



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

March 4, 2010

Pareto Corporation

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

Management's Discussion and Analysis of Results of Operations and Financial Position ("MD&A") of Pareto Corporation ("the Company" or "Pareto"), dated March 4, 2010, summarizes the significant factors affecting the consolidated operating results, financial condition, liquidity and cash flows of Pareto for the year ended December 31, 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, 2009, 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 and on SEDAR at www.sedar.com.

Forward-looking Statements

The Company and its representatives periodically make written and spoken forward-looking statements, including those contained in this report. By their nature, forward-looking statements are subject to risks and uncertainties that could result in actual performance being materially different from anticipated results. The Company cautions readers, when making decisions, to consider the risks and uncertainties of forward-looking statements. The Company relies upon litigation protection for forward-looking statements.

Non-GAAP Measures

In this discussion and analysis, management uses "EBITDA" (earnings before amortization, net interest and finance charges, share-based compensation, 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 helps its clients sell more by implementing their Shopper Marketing strategies with optimal impact, inside and outside of the store. We deliver services on behalf of our clients that directly impact the way their customers buy. Pareto's focus is on the details of marketing programs, utilizing technology to drive efficient and effective marketing implementation. The Shopper Marketing products and services which Pareto offers to its clients can be grouped into those enhancing the Shopper Experience and those influencing Shopper Behaviors:

- Shopper Experience
 - In Store Messaging
 - Promotions & Special Events
 - Planograms/Merchandising
 -
- Shopper Behaviour
 - Direct to Shopper Messaging (Direct Marketing)
 - Incentives and Loyalty

Pareto provides measurable, quantifiable services that complement and support its clients' marketing and sales departments. The value proposition to the client is overall reduced promotion costs and the benefits of Pareto's management system in terms of reduced cycle times, program effectiveness and compliance, mass customization and data availability.

Pareto Corporation

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

Pareto is committed to continuing to develop and release proprietary technology that enables its clients to measure marketing program effectiveness. In a retail environment this reduces cycle time, increases compliance and lower costs. In an economic environment where marketing dollars are cautiously invested, Pareto believes that providing its clients with the metrics necessary to measure program effectiveness is essential. Pareto's technology provides the data to drive marketing investment decisions.

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 are typically sold on a fixed fee basis which includes in-store messaging, some promotions, direct marketing services, and special events. For example, the Company typically sells finished goods (such as in-store signage and direct mail) bundled with an end to end management system (which may include web or data management and distribution) for a fixed price per unit. 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.

Planograms/Merchandising services and some promotions programs are sold on a time and materials 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. Pareto operates a client-centric operating structure which allows the company flexibility to respond to the ever-changing needs of its clients. The Company is uniquely positioned to design an integrated solution that leverages all of its core capabilities or to execute individual marketing tactics when required. Pareto is the one-stop shop for clients who need to seamlessly integrate multiple marketing activities that influence shopper behavior at critical decision points. 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 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

Pareto Corporation

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

reduction programs, and achieve a more seamless interaction with the client personnel. We are shifting our focus towards more strategic relationships, and away from opportunistic or reactive business. We are striving to build enterprise-wide relationships.

Competition in the marketing industry is intense, and competitors range from small, owner-managed companies to diversified multinational agency groups. While the industry is highly fragmented overall, the trend for many years has been towards consolidation. While many companies may provide services which are similar to the Company's, Pareto's focus on shopper marketing 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 provides shopper marketing services that are designed to produce measurable results and help our clients sell more. While overall marketing budgets have been reduced during economic downturns, it is services like advertising or branding that tend to be viewed as being most dispensable. Conventional media has grown increasingly fragmented, making it more difficult for marketers to reach their target audiences. The traditional focus on brands and mass advertising are less effective. Recent research indicates that shopper marketing is the fastest growing segment of the marketing industry. Total in-store marketing expenditures are on the increase and are projected to continue to be a larger percentage of marketing budgets. Our customers are indicating that these in-store, or shopper marketing, programs are more effective than traditional programs and deliver the highest return on investment of any marketing programs. Shopper marketing solutions are designed to influence consumers' decisions at the point of sale and provide measurable sales lift.

Pareto provides incentive solutions, encompassing loyalty programs and events. 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.

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.

Pareto has not seen a significant impact on its operations in the last 12 months as a result of the current global economic situation. The Company's customer base includes blue chip clients that are reasonably diversified and poses minimal credit risk. Over the last 12 months, the Company has not experienced any significant collection problems on accounts receivable.

All of the Company's operations are located in Canada with little selling or 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 December 31:

	2009	2008	\$ Change	% Change
Revenue	\$ 19,539,986	\$ 21,730,884	\$ (2,190,898)	-10.1%
Operating and administrative expenses	16,295,886	18,621,596	2,325,710	12.5%
EBITDA ⁽²⁾	\$ 3,244,100	\$ 3,109,288	\$ 134,812	4.3%
	16.6%	14.3%	6.2%	
Amortization of long-term assets	\$ 379,676	\$ 229,052	\$ (150,624)	-65.8%
Interest expense	160,313	112,571	(47,742)	-42.4%
Interest income	(4,047)	(81,949)	(77,902)	-95.1%
Gain on disposal of long-term assets	(9,418)	-	9,418	100.0%
Impairment of convertible debenture	248,997	-	(248,997)	-100.0%
Share-based compensation	202,706	210,838	8,132	3.9%
	978,227	470,512	(507,715)	-107.9%
Earnings before income taxes	2,265,873	2,638,776	(372,903)	-14.1%
Income taxes	1,011,087	1,014,883	3,796	0.4%
Net earnings	\$ 1,254,786	\$ 1,623,893	\$ (369,107)	-22.7%
Basic earnings per share	\$ 0.031	\$ 0.038	\$ -0.007	-18.4%
Diluted earnings per share	\$ 0.030	\$ 0.036	\$ -0.006	-16.7%

Operating Results for the year ended December 31:

	2009	2008	\$ Change	% Change
Revenue	\$ 70,363,198	\$ 77,164,336	\$ (6,801,138)	-8.8%
Operating and administrative expenses ⁽¹⁾	60,902,385	69,109,895	8,207,510	11.9%
EBITDA ⁽²⁾	\$ 9,460,813	\$ 8,054,441	\$ 1,406,372	17.5%
	13.4%	10.4%	20.7%	
Amortization of long-term assets	\$ 1,015,237	\$ 882,330	\$ (132,907)	-15.1%
Non-recurring expenses ⁽¹⁾	-	182,391	182,391	100.0%
Interest expense	308,620	516,898	208,278	40.3%
Interest income	(110,039)	(102,508)	7,531	7.3%
Gain on disposal of long-term assets	(9,418)	-	9,418	100.0%
Impairment of convertible debenture	248,997	-	(248,997)	-100.0%
Share-based compensation	832,080	815,643	(16,437)	-2.0%
	2,285,477	2,294,754	9,277	0.4%
Earnings before income taxes	7,175,336	5,759,687	1,415,649	24.6%
Income taxes	2,694,695	2,073,072	(621,623)	-30.0%
Net earnings	\$ 4,480,641	\$ 3,686,615	\$ 794,026	21.6%
Basic earnings per share	\$ 0.112	\$ 0.086	\$ 0.026	30.2%
Diluted earnings per share	\$ 0.106	\$ 0.082	\$ 0.024	29.3%

⁽¹⁾ Operating and administrative expenses for 2008 exclude non-recurring expenses totaling \$182,391 for costs incurred during the third quarter of 2008 by the company for its September 18, 2008 terminated substantial issuer bid. ⁽²⁾ See "Non-GAAP Measures"

Pareto Corporation

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

Fourth Quarter and Annual Results

Revenue

In the fourth quarter of 2009, the Company generated \$19.5 million of revenue compared to \$21.7 million in 2008, a decrease of \$2.2 million or 10%. Revenue decreased this quarter in our incentives and loyalty services, down \$1.5 million or 21% and in the merchandising services, down \$1.8 million or 51% over the same period last year. Revenue increased this quarter in direct marketing services, up \$0.5 million or 20% and in our in-store messaging services, up \$0.2 million or 3%.

