THE MONEY MEN: Pareto's Kerry Shapansky (left) and Mentor Fund's Perry Miele

Look Out Below

A new generation of aggressive investors is putting its money into below-the-line agencies whose services boost marketing ROI BY PAUL-MARK RENDON

Among the crowd on a mid-May afternoon, inside the soaring, glass-walled conference room at the Toronto Stock Exchange, there are no irate shareholders. Outside the building, there are no protesters of perceived corporate misdeeds. This day, men with grey hair wearing grey suits and only slightly more colourful expressions, are taking care of business at the annual stockholders' meeting of Pareto Corp. The mood is about as sexy as a tax seminar in Kitchener, and that's just the way Kerry Shapansky wants it.

Shapansky, the 41-year-old president and chief executive of the Toronto-based marketing services company, simply doesn't care to be sexy in business. During his carefully scripted speech to the 150-person audience, he lets the numbers speak for themselves. Last year's revenues were $53 million, up from $39 million in 2004 and just $2 million in 2001. Earnings before interest, taxes, depreciation and amortization (EBITDA), climbed to $5.5 million in 2005, out of a $2-million hole in 2001. Cash flow is up. Total debt is down. Sexy be damned–people are working here.

But Pareto's string of financial success has gone largely unnoticed in an industry where high-profile assignments and showmanship are very much what attracts talent to the marketing business. Shapansky says the company's low profile is partly due to a corporate belief in practicality. Its no-nonsense offices are in North York, Ont., in what he calls a "cheap rent zone," far from the trendy loft offices on Toronto's King Street. "This is deliberate," he says. "This is austere. A client walks in here, we don't want them to think 'agency.' "

Make no mistake, though. Pareto is in the marketing services business, and is therefore an agency in almost every sense of the word. Thing is, its niche is in what marketing snobs would quickly dismiss as grunt work: print distribution, in-store signage, direct, incentive and corporate event marketing. Those tray liners at Quiznos? In-store displays at The Home Depot and Shoppers Drug Mart? Direct-mail execution for Bell ExpressVu? All of it, Pareto's handiwork. Not the most creatively stimulating stuff at times, but definitely consumer-connected and effective. "I love Cannes," Shapansky says, "but I'd rather be there for the film festival than the advertising festival."

Nevertheless, Pareto and a growing nucleus of Canadian below-the-line marketing services players are making moves that demand attention. Fuelled by a $30-billion Canadian market for their services and a belief that marketers are thinking less and less of ad agencies as saviours, Shapansky's world is growing at a fast clip.

"I don't see any limitations in this market," says Shapansky, who, prior to joining Pareto worked as the president of incentive marketing firm Maritz Canada, a company he helped grow to $120 million in revenues from $12 million in just six years. "I don't see any limitations in what clients are prepared to do. I don't see any limitations in people willing to say they've got capital to help us grow."

"Marketing is going to move from a world of art and intuition to a world of algorithms," says Capital C's Tony Chapman

And growth is high on the agenda. Since 2002, publicly traded Pareto has acquired three companies: Naylor Event Management, marketing services firm Barry Rayner Associates and, just last month, employee marketing specialist Trajectory Business Performance Inc., which it renamed Pareto Trajectory. Clients– including Scotiabank, IBM, Ford of Canada and McDonald's–have wide-spanning, often national footprints.

In 2005, Pareto launched a division called Elevate Incentives, a company that buys Aeroplan miles in bulk and resells them for use in channel marketing and employee incentive programs. Shapansky says more launches and acquisitions are on the horizon. It's all part of his plan to make Pareto a $150-million company by 2008, with EBITDA of $20 million.

For that to happen, Shapansky says the company will likely need to grow 20% organically from last year, as well as make new business acquisitions of at least $15 million this year alone. "That'll take us to $80 or $85 million (in revenues). We'll grow organically off of that, add something else...I think it's imminently achievable."

One of Shapansky's supporters in his quest is Perry Miele, the marketing industry veteran who was president of Draft Worldwide's International Group in the late 1990s. Miele, a well-connected member of the Bay Street cognoscenti, now serves as chair of Toronto's Beringer Capital, a mid-size private equity firm that manages the Mentor Fund. The Fund invests strictly in marketing and communications companies with a primary investment strategy in below-the-line operations, including Pareto.

