

Pareto Corporation

Consolidated Financial Statements
For the years ended December 31, 2006 and 2005

Auditors' Report

To the Shareholders of Pareto Corporation

We have audited the consolidated balance sheets of Pareto Corporation as at December 31, 2006 and 2005 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, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(Signed) BDO Dunwoody LLP

Chartered Accountants

Toronto, Ontario
March 1, 2007

Pareto Corporation
Consolidated Balance Sheets

For the years ended December 31

2006

2005

Assets

Current assets

Cash	\$ 5,020,127	\$ 5,078,927
Accounts receivable	12,399,746	10,760,008
Inventory and work in progress	2,457,361	2,236,432
Other current assets	540,698	231,876
Current future income tax assets (note 9)	2,903,293	97,854
	23,321,225	18,405,097

Loans receivable (note 13)	616,667	433,333
Long-term future income tax assets (note 9)	850,590	-
Deferred costs (note 2)	513,708	609,791
Capital assets (note 3)	1,722,298	990,622
Goodwill and intangible assets (note 4)	17,782,873	11,479,110
	\$ 44,807,361	\$ 31,917,953

Liabilities and Shareholders' Equity

Current liabilities

Accounts payable and accrued liabilities	\$ 14,059,056	\$ 10,841,641
Current portion of deferred revenue	2,607,264	4,151,498
Income taxes payable	275,091	927,065
Current future income tax liabilities (note 9)	131,225	90,551
Current portion of acquisition notes payable (note 5)	1,350,000	335,000
Current portion of long-term debt (note 6)	500,000	500,000
Current portion of capital lease obligations (note 7)	264,295	-
	19,186,931	16,845,755

Long-term deferred revenue	-	474,144
Long-term future income tax liabilities (note 9)	625,772	398,141
Long-term debt (note 6)	165,992	832,996
Long-term capital lease obligations (note 7)	992,060	-
Long-term acquisition notes payable (note 5)	100,000	-
Total liabilities	21,070,755	18,551,036

Shareholders' equity

Share capital (note 8(b))	17,176,172	7,576,707
Contributed surplus	268,895	254,192
Common share purchase warrants (note 8 (e))	-	126,454
Retained earnings	6,291,539	5,409,564
Total shareholders' equity	23,736,606	13,366,917
	\$ 44,807,361	\$ 31,917,953

On behalf of the Board:

(signed) David Atkins - Director _____

(signed) Kerry Shapansky – Director _____

Pareto Corporation

Consolidated Statements of Operations and Retained Earnings

For the years ended December 31	2006	2005
Revenue	\$ 51,080,008	\$ 52,950,769
Operating and administrative expenses	48,330,272	47,444,182
	2,749,736	5,506,587
Amortization of capital assets	361,174	337,214
Amortization of intangible assets and deferred costs	268,350	225,643
Interest and finance charges, net	82,617	277,116
Gain on acquisition (note 1 (b))	(192,042)	-
Share-based compensation	134,210	101,867
	654,309	941,840
Earnings before income taxes and non-controlling interest	2,095,427	4,564,747
Income taxes (note 9)	545,632	1,660,348
Non-controlling interest	-	(70,633)
Net earnings for the year	1,549,795	2,975,032
Retained earnings, beginning of year	5,409,564	2,434,532
Excess price paid over carrying value on repurchase of common shares	(667,820)	-
Retained earnings, end of year	\$ 6,291,539	\$ 5,409,564
Basic and diluted earnings per share (note 10)	\$ 0.04	\$ 0.08
Average number of common shares outstanding:		
Basic	42,554,794	36,570,640
Diluted	44,130,278	38,912,305