The merchandising service decline was due mainly to large non-recurring projects completed in the previous year as well as retailers deferring spending from the fourth quarter into 2010. The incentive and loyalty services are the one part of our business that has been most adversely impacted by the economic downturn. This decline is the result of programs completed in 2009 and not recurring. The increase in direct marketing services this quarter is the result of new business that we have won this year, which has offset declines in sales to financial services clients.

In 2009, revenues decreased by 8.8% or \$6.8 million to \$70.4 million from \$77.2 million in the same period last year. Revenue decreased in our incentives and loyalty services, down \$6.9 million or 29%, in the merchandising services down \$4.0 million or 27%. Revenue increased in in-store messaging services, up \$3.8 million or 14%, direct marketing services by \$1.1 million or 10%.

Increased revenues from the in-store messaging services were driven by new business that we have won as well as increasing volume with our existing clients. Our in-store messaging services 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. Increased revenues from direct marketing services are the result of new business that we have won this year, which has offset declines in sales to financial services clients.

The merchandising service decline was due mainly to a large \$2.5 million project undertaken during 2008 with similar projects not recurring in 2009, as well as, retailers deferring spending from the fourth quarter into 2010. Our incentive and loyalty services decline is the result of several customers cancelling large scale events for 2009, opting for smaller scale incentive programs or deferring until 2010. A number of our largest incentive event programs that took place in 2008 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.

At the beginning of 2009, in addition to our focus on cost reduction, we exited relationships with a number of customers where the service offerings were insufficiently profitable. The impact of these decisions are seen in 2009 through reduced revenues, but significantly improved margins with the removal of the insufficiently profitable business but also in the improved operating focus of our business.

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

- ❖ Fixed fee basis - \$ 10.9 million or 16% (\$15.9 million or 20% in 2008)
- ❖ Time and materials basis - \$42.5 million or 60% (\$37.6 million or 49% in 2008)
- ❖ Resale of reward units - \$16.9 million or 24% (\$23.7 million or 31% in 2008)

Pareto Corporation

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

Operating and Administrative Expenses

In the fourth quarter of 2009, the Company incurred \$16.3 million in operating and administrative expenses compared to \$18.6 million in 2008, a decrease of \$2.3 million or 12.5%. As a percentage of revenue, operating and administrative expenses represented 83.4% in the fourth quarter of 2009 as compared to 85.7% 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.

In 2009, operating and administrative expenses decreased by 11.9% to \$60.9 million compared to \$69.1 million in the same period last year. As a percentage of revenue, operating and administrative expenses represented 86.6% in 2009 as compared to 89.6% in 2008.

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

At the beginning of 2009, we had a focused effort to squeeze savings opportunities out of the business, which resulted in material costs reductions. Additionally, we exited relationships with a number of customers where the service offerings were insufficiently profitable. The impact of these decisions is seen in 2009 through significantly improved margins with the removal of the insufficiently profitable business but also in a sharper focus operationally.

We have invested significant capital into our production facility during the third quarter and have begun to see improved efficiencies for the customers utilizing this technology.

During 2009, we have undertaken a more focused effort to squeeze savings opportunities out of the business. As a result, we have found material cost reductions. We continue to strive for ways to ensure SG&A remains at an appropriate level.

EBITDA

In the fourth quarter of 2009, the Company generated \$3.2 million of EBITDA (see "Non-GAAP Measures"), compared with \$3.1 million in 2008, an increase of 4%. EBITDA as a percentage of revenue represented 16.6% in 2009 compared to 14.3% in 2008.

In 2009, the Company generated \$9.5 million of EBITDA, compared to \$8.1 million in 2008. EBITDA as a percentage of revenue represented 13.4% in fiscal 2009 compared to 10.4% in 2008. The Company believes that overall, this level of margin percentage will be maintained during 2010.

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

Amortization, Interest, Allowance for Impairment, Share-based Compensation and Non-recurring expenses

In the fourth quarter of 2009, the Company incurred amortization, interest, allowance for impairment of convertible debenture and share-based compensation expenses of \$1.0 million compared to \$0.5 million in 2008, an increase of \$0.5 million or 108%. This increase was driven primarily by an allowance set up for the impairment of convertible debentures, interest expenses as a result of higher debt levels assumed in the third quarter in connection with the substantial issuer bid compared to prior year and higher amortization of long-term assets resulting from the a significant investment in the third quarter of the year.

Pareto Corporation

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

In fiscal 2009, total amortization, interest, allowance for impairment of convertible debenture and share-based compensation expenses were at the same level compared to the same period last year. An allowance was set up for the impairment of convertible debentures in the fourth quarter of \$0.2 and an increase in amortization of \$0.1 due to the capital investment in the third quarter of \$200, however this was offset by lower interest costs, (\$0.2 million) due to lower debt levels throughout the first three quarters, non-recurring costs of \$0.2 million incurred in 2008 related to the cancelled substantial issuer bid.

The convertible debentures are not in arrears; however, based on an assessment of the credit quality of the borrower. At December 31, 2009, the Company recorded an allowance for loan impairment of \$248,997 and ceased recognizing interest income on the convertible debentures.

Income Taxes

In the fourth quarter of 2009 and 2008, the Company incurred income tax expenses of \$1.0 million. Income taxes represented 45% of earnings before tax compared to 39% in 2008, as the tax provision has been adjusted for prior year tax returns completed this fiscal year.

For the year, the overall tax rate was 37% compared to 36% in 2008. The Company anticipates the overall tax rate to be 35% in 2010.

Net earnings

In the fourth quarter of 2009, the Company generated \$1.3 million of net earnings, the compared to \$1.6 million in 2008, a decrease of \$0.3 million or 22.7%. In 2009, net earnings of \$4.5 million represented a 22% increase compared to \$3.7 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 6.4% for the fourth quarter compared to 7.5% in 2008. For the twelve month period, net earnings as a percentage of revenue was 6.4% compared to 4.8% in 2008. Excluding the effect of income taxes, earnings before income taxes were 11.6% of revenue for the quarter compared to 12.1% in 2008, and 10.2% of revenue for the twelve month period compared to 7.5% in 2008.

Earnings per share

Basic and diluted earnings per share were \$0.031 and \$0.030 for the fourth quarter 2009 compared to and \$0.038 and \$0.036 respectively, for 2008. For the year, basic and diluted earnings per share were \$0.112 and \$0.106 in 2009 compared to \$0.086 and \$0.082 respectively, in 2008.