Why the narrow scope? "These new CMOs, they're no longer impressed by a lot of sizzle," Miele says. "They want to quantify every investment they make. Seven years ago, they were still willing to be more qualitative. Today, it's quantify everything."

To date, the Mentor Fund has made Canadian-based investments of more than $25 million in companies that have a combined value of over $60 million. Aside from Pareto, that roster includes Yield Integrated Advertising and Pirate Entertainment Group, an offshoot of the well-known radio advertising company, Pirate Radio & Television.

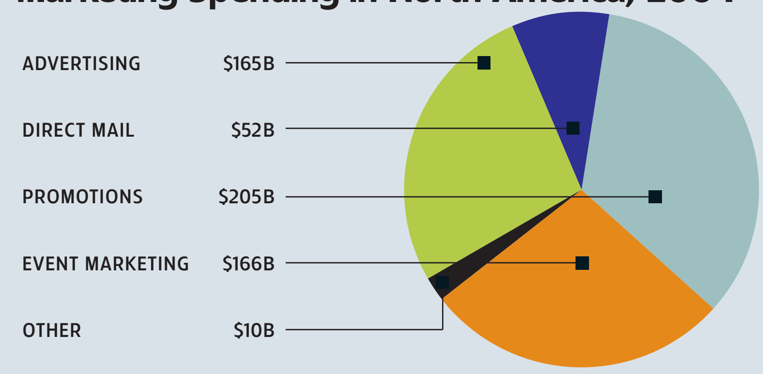
Stateside, the Mentor Fund has put its money into outfits like Mr. Youth, a youth marketing company that helped launch Victoria Secret's "Pink" line by throwing a pyjama party in Miami's South Beach during spring break 2004. Four thousand college co-eds attended, and the party generated 13 million impressions and headlines on TV properties like CNN, *Entertainment Tonight* and MTV. It's just the

PHOTOGRAPHY: JOHN HRYNIUK

sort of non-advertising initiative that Miele says marketers salivate over and will pay big dollars to get.

In March, in a deal worth as much as $68 million, the Mentor Fund acquired Budco, a Highland Park, Mich.-based company that might best be described as Pareto's American cousin. Budco's ties to Pareto are strong: The two companies maintain a reciprocal fulfilment agreement– Budco for Pareto's U.S. business, and vice-versa. Miele says there's plenty of wealth to go around: According to Beringer's own research, more than two-thirds of North America's US$600-billion marketing industry expenditures are below the line (*see Marketing spending in North America, 2004, above*).

Marketing Spending in North America, 2004



SOURCES: UNIVERSAL McCANN'S COEN REPORT, PROMO 2004 INDUSTRY TRENDS REPORT, DIRECT MARKETING ASSOCIATION, DATAMONITOR, COUNCIL OF PUBLIC RELATIONS, BERINGER ESTIMATES, PROMOTION MARKETING ASSOCIATION

That's impressive and part of the reason Michael Beckerman left his post as chief marketing officer at BMO Financial for a job as head of Pareto's retail division last October. The well-travelled marketer says he wanted a job on the agency side after spending 20 years as a marketer, and became impressed with the work Pareto was doing for outfits like Shoppers Drug Mart and Home Depot. Traditional agencies "dabbling" in below-the-line marketing didn't tell him enough of a credible story, he says. "That model didn't interest me. Everybody had their brand DNA, brand pyramid or parallelogram, and it seemed like a lot of 'me-too' stuff."

"I would be surprised to see us move above the line," says Pareto's Shapansky, "but I wouldn't absolutely rule it out"

To many in the industry, it was the kind of hire that legitimized Pareto's presence on the scene. "I just don't know why he would leave such a high-profile job," says one industry watcher, who preferred to remain anonymous. (Beckerman's personal share in Pareto includes 333,000 common shares. Shapansky himself owns 5.4 million Pareto shares, while Kim Naylor, head of channel marketing, owns 2.5 million.)

"I think people who really knew me weren't surprised (about leaving BMO)," Beckerman says.

"Some of the ways we're broadening our retail service offering, the new client relationships we bring on board–people will start to get it. They'll start to figure out there's a grander plan," Shapansky adds.