Pareto Corporation
Consolidated Statements of Cash Flows

For the years ended December 31

2006

2005

Operating activities

Net earnings for the period	\$ 1,549,795	\$ 2,975,032
Items not involving cash:		
Amortization of capital assets	361,174	337,214
Amortization of intangible assets and deferred costs	268,350	225,643
Non-cash interest and finance charges	13,124	45,353
Share-based compensation	134,210	101,867
Non-controlling interest	-	(70,633)
Gain on acquisition	(192,042)	-
Future income tax provision	435,970	219,010
	<u>2,570,581</u>	<u>3,833,486</u>
Changes in non cash operating accounts	<u>(3,670,423)</u>	<u>473,260</u>
	<u>(1,099,842)</u>	<u>4,306,746</u>

Investing activities

Capital asset additions	(927,724)	(168,937)
Other asset additions	(66,792)	(110,614)
Acquisitions, net of cash acquired	<u>(4,861,098)</u>	<u>(202,227)</u>
	<u>(5,855,614)</u>	<u>(481,178)</u>

Financing activities

Proceeds from loans receivable	683,333	200,000
Repayment of acquisition notes payable	(335,000)	(435,000)
Repayment of long-term debt	(667,004)	(667,004)
Repayment of capital lease obligations	(103,690)	-
Issuance of shares	8,724,405	1,196,396
Share issue costs	(652,097)	(5,089)
Repurchase of common shares	<u>(753,291)</u>	<u>-</u>
	<u>6,896,656</u>	<u>289,303</u>

Increase (decrease) in cash for the period (58,800) 4,114,871

Cash and cash equivalents, beginning of period 5,078,927 964,056

Cash and cash equivalents, end of period \$ 5,020,127 \$ 5,078,927

Supplementary cash flow disclosures (note 11)

Pareto Corporation

Summary of Significant Accounting Policies

December 31, 2006 and 2005

Nature of business

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

Basis of consolidation

The Company consolidates the financial statements of all controlled subsidiaries starting at the date control is acquired. Inter-company transactions and balances are eliminated upon consolidation.

Accounting 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. Actual results could differ from management's best estimates as additional information becomes available in the future.

Work in progress and inventory

Work in progress and inventory are carried at the lower of cost and net realizable value, and are recorded on a project-specific basis.

Deferred costs

Deferred finance costs are amortized on a straight-line basis over the term of the related indebtedness. Deferred start-up costs, the incremental costs directly related to placing a new business operation into service, are amortized on a straight-line basis over an estimated useful life of 5 years.

Capital assets

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

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

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. 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.

Pareto Corporation

Summary of Significant Accounting Policies

December 31, 2006 and 2005

Goodwill and intangible 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. During the fourth quarter of 2006, the Company completed the annual assessment and found no impairment of goodwill.

Intangible assets consist of the value of the Company's acquired customer relationships. In the marketing services industry, these are typically long-term in nature, and therefore customer relationship assets are amortized on a straight-line basis over an estimated useful life of 10 years.

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. Future tax assets and liabilities are adjusted to reflect changes in tax rates and laws in the period such changes are enacted, resulting in adjustments to the current period's consolidated statement of operations.

Revenue recognition

For print management, direct marketing, event management, fulfillment and distribution, and customer incentive and loyalty management services, revenues are recognized on a completed project basis. Costs incurred in advance of a project's completion are reflected as work in progress. Customer billings 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.

Earnings per share

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

Stock-based compensation

The compensation cost for options granted to employees, directors 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, with a corresponding amount included in equity as contributed surplus.

Financial instruments

Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest rate, currency or credit risks arising from its financial instruments. Fair values of financial instruments approximate carrying values unless otherwise noted.

Foreign currencies

Monetary assets and liabilities denominated in foreign currencies are translated at the exchange rates in effect as of the balance sheet date. Revenue and expense items are translated at the exchange rates prevailing on the date the transactions occur.

Pareto Corporation
Notes to Consolidated Financial Statements

December 31, 2006 and 2005

1. Business combinations

- a) On October 3, 2006 the Company acquired all of the outstanding shares of Secom Plus Inc. ("Secom") a Montreal based retail sales and merchandising company for initial consideration of \$5,000,000, comprised of \$3,250,000 in cash, \$1,250,000 of acquisition notes payable, and 450,450 common shares with a fair value of \$500,000 at that date. The acquisition was accounted for as a purchase.