Pareto Corporation

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

Liquidity and Capital Resources

Financial Position

	December 31, 2009	December 31, 2008	\$ Change	% Change
Bank Indebtedness	\$ 415,602	\$ 654,573	(238,971)	-37%
Long-term loans	11,541,099	-	11,541,099	100%
Capital lease obligation	-	709,279	(709,279)	-100%
Total debt	11,956,701	1,363,852	10,592,849	777%
Shareholders' equity	18,869,034	27,311,479	(8,442,445)	-30%
Total capitalization	\$ 30,825,735	\$ 28,675,331	\$ 2,150,404	8%
Working capital position	\$ 1,026,258	\$ 943,396	\$ 82,862	9%

Debt:Shareholders' equity	0.63:1	0.05:1
Debt:Total Capitalization	0.39:1	0.05:1
Debt:EBITDA	1.26:1	0.17:1

Sources of short-term liquidity include cash provided by operating activities, a \$10 million operating line of credit secured by a general security agreement over the assets of Pareto and its subsidiaries, which is repayable on demand, and a \$15 million term loan facility.

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

The Company's policy is to maintain a strong capital base and ensure that financial flexibility is present to increase shareholder value through organic growth and selective acquisitions as well as allow the Company to respond to changes in economic and/or marketplace conditions. Furthermore, the Company manages its capital to endeavor that it can continue with its dividend policy. In order to maintain or adjust its capital structure, the Company may issue new shares, purchase shares for cancellation pursuant to a normal course issuer bid, raise debt or refinance existing debt with different characteristics. Although there are no externally imposed capital requirements, the Company is subject to certain covenants on its credit facilities which include a ratio to maintain shareholders' equity, and EBITDA⁽¹⁾ at a certain level. At December 31, 2009, the Company is in compliance with those covenants.

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 December 15, 2009, the company declared a special cash dividend of \$0.04 per issued and outstanding share payable on January 15, 2010, to shareholders of record at the close of business on December 31, 2009.

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 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 September 15, 2009, the Company declared a quarterly dividend of \$0.015 per issued and outstanding share, payable on October 15, 2009, to shareholders of record at the close of business on September 30, 2009. On December 15, 2009, the Company declared a quarterly dividend of \$0.015 per issued and outstanding share, payable on January 15, 2010 to shareholders of record at the close of business on December 31, 2009.

Pareto Corporation

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

On September 9, 2009, the Company entered into 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 \$15 million and a revolving 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 Company is in compliance with the covenants of the long term credit facility at September 30, 2009. The revolving 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.

On September 17, 2009, the Company announced the results of its "modified Dutch Auction" offer previously announced August 7, 2009 to purchase for cancellation up to \$10,000,000 of its common shares. The auction process was over-subscribed with 12,099,345 shares validly tendered to the Offer. Pursuant to the terms of the offer, the Company determined the purchase price to be \$0.95 per share and purchased for cancellation 10,526,315 shares for a total cost of \$10,000,000 plus transaction costs of \$170,150. These 10,526,315 shares represented approximately 24.4% of the total shares outstanding as of September 16, 2009. Shares deposited to the offer at or below \$0.95 per share were purchased for cancellation at the purchase price of \$0.95 per share subject to a proration factor of 95.3%. The payment was funded by the Company's new credit facility.

On January 12, 2010 the Company announced, that effective January 1, 2010, the Company acquired all of the outstanding shares of Direct Sales Force Inc. (DSF), a Canadian intercept marketing and sales company. The initial purchased price totaled \$5,570,145, comprised of \$4,107,982 in cash and 1,539,119 common shares with a fair value of \$1,462,163 at that date. Additional consideration to a maximum of approximately \$4,178,000 could be payable over a two-year period contingent upon DSF achieving certain future growth performance benchmarks. A total of 100,000 stock options were issued to employees of DSF, with terms and conditions in accordance with the Company's stock option plan.

While the overall debt position increased significantly, the overall approach to capital management did not change during the year.

Operating activities

The Company generates strong cash flows from operations. In the fourth quarter of 2009, Pareto's operating activities generated \$2.4 million of cash flow compared to \$4.4 million of cash flow generated in 2008, a decrease of \$2 million. Operating activities before changes in non-cash operating accounts generated \$2.2 million of cash flow in 2009 and 2008. Non-cash operating accounts generated \$0.3 million during the quarter compared to \$2.3 million generated during the same period in 2008.

In 2009, operating activities generated \$5.7 million of cash flow compared to \$7.2 million of cash flow generated in 2008, a decrease of \$1.5 million. Operating activities before changes in non-cash operating accounts generated \$6.7 million of cash flow in 2009 compared to \$6.5 million in 2008, an increase of 0.2 million. This increase was mainly due to increased net earnings for the twelve month period of \$0.8 million, the non-cash impact of the allowance set up for the impairment of convertible debentures of \$0.3 and the increase in capital assets amortization of \$0.1, offset by the impact of cash taxes versus prior year losses available of \$0.8 million and a one time non-cash leasehold inducement of \$0.2 million received in 2008. Non-cash operating accounts utilized \$1.0 million of cash flow in 2009 compared to \$0.7 million generated in 2008, a decrease of \$1.7 million.

Our accounts receivable balance showed a \$2.3 million increase during the twelve months of the year to \$18.8 million from \$16.5 million at December 31, 2008. This figure represents an average Days Sales Outstanding of 96 days compared to 70 days at December 31, 2008.

Pareto Corporation

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

Investing activities

During the fourth quarter 2009, investing activities utilized \$0.2 million of cash flow, using \$0.3 million for capital asset additions to our production facility, used \$0.05 million for internally developed software, and \$0.15 million as a short term loan to Peerset Inc. ("Peerset"), offset by the \$0.1 million proceeds from the disposal of a capital asset, compared to a utilization of \$2.1 million for the same period last year. In 2008, \$2 million was utilized for payment of outstanding acquisition notes payable, and \$0.1 million used for capital asset additions.

In 2009, investing activities utilized \$2.6 million of cash flow, using \$2.1 million for capital asset additions, \$0.1 million for internally developed software and \$0.5 as a loan to Peerset, offset by the \$0.1 proceeds from the disposal of a capital asset and a \$0.1 million repayment of a loan receivable, compared to a utilization of \$6.3 million for the same period last year. In 2008, \$5.1 million was utilized for payment of outstanding acquisition notes payable from the Secom Plus Inc. acquisition in 2006, \$0.7 million was utilized to provide financing to Peerset, in return for a three year convertible debenture, used \$0.7 million for utilized for capital asset additions offset by \$0.2 million provided by cash lease inducements.

Financing activities

In the fourth quarter of 2009 financing activities used \$0.8 million of cash flow compared to \$0.01 million in the same period last year. During the current quarter, \$0.3 million was used for the scheduled repayment of the three year term loan drawn out of the new credit facility and \$0.5 million was utilized to pay dividends.

In 2009, financing activities utilized \$2.8 million of cash flow compared to \$1.2 million in the same period last year, an increase of \$1.6 million. In 2009, \$11.5 million was provided by a three year term loan drawn out of the new credit facility. This was offset by \$10.2 million utilized to fund the Company's substantial issuer bid, \$0.7 million was utilized as full payment of capital lease obligations and \$3.5 million was utilized to pay dividends. In 2008, \$0.3 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 under a normal course issuer bid.

