for the purchase of common shares of the Company.

### Risks and Uncertainties

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

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### 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.

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. During the six month period ending June 30, 2009 Pareto generated revenues from one client representing greater than 10% of revenues (25%, 2008 – 25%). 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

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

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risk of key client dependence by winning new clients through strategic acquisitions and internal growth.

### Credit Risk

At June 30, 2009, accounts receivable represented 31% of consolidated assets (December 31, 2008 – 36%). 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. 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 in the 2009 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.

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

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### 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.

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 impairment in goodwill and 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.

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

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### 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 June 30, 2009, 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 June 30, 2009. 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.

### 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 June 30, 2009.

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 quarter ended June 30, 2009, 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.

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### Recent Accounting Developments

#### d) New accounting policies

**Goodwill and Intangible Assets** – In February 2008, the CICA issued Handbook Section 3064, Goodwill and Intangible Assets, replacing the existing guidance on goodwill and other intangible assets and research and development costs. The standard is effective for interim and annual financial statements for fiscal years beginning on or after October 1, 2008. The new standard established revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets and provides guidance for the treatment of various preproduction and start-up costs, and requires that these costs be expensed as incurred.

The Company applied the new accounting standard retrospectively at the beginning of its current fiscal year, with restatement of prior periods. Certain assets, notably, start-up and other deferred costs previously included on the Company's balance sheet as Deferred Costs prior to the Company's current fiscal year no longer meet the new recognition or measurement criteria and the definition of an asset were removed from the consolidated balance sheets in accordance with CICA Handbook Section 1506, Accounting Changes. The balance of any such Deferred Costs as at the end of the Company's 2008 fiscal year was reflected as a charge to opening retained earnings.

**Net Earnings Impact** – For the three months ending June 30, 2008, the implementation of the new standard resulted in an increase the Company's pre-tax net earnings of \$35,086, a decrease to future income taxes of \$11,578 and an increase in net earnings of \$46,664. For the six months ending June 30, 2009, the implementation of the new standard resulted in an increase to the Company's pre-tax net earnings of \$74,875, a decrease to future income taxes of \$24,709 and an increase in net earnings of \$99,584.

**Balance Sheet Adjustments** – The impact on balances as at December 31, 2008 was a non-cash reduction of \$118,490 to opening retained earnings (\$245,825 at January 1, 2008 and \$ 192,905 at April 1, 2008), a \$159,838 reduction in deferred costs and a \$41,348 reduction in long-term future income tax liabilities

#### e) 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.

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

**Business Combinations and Minority Interest** - In October of 2008, the CICA issued Handbook Section 1582, Business Combinations (CICA 1582), concurrently with Handbook Sections 1601, Consolidated Financial Statements (CICA 1601), and 1602, Non-controlling Interests (CICA 1602). CICA 1582, which replaces Handbook Section 1581, Business Combinations, establishes standards for the measurement of a business combination and the recognition and measurement of assets acquired and liabilities assumed. CICA 1601, which replaces Handbook Section 1600, carries forward the existing Canadian guidance on aspects of the preparation of consolidated financial statements subsequent to acquisition other than non-controlling interests. CICA 1602 establishes guidance for the treatment of non-controlling interests subsequent to acquisition through a business combination. These new standards are effective for the Company's interim and annual consolidated financial statements commencing on September 1, 2011 with earlier adoption permitted as of the beginning of a fiscal year. The Company is assessing the impact of the new standards on its consolidated financial statements.

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### SUMMARY OF QUARTERLY AND ANNUAL RESULTS

Quarter ended 30 June, 2009	Mar 31	Jun 30	Sep 30	Dec 31	Last 12 months
<b>Quarterly information:</b>					
Revenue	\$ 16,182,996	17,048,569			\$ 73,088,879
EBITDA <sup>1</sup>	1,411,127	2,133,760			8,426,042
EBITDA Margin	8.7%	12.5%			11.5%
Net earnings	656,770	1,073,962			3,971,204
Basic and diluted earnings per share <sup>2</sup>	0.015	0.02			0.09
Cash dividends declared	643,967	645,147			3,006,360

Year Ended 31 December, 2008	Mar 31	Jun 30	Sep 30	Dec 31	Total
<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	456,773	914,954	658,152	1,582,320	3,612,199
Basic and diluted earnings per share <sup>2</sup>	0.01	0.02	0.02	0.04	0.08
<b>Annual information:</b>					46,171,038
Total assets					
Total long-term financial Liabilities, including current portion					1,363,852
Cash dividends declared					1,717,246

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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					45,586,523
Total long-term financial liabilities, including current portion					4,057,613
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 Incentives 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).