A summary of the fair value of the net assets acquired and consideration given is as follows:

Cash	\$ 208,764
Other current assets	2,477,676
Future income asset	27,090
Capital assets	129,504
Intangible assets	1,024,270
Current liabilities	(2,815,805)
Future income tax liability	(370,600)
Net identifiable assets acquired	<u>680,899</u>
Purchase consideration	
Cash	3,250,000
Acquisition note payable (note 5(c))	1,250,000
Integration costs	75,000
Transaction costs	430,923
Share capital issued (450,450 common shares)	500,000
	<u>5,505,923</u>
Excess of purchase price consideration allocated to goodwill	<u>\$ 4,825,024</u>

Additional cash consideration of up to \$5.0 million is payable in 2008 based on the operating results of Secom in 2007 and if paid would be accounted for as an increase in goodwill. The company expects approximately \$75,000 of the above total goodwill to be deductible for income tax purposes.

Pareto Corporation

Notes to Consolidated Financial Statements

December 31, 2006 and 2005

1. Business combinations (continued)

- b) On August 10, 2006, the Company acquired all of the outstanding shares of SourceLink Canada Corporation (SourceLink Canada) a Markham based direct marketing company for total cash consideration of \$1.2 million. The acquisition was accounted for as a purchase.

A summary of the fair value of net assets acquired and consideration given is as follows:

Cash	\$ 484,861
Other current assets	3,099,746
Future income tax asset	3,857,284
Current liabilities	(4,544,282)
Long-term liabilities	(1,093,725)
Net identifiable assets acquired	<u>1,803,884</u>

Purchase consideration	
Cash	1,200,000
Integration costs	250,000
Transaction costs	161,842
	<u>1,611,842</u>
Excess of fair value of assets acquired reflected as gain on acquisition	<u>\$ 192,042</u>

- c) On April 30, 2006, the Company acquired certain operating assets and liabilities of Trajectory Business Performance Inc. ("Trajectory") a Toronto based sales force training company for initial consideration of \$600,000, comprised of \$400,000 in cash and \$200,000 of acquisition notes payable. The acquisition was accounted for as a purchase.

A summary of the fair value of the net assets acquired and consideration given is as follows:

Other current assets	\$ 153,232
Capital assets	35,622
Future income tax asset	309,920
Intangible assets	77,500
Bank overdraft	(50,695)
Other current liabilities	(163,115)
Net identifiable assets acquired	<u>362,464</u>

Purchase consideration	
Cash	400,000
Acquisition notes payable (note 5 (b))	200,000
Integration costs	196,769
Transaction costs	61,263
	<u>858,032</u>
Excess of purchase price consideration allocated to goodwill	<u>\$ 495,568</u>

Pareto Corporation
Notes to Consolidated Financial Statements

December 31, 2006 and 2005

1. Business combinations (continued)

Additional cash consideration is payable based on future operating results as follows and if paid would be accounted for as an increase in goodwill:

2007	\$	325,000
2008	\$	125,000

In addition, the Company issued to the vendor 258,065 warrants to acquire 258,065 common shares of the Company at \$1.55 per share. The warrants expire on May 20, 2008. The exercise of the warrants is conditional upon the earning of the above additional consideration and the fair value of the warrants of \$101,678 will be added to goodwill if earned.

The company expects the goodwill amount to be deductible for income tax purposes.

- d) On September 30, 2005, the Company acquired the remaining 33.3% of Pareto Dialogue Inc. ("Dialogue") for total cash consideration of \$91,000. The consideration exceeded the net assets acquired by \$11,227 with the excess amount allocated to goodwill. During 2004, the Company increased its ownership of Dialogue from 51% to 66.7% for cash consideration of \$47,000 which approximated the net assets acquired and there was no excess of purchase price.