Off- Balance Sheet Arrangements

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

Contractual Obligations

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

	Payments due by period				
	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
Term loan	\$ 11,700,000	\$ 1,350,000	\$ 10,350,000	\$ -	\$ -
Operating leases	6,179,555	1,097,795	1,850,405	1,324,397	1,906,959
Total contractual obligations	\$ 17,879,555	\$ 2,447,795	\$ 12,200,405	\$ 1,324,397	\$ 1,906,959

Outstanding Share Data

At December 31, 2009 an unlimited number of common shares were authorized and 32,584,166 (34,139,952 at March 4, 2010) common shares were outstanding. The Company had 2,654,209 options (2,687,653 at March 4, 2010) outstanding to acquire common shares pursuant to its Option Plan of which 1,219,418 (1,202,751 at March 4, 2010) are exercisable. The Company also has 1,924,285 restricted stock units currently outstanding, all convertible to common shares on a one to one basis. See note 13 to the consolidated financial statements for further information on the Company's share capital.

Pareto Corporation

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

Non-GAAP Earning Measures

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

	Year ending December 31, 2009	Year ending December 31, 2008
Net earnings	\$ 4,480,641	\$ 3,686,615
Income Taxes	2,694,695	2,073,072
Amortization of capital assets and intangible assets	1,015,237	882,330
Interest	198,581	414,390
Non-recurring expenses ⁽¹⁾	-	182,391
Gain on disposal of long-term assets	(9,418)	-
Impairment of convertible debentures	248,997	-
Share-based compensation	832,080	815,643
EBITDA	\$ 9,460,813	\$ 8,054,441

⁽¹⁾ Non-recurring expenses relate to costs incurred during the third quarter of 2008 by the company for its September 18, 2008 terminated substantial issuer bid.

Transactions with Related Parties

In 2009, the Company received repayment of \$100,000 on a loan to an executive of the Company issued May 2006 for the purchase of common shares of the Company.

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.

Risks and Uncertainties

Economic Uncertainty

The marketing services industry is subject to the effects of economic downturns. The Company is also exposed to the risk of clients changing their business plans or reducing their budgets for the Company's services. As a result, the Company's business, financial condition, and operating results may be affected in a material adverse manner.

Access to Capital Resources

Management considers the Company's capital resources adequate to meet the Company's operating, capital expenditure, and financing requirements. While the Company expects to generate positive cash flow from operations, the Company may consider acquisition opportunities. Depending on the size of an acquisition, the Company may need to secure external capital, in the form of debt or share equity, to finance the acquisition. The incurrence of additional indebtedness will result in increased interest expense.

Pareto Corporation

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

Competition

The marketing services industry is highly competitive. The Company has competition in all major markets in which it does business from competitors that range from large multinational agencies to smaller, regional agencies. The Company must compete with these companies, firms and agencies in order to maintain existing client relationships and to obtain new clients and assignments. Competitive factors include account management and creative capabilities and reputation, management, personal relationships, quality and reliability of service, and expertise in particular niche areas of the marketplace. As the Company continues to expand through strategic acquisitions or organic growth, this may reduce the number of competitors in the market; however the success achieved may be a springboard for other companies to enter the market, therefore the competitive landscape is ever fluctuating and difficult to predict.

Dependence Upon a Limited Number of Clients

Although the Company has a significant number of clients, a relatively small number of them contribute the majority of the Company's revenue and gross profit. In 2009 Pareto generated revenues from one client representing greater than 10% of revenues (25%, 2008 – 27%). The Company's current contract with this customer has a multi year term.

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 has been historically successful in maintaining and renewing contracts. The Company also reduces the risk of key client dependence by winning new clients through strategic acquisitions and internal growth.

Credit Risk

The company's exposure to credit risk in relation to its financial assets is through cash, accounts receivable, and loans receivable. The Company's credit risk is primarily attributable to its trade receivables. 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. At December 31, 2009, accounts receivable represented 38% 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 bodied 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.

Pareto Corporation

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

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.

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. The amounts disclosed in the balance sheet are net of allowances for bad debts, which are established based on the specific credit risk associated with the customer and other relevant information. The allowance for doubtful accounts as at December 31, 2009 is \$120,937 (2008 - \$109,053). The net change during the year ended December 31, 2009 was \$11,884 with \$90,183 included in operating and administrative expenses. The balance of trade accounts receivable includes \$5,941,162 (2008 - \$5,719,640) that is overdue due and not impaired.

Valuation of Loans Receivable

Investments recorded as impaired loans are accounted for at their face amount net of the allowance for loan impairment. When a loan is deemed to be impaired, its carrying amount is reduced to its estimated realizable amount which is measured by discounting the expected future cash flows at the effective interest rate inherent in the loans. The amount initially recognized as an impairment loan, together with any subsequent change, is charged to the allowance as an adjustment. The determination of an impairment allowance involves estimation of realizable amounts and future cash flows, and is therefore subject to measurement uncertainty. Changes in general economic conditions, the borrower's operations or credit quality could result in a material change in the carrying amount of the investments. At December 31, 2009, the Company recorded an allowance for loan impairment of \$248,997 and ceased recognizing interest income on the convertible debentures.

Pareto Corporation

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

Goodwill and Intangible Assets

Goodwill and intangible assets represent the Company's most significant assets. Goodwill represents the consideration paid for acquisitions in excess of the fair market value of the net identifiable assets acquired. The carrying value of the goodwill is assessed at least annually by comparing it to its fair value. 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 4 year 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 and internally developed software. In the marketing services industry, customer relationship assets are typically long-term in nature, and therefore are amortized on a straight-line basis over an estimated useful life of 10 years. Internally developed software are costs to design, develop and implement proprietary software including fees paid to independent contractors, salaries and related expenses of personnel engaged in these activities, and are amortized on a straight-line basis over an estimated useful life of 5 years.

No impairment in goodwill and intangible assets were noted during the year-ended December 31, 2009.

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.

Pareto Corporation

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

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:

Cash and Bank indebtedness	Held for trading
Accounts receivable	Loans and receivables
Loans receivable	Loans and receivables
Accounts payable and accrued liabilities	Other financial liabilities
Long term loans	Other financial liabilities

The Company, on occasion, engages in transactions in foreign currencies, most commonly involving the US dollar and the Euro. The Company mitigates its risk by billing whenever possible in the relevant currency and, on occasion, enters into derivative instruments to manage this risk. At December 31, 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 December 31, 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 December 31, 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 December 31, 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.

Pareto Corporation

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

Recent Accounting Developments

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 end of the Company's 2008 fiscal year was reflected as a charge to opening retained earnings.

The implementation of the new standard resulted in a reduction in retained earnings at January 1, 2009 and 2008 of \$118,490 and \$245,825, respectively. The impact on balances at December 31, 2008 was a decrease in deferred costs of \$159,838 and decrease in long term future income tax liabilities of \$41,348.

b) Future Accounting Policy Changes

International Financial Reporting Standards

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

The Company has used internal resources to understand, identify and assess the overall effort required to adopt IFRS and has met with an external consultant 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.

Initiation phase – this phase starts with the selection of the key players in the changeover process and their participation in initial training sessions, a high level analysis between IFRS and the Company's accounting policies, and the preliminary identification of the major categories that may have a material impact to the Company's financial statements. The last stage of this phase involves the selection among the elections available under First Time Adopters of IFRS (IFRS1) it will make and identifying the mandatory exemptions required.

International Financial Reporting Standards (continued)

Detailed assessment phase – in this phase, the Company plans to prepare a model for IFRS financial statements including notes, compile financial information for comparative financial statements, and draft preliminary changes to its accounting policies as it acquires a more detailed understanding of those changes required under IFRS. The evaluation of the impact of the changes on information systems and processes, internal controls on financial information, controls and procedures for communicating information, as well as the impact on the Company's contractual undertakings in operating its business are also involved at this stage.