Like Shapansky, Tony Chapman has a grander plan to which he has also managed to attract big investors. The founder and president of Toronto's Capital C last August sold 80% of his promotions agency to Newport Partners Income Fund, simultaneously becoming a major stakeholder in the fund, which invests in 12 other companies across the country (four of which, including Capital C, are in the below-the-line marketing space).

Chapman's plans include merging one of those firms, CRM and data management agency Kenna Group, with Cap C as early as this month. "Combined, we're going to be a $25-million net revenue firm, with 80 programmers dying to do nothing but create algorithms on how data should be managed."

The Newport investment will allow Chapman to expand his retail, direct and digital offerings. The Kenna merger, meanwhile, coupled with Cap C's present 50% stake in Montreal's P2P experiential marketing firm, will better equip him for something he describes as the marketing sea change that lies ahead. "Marketing is going to move from a world of art and intuition to a world of algorithms," he says.

That means more one-to-one communication. Personalized, tailored, calibrated–the sort of stuff Shapansky would say Pareto was born to execute. The trend is evident in Aeroplan's new redemption structure, which will allow its members to access all seats on Air Canada flights by the end of 2006, as opposed to the mere 15% of any flight they're currently allowed to access. It'll likely mean an uptick in sales for Elevate Incentives.

Pareto's other business areas, meanwhile, remain solid. The company last August renewed a three-year deal with Shoppers Drug Mart worth at least $45 million, and in March picked up its first fast-food client in Quiznos Sub. It's all enough to make Andy Nasr, an analyst at Toronto's Raymond James financial services firm, say Pareto is in a good spot, especially if it's ever able to cross-sell its various offerings to clients. Couple that with the trend among marketers to outsource non-core and time-intensive operations, and Pareto's prospects look better and better. Warehousing promo material "is not something Shoppers is ever going to want to do themselves," Nasr says.

But others contend that Pareto may

be successfully painting itself into a corner, and may eventually dabble in something the company says it simply doesn't do: creative.

"If he does a great job, clients are going to demand more of him," says one industry source. "And what's he going to do? Say no? You don't do that in the service business. You find a way to look after your client's needs."

To this, Shapansky offers a response worthy of the campaign trail: "Never say never. I would be surprised to see us move above the line, but I wouldn't absolutely rule it out."

Pareto is currently eyeing about a dozen potential acquisition targets, with plans to complete "a couple" of them. None live in the above-the-line space, Shapansky says. Still, don't expect the Pareto of today to be the same creature this time next year, or in a few months for that matter.

"My role as a leader is to push uncomfortable change on our organization, and to have us changing faster than our clients are changing," he says, pointing to a seven-foot dinosaur skeleton on display in one of Pareto's meeting rooms. "If we don't do that, we'll become that dinosaur. And it can happen fast." M

How important are below-the-line services to your organization?

Log onto www.marketingmag.ca to take part in the Marketing Online Poll.

Perry Miele

Chair, Beringer Capital
Managing director, The Mentor Fund

VITALS: 47, born in Thunder Bay, Ont.; graduated from the University of Western Ontario in 1981 with a BA specializing in economics. Wife, Kathy, is a stay-at-home mom with son Anthony, 9, and daughter Bianca , 11.

YOU MAY NOT KNOW: Miele is a fishing fanatic who has substituted for host Bob Izumi on Izumi's *Real Fishing* TV show. "I'm one of those guys who goes on an annual fishing trip with his high school fishing buddies," Miele says. A longtime supporter of the Conservative Party, Miele was also a key decision maker on Prime Minister Stephen Harper's winning advertising campaign.

Kerry Shapansky

President and CEO, Pareto Corp.

VITALS: 41, born in Lloydminster, Sask. Wife, Mandy, is CFO at Xerox Canada. Four children: Taylor, 15 and Sydney, 13; and stepdaughters Sarah, 16, and Melissa, 15.

YOU MAY NOT KNOW: Citing a need "to make my way in the world," Shapansky dropped out of school during his second year of study at the University of Waterloo. He has starred in TV commercials for Fisher's department store in Lloydminster and once worked as a night supervisor, inspecting heavy oil extracting equipment in Western Canada's tar sands area. A contributor to the Free the Children charity, Shapansky and his wife took their children to Africa last year to help construct a school. Calls himself "a bit of a control freak. I have a blend of photographic memory and a real penchant for details, numbers, facts and figures, which drives my people crazy."