2. Deferred costs

	2006	2005
Deferred finance costs	\$ 93,039	\$ 39,372
Deferred start-up costs	420,669	570,419
	<u>\$ 513,708</u>	<u>\$ 609,791</u>

- a) In 2003, the Company entered into a shareholders' agreement for Pareto Dialogue Inc. ("Dialogue"). Dialogue began operations in 2003, and provides fulfillment and distribution services. Costs incurred for the new business before December 1, 2003 were deferred and are being amortized on a straight-line basis over five years.
- b) In 2004, the Company formed a new subsidiary, Elevate Incentives Inc. ("Elevate"). Elevate manages employee and channel incentive programs. Elevate began operations in 2005 and costs incurred for the new business before that date have been deferred and are being amortized on a straight-line basis over five years.

Pareto Corporation
Notes to Consolidated Financial Statements

December 31, 2006 and 2005

3. Capital assets

2006			
	Cost	Accumulated Amortization	Net Book Value
Computer software	\$ 1,237,608	\$ 672,488	\$ 565,120
Computer hardware	873,265	448,518	424,747
Furniture and fixtures	1,105,442	540,369	565,073
Leasehold improvements	400,847	233,489	167,358
	\$ 3,617,162	\$ 1,894,864	\$ 1,722,298

2005			
	Cost	Accumulated Amortization	Net Book Value
Computer software	\$ 741,224	\$ 639,009	\$ 102,215
Computer hardware	658,457	340,463	317,994
Furniture and fixtures	884,817	423,707	461,110
Leasehold improvements	239,814	130,511	109,303
	\$ 2,524,312	\$ 1,533,690	\$ 990,622

4. Goodwill and intangible assets

2006			
	Cost	Accumulated Amortization	Net Book Value
Goodwill	\$ 16,017,153	\$ -	\$ 16,017,153
Intangible assets – customer relationships	2,111,106	345,386	1,765,720
	\$ 18,128,259	\$ 345,386	\$ 17,782,873

2005			
	Cost	Accumulated Amortization	Net Book Value
Goodwill	\$ 10,696,561	-	\$ 10,696,561
Intangible assets – customer relationships	1,009,336	226,787	782,549
	\$ 11,705,897	\$ 226,787	\$ 11,479,110

Pareto Corporation
Notes to Consolidated Financial Statements

December 31, 2006 and 2005

5. Acquisition notes payable

The balance of acquisition notes payable relates to the following business combinations:

	2006	2005
Naylor Event Management Inc. ("Event") (a)	\$ -	\$ 335,000
Trajectory (b)	200,000	-
Secom (c)	1,250,000	-
	<u>1,450,000</u>	335,000
Less current portion	<u>1,350,000</u>	335,000
	<u>\$ 100,000</u>	\$ -

- a) The note was non-interest bearing and was repaid in April 2006.
- b) The notes are non-interest bearing and are repayable in six equal installments beginning January 1, 2007.
- c) The note is non-interest bearing and was repaid on January 3, 2007.

6. Long-term debt

	2006	2005
Bank credit facility (a)	\$ -	\$ -
Subordinated debt (b)	<u>665,992</u>	1,332,996
	<u>665,992</u>	1,332,996
Less current portion	<u>500,000</u>	500,000
	<u>\$ 165,992</u>	\$ 832,996

- a) During the year, the amount available under the Company's operating line of credit was \$5,500,000. The rate of interest under the operating line is prime plus 1.5%, payable monthly. The facility is secured by a general security agreement over the assets of the Company and its subsidiaries, and is repayable on demand.
- b) On November 18, 2004, the Company issued subordinated debt with a principal amount of \$2,000,000. Variable interest will be paid monthly at bankers' acceptance rates plus 3.5%. In addition, commencing in January 2005, the Company pays monthly fees of \$6,000 in respect of the subordinated debt. Scheduled principal repayments on the subordinated debt are due in the following years: 2007 - \$500,000; and 2008 - \$165,992. The Company may make a discretionary prepayment of \$167,000 in 2007.