Design and implementation phase – in this phase, the Company starts to design and develop solutions to address the differences identified in the previous phases. Changes required to the existing accounting policies, financial reporting, information systems and business processes are identified, and modifications to contractual agreements are made as required. The final part of this phase involves implementing the changes identified and tested to ensure that any concerns are addressed prior to the changeover date.

These phases will often be in process simultaneously as they are applied to individual IFRS. To date, the project has nearing the completion of the initiation phase. Training sessions required for the IFRS changeover team including the stakeholders will be conducted throughout 2010 and 2011.

The following list contains the IFRS standards currently in effect which have been identified as having a potentially significant impact on the Corporation's consolidated financial statements. The evaluation is not definitive and the list is not exhaustive. Changes could be made during the changeover to IFRS following a more in-depth analysis and possible changes to existing standards.

- First-time adoption of International Financial Reporting Standards (IFRS 1)
- Income Taxes (IAS 12)
- Property, Plant and Equipment (IAS 16)
- Consolidated and Separate Financial Statements (IAS 27)
- Impairment of Assets (IAS 36)

At this time, the Company cannot quantify the impact of IFRS to its financial statements. As the conversion process is implemented, the Corporation will outline the consequences of the transition to IFRS in its financial disclosures.

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.

Pareto Corporation

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

SUMMARY OF QUARTERLY AND ANNUAL RESULTS

Year ended 31 December, 2009	Mar 31	Jun 30	Sep 30	Dec 31	Last 12 months
Quarterly information:					
Revenue	\$ 16,182,996	17,048,569	17,591,647	19,539,986	\$ 70,363,198
EBITDA ¹	1,411,127	2,133,760	2,671,826	3,244,100	9,460,813
EBITDA Margin	8.7%	12.5%	15.2%	16.6%	13.4%
Net earnings	656,770	1,073,962	1,495,122	1,254,786	4,480,641
Basic and diluted earnings per share ²	0.01	0.02	0.03	0.03	0.11
Annual information:					
Total assets					49,760,183
Total long-term financial Liabilities, including current portion					11,956,701
Cash dividends declared	643,967	645,147	488,762	1,792,140	3,570,016

Year Ended 31 December, 2008	Mar 31	Jun 30	Sep 30	Dec 31	Total
Quarterly information:					
Revenue	\$ 16,453,170	\$ 20,853,852	\$ 18,126,430	\$ 21,730,884	\$ 77,164,336
EBITDA ¹	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	456,775	961,617	644,330	1,623,893	3,686,615
Basic and diluted earnings per share ²	0.01	0.02	0.01	0.04	0.08
Annual information:					
Total assets					46,011,200
Total long-term financial Liabilities, including current portion					1,363,852
Cash dividends declared					1,717,246

Pareto Corporation

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

Year Ended 31 December, 2007	Mar 31	Jun 30	Sep 30	Dec 31	Total
Quarterly information:					
Revenue	\$ 14,716,308	\$ 24,347,041	\$ 14,345,259	\$ 20,931,405	\$ 74,340,013
EBITDA ¹	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 ²	0.01	0.03	0.00	0.03	0.07
Annual information:					
Total assets					45,586,523
Total long-term financial liabilities, including current portion					4,057,613
Cash dividends declared					-

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

² The quarterly figures do not add to the annual or LTM figures 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.



Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

**To the Shareholders of
Pareto Corporation**

We have audited the consolidated balance sheets of Pareto Corporation as at December 31, 2009 and 2008 and the consolidated statements of operations and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants, Licensed Public Accountants

Toronto, Ontario
March 4, 2010

Pareto Corporation
Consolidated Balance Sheets

As at	December 31 2009	December 31 2008 note 3
Assets		
Current assets		
Cash	\$ 48,623	\$ -
Accounts receivable	18,766,352	16,460,617
Inventories (note 4)	1,684,849	1,746,355
Prepaid expenses	645,236	466,040
Current future income tax assets (note 14)	41,982	38,167
	<u>21,187,042</u>	<u>18,711,179</u>
Loans receivable and other assets (note 5)	1,570,737	1,299,045
Long-term future income tax assets (note 14)	71,243	258,209
Capital assets (note 6)	4,591,668	3,340,697
Intangible assets (note 7)	1,280,916	1,343,493
Goodwill (note 8)	21,058,577	21,058,577
	<u>\$ 49,760,183</u>	<u>\$ 46,011,200</u>
Liabilities and Shareholders' Equity		
Current liabilities		
Bank indebtedness (note 9)	\$ 415,602	\$ 654,573
Accounts payable and accrued liabilities	11,035,642	12,032,040
Dividends payable	1,792,129	1,717,246
Deferred revenue	3,044,381	2,023,252
Income taxes payable (note 14)	2,413,569	983,915
Current portion of capital lease obligations (note 10)	-	314,275
Current portion of lease inducements (note 11)	42,482	42,482
Current portion of long-term loan (note 12)	1,350,000	-
	<u>20,093,805</u>	<u>17,767,783</u>
Long-term future income tax liabilities (note 14)	305,985	194,192
Long-term capital lease obligations (note 10)	-	395,004
Deferred lease inducements (note 11)	300,260	342,742
Long-term loan (note 12)	10,191,099	-
Total liabilities	<u>30,891,149</u>	<u>18,699,721</u>
Shareholders' equity		
Share capital (note 13(b))	12,635,777	16,501,855
Contributed surplus (note 13(f))	2,091,495	1,492,547
Retained earnings and accumulated other comprehensive income	4,141,762	9,317,077
Total shareholders' equity	<u>18,869,034</u>	<u>27,311,479</u>
	<u>\$ 49,760,183</u>	<u>\$ 46,011,200</u>

On Behalf of the Board:

(Signed) Kerry Shapansky-Director

(Signed) David Atkins-Director

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

Pareto Corporation
Consolidated Statements of Operations and Retained Earnings

For the years ended	December 31 2009	December 31 2008 note 3
Revenue	\$ 70,363,198	\$ 77,164,336
Operating and administrative expenses	60,902,385	69,292,286
	9,460,813	7,872,050
Amortization of capital assets	804,123	671,216
Amortization of intangible assets	211,114	211,114
Interest expense	308,620	516,898
Interest income	(110,039)	(102,508)
Gain on sale of capital asset	(9,418)	-
Impairment of convertible debentures (note 5(d))	248,997	-
Share-based compensation (note 13(f))	832,080	815,643
	2,285,477	2,112,363
Earnings before income taxes	7,175,336	5,759,687
Income taxes (note 14)	2,694,695	2,073,072
Net earnings and comprehensive income for the year	4,480,641	3,686,615
Retained earnings, beginning of year	9,317,077	7,877,806
Dividends declared	(3,570,016)	(1,717,246)
Excess price paid over carrying value on repurchase of common shares	(6,085,940)	(530,098)
Retained earnings, end of year	\$ 4,141,762	\$ 9,317,077
Basic earnings per share	\$ 0.112	\$ 0.086
Diluted earnings per share (note 15)	\$ 0.106	\$ 0.082
Weighted average number of common shares outstanding:		
Basic (note 15)	39,979,183	42,983,113
Diluted (note 15)	42,181,165	44,768,231

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

Pareto Corporation
Consolidated Statements of Cash Flows

For the years ended	December 31 2009	December 31 2008 note 3
Operating activities		
Net earnings for the year	\$ 4,480,641	\$ 3,686,615
Items not involving cash:		
Amortization of capital assets	804,123	671,216
Amortization of intangible assets	211,114	211,114
Amortization of lease inducement (note 11)	(42,482)	(39,191)
Non-cash interest	(90,189)	(74,548)
Non-cash lease expense	-	197,130
Share-based compensation (note 13 (f))	832,080	815,643
Impairment of convertible debentures	248,997	-
Gain on sale of capital asset	(9,418)	-
Future income tax provision (notes 14)	294,944	1,066,620
	6,729,810	6,534,599
Changes in non cash operating accounts (note 16)	(984,041)	697,456
	5,745,769	7,232,055
Investing activities		
Capital asset additions	(2,152,559)	(728,808)
Intangible asset additions	(148,538)	-
Proceeds from lease inducement (note 11)	-	227,285
Proceeds from capital asset disposal	106,885	-
Advances for loans receivable and other assets	(530,500)	(738,500)
Proceeds from loans receivable	100,000	-
Acquisitions, net of cash (note 8)	-	(5,066,668)
	(2,624,712)	(6,306,691)
Financing activities		
Dividends paid	(3,495,133)	-
Repayment of capital lease obligations	(709,279)	(281,665)
Proceeds from term loan (note 12)	11,841,099	-
Repayment of term loan (note 12)	(300,000)	-
Issuance of shares	-	98,500
Share issue costs	-	(2,051)
Repurchase of common shares	(10,170,150)	(1,026,430)
	(2,833,463)	(1,211,646)
Increase (Decrease) in cash for the year	287,594	(286,282)
Cash and Bank Indebtedness, beginning of year	(654,573)	(368,291)
Cash and Bank Indebtedness, end of year	\$ (366,979)	\$ (654,573)

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 shopper marketing 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 Pareto Merchandising 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 an accounts receivable balance 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 balance 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 they are 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:

Cash and Bank indebtedness	Held for trading
Accounts receivable	Loans and receivables
Loans receivable and other assets	Loans and receivables
Accounts payable and accrued liabilities	Other financial liabilities
Long-term loans	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.

Impaired loans and allowance for loan impairment

Investments recorded as impaired loans are accounted for at their face amount net of the allowance for loan impairment. When a loan is deemed to be impaired, its carrying amount is reduced to its estimated realizable amount which is measured by discounting the expected future cash flows at the effective interest rate inherent in the loans. The amount initially recognized as an impairment loan, together with any subsequent change, is charged to the allowance as an adjustment.

2. Summary of Significant Accounting Policies (continued)

Capital Assets

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

Computer software	30% declining balance
Computer hardware	30% declining balance
Furniture and fixtures	20% declining balance
Machinery and equipment	Straight-line over useful life of 4 to 10 years
Leasehold improvements	Straight-line over lease term of 3 to 10 years

Intangible Assets

Intangible assets consist of the value of the Company's acquired customer relationships and internally developed software. In the marketing services industry, customer relationship assets are typically long-term in nature, and therefore are amortized on a straight-line basis over an estimated useful life of 10 years. Internally developed software are costs to design, develop and implement proprietary software including fees paid to independent contractors, salaries and related expenses of personnel engaged in these activities, and are amortized on a straight-line basis over an estimated useful life of 5 years.

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 4 year 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.

2. Summary of Significant Accounting Policies (continued)

When the fair value of the reporting unit 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 reporting unit 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 substantively 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.

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, for direct marketing when delivered to the client's distribution agency, for event management when the event is completed, for fulfillment and distribution upon shipment to the client, and for 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.

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

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.

Foreign Currencies

Monetary assets and liabilities denominated in foreign currencies are translated at the exchange rates in effect as of the balance sheet date. Non-monetary assets and liabilities denominated in foreign currencies are translated at the exchange rate prevailing on the date the transactions occurred.

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 earnings.

3. **Changes in Accounting Policies**

c) **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 and 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.

The implementation of the new standard resulted in a reduction in retained earnings at January 1, 2009 and 2008 of \$118,490 and \$245,825, respectively. The impact on balances at December 31, 2008 was a decrease in deferred costs of \$159,838 and decrease in long-term future income tax liabilities of \$41,348.

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

Financial Instruments Disclosures – On January 1, 2009 the Company adopted the CICA amended Section 3862, Financial Instruments Disclosures, which include additional disclosure requirements about fair value measurements of financial instruments and enhanced liquidity risk disclosures. These amendments require a three level hierarchy that reflects the significance of the inputs used in making fair value measurements. Fair value of assets and liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than the quoted prices for which all significant inputs are based on observable market data, either directly or indirectly. Level 3 valuations are based on inputs that are not based on observable market data. The adoption of this new standard did not have a significant impact on the Company's consolidated financial statements.

Financial Instruments – Recognition and Measurement – On January 1, 2009 the Company adopted CICA amended Section 3855, Financial Instruments – Recognition and Measurement, which (i) changes the categories into which a debt instrument is required or permitted to be classified; (ii) changes the impairment model for held-to-maturity financial assets to the incurred credit loss model of CICA 3025, Impaired Loans; and (iii) requires reversal of previously recognized impairment losses on available-for-sale financial assets in specified circumstances. The adoption of this new standard did not have a significant impact on the Company's consolidated financial statements.

d) **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 begun to assess the impact of IFRS on its processes, information systems and consolidated financial statements. At this time, the Company cannot quantify the impact of IFRS to its financial statements. As the conversion process is implemented, the Company will outline the consequences of the transition to IFRS in its financial disclosures.

Business Combinations and Non-Controlling 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.

Pareto Corporation
Notes to Consolidated Financial Statements
December 31, 2009

4. Inventories

	December 31 2009	December 31 2008
Work in progress	\$ 1,299,367	\$ 623,226
Finished goods	385,482	73,129
Loyalty reward units	-	1,050,000
	\$ 1,684,849	\$ 1,746,355

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

5. Loans Receivable and Other Assets

	December 31 2009	December 31 2008
Employee loans receivable (a)	\$ 150,000	\$ 250,000
Employee loan receivable (b)	236,250	236,250
Employee loan receivable(c)	188,500	188,500
Convertible debentures (d)	995,987	624,295
	\$ 1,570,737	\$ 1,299,045

- (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, \$100,000 was repaid to the Company. The loans are carried at the carrying amount of \$150,000 which approximates their fair value. The loans bear 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.

5. Loans Receivable and Other Assets (continued)

- (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 convertible debenture repayable January 31, 2011. 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.

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 convertible debenture also repayable January 31, 2011. In accordance with the terms of the Subscription Agreement, a second amount of \$190,250 was provided to Peerset on July 13, 2009 ("Second Tranche Debenture") and a third amount of \$150,000 was provided to Peerset on December 22, 2009 ("Third Tranche Debenture") in return for a convertible debenture, with terms and conditions substantially similar to the First Tranche Debentures, including the maturity date thereof. The debentures bear 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 for all debentures into equity securities at any time upon a material business change event and/or liquidity event as defined in the agreement. The debentures are secured by a general security agreement over all the present and future assets of Peerset.

The Peerset debentures have been classified as loans and receivables. Management assessed the value of the conversion right to be insignificant at the date of issue and at December 31, 2009 based on an assessment of the conversion rights and term to expiry.

The convertible debentures are not in arrears; however, based on an assessment of the credit quality of the borrower, at December 31, 2009, the Company recorded an allowance for loan impairment of \$248,997 and ceased recognizing interest income on the convertible debentures. The determination of an impairment allowance involves estimation of realizable amounts and future cash flows, and is therefore subject to measurement uncertainty. Changes in general economic conditions, the borrower's operations or credit quality could result in a material change in the carrying amount of the investments.

At December 31, 2009, the carrying amount of the debentures include \$131,587 of accrued interest from the first issue date and approximates fair value based on the present value of estimated cash flows at current interest rates.

Pareto Corporation
Notes to Consolidated Financial Statements
December 31, 2009

6. Capital Assets

December 31, 2009	Cost	Accumulated Amortization	Net book Value
Computer software	\$ 1,911,676	\$ 1,143,219	\$ 768,457
Computer hardware	1,161,674	763,044	398,630
Furniture and fixtures	1,269,078	773,365	495,713
Machinery and equipment	2,253,583	370,104	1,883,479
Leasehold improvements	1,680,982	635,593	1,045,389
	\$ 8,276,993	\$ 3,685,325	\$ 4,591,668

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	1,237,567	655,880	581,687
Machinery and equipment	697,230	185,742	511,488
Leasehold improvements	1,621,015	478,516	1,142,499
	\$ 6,246,263	\$ 2,905,566	\$ 3,340,697

7. Intangible Assets

2009	Cost	Accumulated Amortization	Net book Value
Customer relationships	\$ 2,111,106	\$ 978,728	\$ 1,132,378
Internally developed software	148,538	-	148,538
Balance at December 31, 2009	\$ 2,259,644	\$ 978,728	\$ 1,280,916

2008	Cost	Accumulated Amortization	Net book Value
Customer relationships	\$ 2,111,106	\$ 767,613	\$ 1,343,493

Pareto Corporation
Notes to Consolidated Financial Statements
December 31, 2009

8. Goodwill

Balance at December 31, 2007	\$ 19,058,577
Additional consideration from acquisition of Secom Plus Inc.	2,000,000
Balance at December 31, 2008 and December 31, 2009	\$ 21,058,577

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. Additional 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.

9. Bank Indebtedness

On September 9, 2009, the Company entered into 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 \$15 million and a revolving line of credit in the amount of \$10 million. The revolving line of credit bears interest at an annual rate equal to prime rate plus 1% and is repayable in monthly interest-only payments. As at December 31, 2009, the prime rate was 2.25% (3.5% as of December 31, 2008).

10. Capital Lease Obligations

At December 31, 2009, the Company has no outstanding capital lease commitments. In 2009, the Company paid the outstanding amount of the leases funded by a term loan drawn from the Company's new credit facility discussed in note 12.

11. Deferred Lease Inducements

During the year ended December 31, 2008 the Company received various lease inducements under two of its ten-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	(22,728)	(19,754)	(42,482)
Balance at December 31, 2009	\$ 191,298	\$ 151,444	\$ 342,742
Less: Current portion	22,728	19,754	42,482
	\$ 168,570	\$ 131,690	\$ 300,260

Pareto Corporation
Notes to Consolidated Financial Statements
December 31, 2009

12. Long term loan

On September 21, 2009, the Company drew upon its new credit facility in note 9 to fund the Company's substantial issuer bid described in note 20 for \$10 million and to fund the purchase of capital assets and repayment of capital leases of \$2 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 term loan was initially recognized at its fair value including all directly attributable transaction costs. After initial recognition, the balance is measured at amortized cost using the effective interest method. The loan has a term of three years and is payable on September 8, 2012. The Company's effective interest rate for the year ended December 31, 2009 is 4.25%. The Company is in compliance with the covenants of the long-term loan as at December 31, 2009.

	Amount
Principal amount	12,000,000
Less: Transaction costs	(158,901)
Initial proceeds	11,841,099
Repayment	(300,000)
Sub-total	11,541,099
Less: Current portion	1,350,000
Balance at December 31, 2009	10,191,099

The aggregate future minimum principal payments are as follows:

	Amount
2010	1,350,000
2011	1,800,000
2012	8,550,000
Balance at December 31, 2009	11,700,000

13. 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)
Balance, December 31, 2008	42,931,148	\$ 16,501,855
Shares issued on redemption of restricted stock units	179,333	218,132
Shares repurchased for cancellation	(10,526,315)	(4,084,210)
Balance, December 31, 2009	32,584,166	12,635,777

Pareto Corporation
Notes to Consolidated Financial Statements
December 31, 2009

13. Share Capital (continued)

On September 17, 2009, the Company announced the results of its "modified Dutch Auction" offer previously announced August 7, 2009 to purchase for cancellation up to \$10,000,000 of its common shares. The auction process was over-subscribed with 12,099,345 shares validly tendered to the Offer. Pursuant to the terms of the offer, the Company determined the purchase price to be \$0.95 per share and purchased for cancellation 10,526,315 shares for a total cost of \$10,000,000 plus transaction costs of \$170,150. These 10,526,315 shares represented approximately 24.4% of the total shares outstanding as of September 16, 2009. Shares deposited to the offer at or below \$0.95 per share were purchased for cancellation at the purchase price of \$0.95 per share subject to a proration factor of 95.3%. The payment was funded by the Company's new credit facility (note 12).

e) 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 common shares 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.

Stock option transactions under the Plan, including options issued as incentives, during the year 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
Granted in 2009	797,630	0.50
Exercised in 2009	-	-
Expired in 2009	(65,000)	0.87
Forfeited in 2009	(152,110)	0.99
Options outstanding, December 31, 2009	2,654,209	\$ 0.87

	Number of Options Exercisable	Weighted Average Exercise Price
Options exercisable, December 31, 2008	751,938	\$ 1.11
Vested in 2009	604,145	1.04
Expired in 2009	(65,000)	0.87
Forfeited in 2009	(71,665)	1.01
Options exercisable, December 31, 2009	1,219,418	\$ 1.09

Pareto Corporation
Notes to Consolidated Financial Statements
December 31, 2009

13. Share Capital (continued)

The range of exercise prices for options outstanding and exercisable options at December 31, 2009 are as follows:

Exercise Price	Number Outstanding	Weighted Average Contractual Life	Number Exercisable	Weighted Average Contractual Life
\$0.50 - \$0.75	1,166,708	4.01	123,030	3.67
\$0.76 - \$1.00	44,167	0.30	44,167	0.30
\$1.01 - \$1.25	1,303,334	2.40	912,221	2.36
\$1.26 - \$1.53	140,000	1.32	140,000	1.32
	2,654,209	3.02	1,219,418	2.30

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. 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 December 31, 2009, 1,090,952 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
Granted in 2009	300,000
Redeemed in 2009	(179,333)
Forfeited in 2009	(23,000)
RSU's outstanding, December 31, 2009	1,924,285

Pareto Corporation
Notes to Consolidated Financial Statements
December 31, 2009

13. Share Capital (continued)

e) Share-based compensation:

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

	2009	2008
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

f) Contributed surplus

In the twelve months ending December 31, 2009, \$832,080 (2008 - \$815,643) of share based compensation was added to contributed surplus with \$218,133 (2008 - \$26,609) of contributed surplus reallocated to share capital as a result of restricted stock units redeemed in the period.

14. Income Taxes

The significant components of future income tax assets (liabilities) consist of the following:	2009	2008 (note3)
Capital assets	\$ 70,133	\$ 392,707
Share issuance costs	44,710	146,971
Intangible assets	(307,603)	(443,354)
Deferred costs	--	5,860
	\$ (192,760)	\$ 102,184
Current future income tax assets	\$ 41,982	\$ 38,167
Long-term future income tax assets	71,243	258,209
Current future income tax liabilities	-	-
Long-term future income tax liabilities	(305,985)	(194,192)
Future income tax assets, net	\$ (192,760)	\$ 102,184

Pareto Corporation
Notes to Consolidated Financial Statements
December 31, 2009

14. **Income Taxes (continued)**

A reconciliation between income taxes provided at actual rates and at the basic rate of 33.0% (2008 – 33.5%) for federal and provincial taxes is as follows:		
	2009	2008 (note 3)
Earnings before income taxes	\$ 7,175,336	\$ 5,759,686
Income tax at statutory rates	2,367,861	1,919,446
Tax differences resulting from:		
Income taxed in a different jurisdiction	(532)	(6,157)
Non-deductible items	300,544	316,836
Federal investment tax credits re SR&ED claim	(92,000)	(82,649)
Change in future income taxes due to changes in future enacted rates	(21,713)	(9,427)
Assessments and provision adjustments	140,535	(64,977)
Provision for income taxes	\$ 2,694,695	\$ 2,073,072

	December 31 2009	December 31 2008 (note 3)
Provision for income taxes consists of:		
Current	\$ 2,399,751	\$ 1,006,452
Future	294,944	1,066,620
	\$ 2,694,695	\$ 2,073,072

15. **Earnings Per Share**

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

	December 31 2009	December 31 2008 (note 3)
Net earnings	\$ 4,480,641	\$ 3,686,615
Weighted average number of common shares outstanding	39,979,183	42,983,113
Stock options	237,706	75,986
Restricted stock units	1,964,276	1,709,132
Weighted average number of diluted common shares outstanding	42,181,165	44,768,231
Diluted earnings per share	\$ 0.106	\$ 0.082

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 - \$0.73), meaning their inclusion would increase diluted earnings per share. In 2009, 1,814,022 stock options were excluded because their effect would be anti-dilutive.

Pareto Corporation
Notes to Consolidated Financial Statements
December 31, 2009

16. Supplementary Cash Flow Information

	December 31 2009	December 31 2008
Changes in non-cash operating accounts:		
Accounts receivable	\$ (2,305,735)	\$ 860,788
Inventory and work in progress	61,506	457,956
Prepaid expenses	(179,196)	193,643
Accounts payable and accrued liabilities	(1,011,399)	(1,804,077)
Income taxes payable	1,429,654	863,893
Deferred revenue	1,021,129	125,253
	\$ (984,041)	\$ 697,456
Supplemental cash flow information:		
Interest paid	\$ 308,620	\$ 529,890
Income taxes paid	\$ 970,097	\$ 70,114

17. Commitments

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

2010	\$ 1,097,795
2011	1,040,912
2012	809,493
2013	661,722
2014	662,674
2015 and thereafter	1,906,959

18. Related Party Transactions

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

19. Segmented Information

The Company provides shopper 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.

In 2009, one customer represented greater than 10% of the Company's revenue being 25% (2008 – 27%). Amounts due from this customer accounted for 20% of accounts receivable as at December 31, 2009 (December 31, 2008 – 22%). All of the Company's operations are located in Canada.

Pareto Corporation
Notes to Consolidated Financial Statements
December 31, 2009

20. Capital Management

The Company defines capitalization to include the total of bank indebtedness, long-term loans, capital lease obligation and shareholders' equity. The Company's policy is to maintain a strong capital base and ensure that financial flexibility is present to increase shareholder value through organic growth and selective acquisitions as well as allow the Company to respond to changes in economic and/or marketplace conditions. Furthermore, the Company manages its capital to ensure that it can continue with its dividend policy. In order to maintain or adjust its capital structure, the Company may issue new shares, purchase shares for cancellation pursuant to a normal course issuer bid, raise debt or refinance existing debt with different characteristics. Although there are no externally imposed capital requirements, the Company is subject to certain covenants on its credit facilities which include a ratio to maintain shareholders equity, and EBITDA⁽¹⁾ at a certain level. At December 31, 2009, the Company is in compliance with those covenants.

Management considers the Company's capital resources adequate to meet the Company's operating, capital expenditure, and financing requirements. There were no changes in the Company's approach to capital management during the period.

	December 31, 2009	December 31, 2008
Bank Indebtedness	\$ 415,602	\$ 654,573
Long-term loans	11,541,099	-
Capital lease obligation	-	709,279
Total debt	11,956,701	1,363,852
Shareholders' equity	18,869,034	27,311,479
Total capitalization	\$ 30,825,735	\$ 28,675,331
Debt:Shareholders' equity	0.63:1	0.05:1
Debt:Total Capitalization	0.39:1	0.05:1
Debt: EBITDA ⁽¹⁾	1.26:1	0.17:1

⁽¹⁾ For purposes of calculating ratios, EBITDA is defined as earnings before amortization, net interest and finance charges, share-based compensation, income taxes, gain on sale of capital asset and non-recurring expenses. EBITDA is not a measure defined under 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.

21. Subsequent Event

On January 12, 2010 the Company announced, that effective January 1, 2010, the Company acquired all of the outstanding shares of Direct Sales Force Inc. (DSF), a Canadian intercept marketing and sales company. The initial purchased price totaled \$5,570,145, comprised of \$4,107,982 in cash and 1,539,119 common shares with a fair value of \$1,462,163 at that date. Additional consideration to a maximum of approximately \$4,178,000 could be payable over a two-year period contingent upon DSF achieving certain future growth performance benchmarks. A total of 100,000 stock options were issued to employees of DSF, with terms and conditions in accordance with the Company's stock option plan.

22. Financial Instruments

(a) Fair value of Financial Instruments

The carrying values of cash, trade and other receivables, bank indebtedness and accounts payable and accrued liabilities approximate their fair values due to the short term nature of these instruments. The carrying value of long term loan of \$11,541,099 at December 31, 2009 approximates its fair value because it bears interest at rates to which the Company would currently be able to obtain for loans with similar maturity dates and terms.

(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

The company's exposure to credit risk in relation to its financial assets is through cash, accounts receivable, and loans receivable. The Company's credit risk is primarily attributable to its trade receivables. 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 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. The amounts disclosed in the balance sheet are net of allowances for bad debts, which are established based on the specific credit risk associated with the customer and other relevant information. The allowance for doubtful accounts as at December 31, 2009 is \$120,937 (2008 - \$109,053). The net change during the year ended December 31, 2009 was \$11,884 with \$90,183 included in operating and administrative expenses.

The balance of trade accounts receivable includes \$5,941,162 (2008 - \$5,719,640) that is overdue and not impaired. The Company deals with large, credit worthy clients and bills in advance of the provision of services, whenever possible. Historically, the Company has experienced minimal bad debts.

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.

The following is a contractual maturity analysis of the Company's financial liabilities:

	Total	Less than 1 year	1 to 2 years
Bank indebtedness	415,602	415,602	
Accounts payable and accrued liabilities	11,035,642	11,035,642	
Dividends payable	1,792,129	1,792,129	
Long term loan (Note 12)	11,700,000	1,350,000	10,350,000
	24,943,373	14,593,373	10,350,000

22. Financial Instruments (continued)

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 9) which bears interest at floating interest rates.

Based on the Company's average debt level during the year ended December 31, 2009, the sensitivity of a 100 basis point increase in interest rates would result in an approximate decrease of \$122,000 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, 2009, 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.

23. Comparative Figures

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