Pareto Corporation
Notes to Consolidated Financial Statements

December 31, 2006 and 2005

7. Capital Lease Obligations

	2006	2005
Machinery leases	\$ 1,256,355	\$ -
Less current portion	<u>264,295</u>	-
	<u>\$ 992,060</u>	\$ -

The Company has a series of machinery leases. The leases bear interest at rates between 10% and 12% and expire between 2007 and 2011. The fair value of the leases approximates the carrying value at December 31, 2006. The leases are secured by the machinery acquired. The future payments and interest payable under the leases are as follows:

	Payments	Interest
2007	\$ 389,078	\$ 124,783
2008	\$ 377,239	\$ 94,557
2009	\$ 377,239	\$ 62,963
2010	\$ 377,239	\$ 26,552
2011	\$ 45,197	\$ 882

8. Share capital

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

- b) Issued common shares:

	Number of Shares	Amount
Balance , December 31, 2004	<u>35,160,492</u>	<u>\$ 5,867,592</u>
Shares issued pursuant to private placements (i)	1,333,333	1,433,333
Shares issued on conversion of special warrants (note 8(g))	232,000	46,400
Shares issued on conversion of common share purchase warrants (note 8(e))	28,000	32,586
Shares issued on exercise of stock options	574,277	201,885
Share issue costs	-	(5,089)
Balance, December 31, 2005	<u>37,328,102</u>	<u>\$ 7,576,707</u>
Shares issued pursuant to private placements (ii)	5,666,667	8,366,667
Shares issued on acquisition of Secom (note 1)	450,450	500,000
Shares issued upon conversion of common share purchase warrants (note 8 (e))	772,000	898,454
Shares issued on exercise of stock options	1,493,485	571,912
Shares repurchased for cancellation	(652,500)	(85,471)
Shares issue costs	-	(652,097)
Balance, December 31, 2006	<u>45,058,204</u>	<u>\$ 17,176,172</u>

Pareto Corporation
Notes to Consolidated Financial Statements

December 31, 2006 and 2005

8. Share capital (continued)

- (i) On January 11, 2005, Pareto issued 1,000,000 common shares pursuant to a private placement at an issue price of \$1.00 per common share for gross proceeds of \$1,000,000 (note 13(b)). On October 11, 2005, Pareto issued 333,333 common shares at an issue price of \$1.30 per common share for gross proceeds of \$433,333 (note 13(e)).

- (ii) On March 30, 2006, Pareto issued 5,000,000 common shares pursuant to a private placement at an issue price of \$1.50 per common share for net proceeds of \$6,829,028. On May 16, 2006, Pareto issued 666,667 common shares pursuant to an employee private placement at an issue price of \$1.30 per common share for net proceeds of \$866,667.

c) Stock options

The Company has a stock option plan (the "Plan") for employees, consultants, directors and officers of the Company. Pursuant to the Plan, a total of 3,500,000 of the Company's common shares have been reserved for issue. One-third of granted options vest on each of the anniversary dates of the grant.

Stock option transactions under the plan during the period are as follows:

	Number of Options	Weighted Average Exercise Price
Options outstanding, December 31, 2005	3,045,510	\$ 0.45
Granted in 2006	320,000	1.32
Exercised in 2006	(1,493,485)	0.30
Cancelled in 2006	(486,509)	0.83
Options outstanding, December 31, 2006	1,385,516	\$ 0.67
Options exercisable, December 31, 2006	864,775	\$ 0.37
Options exercisable, December 31, 2005	2,214,676	\$ 0.29

The weighted average grant date fair value of the options granted in 2006 was \$0.41 (2005: \$0.38).

Pareto Corporation
Notes to Consolidated Financial Statements

December 31, 2006 and 2005

8. Share capital (continued)

As at December 31, 2006 the Company had the following options outstanding pursuant to the plan:

Number of Options	Exercise Price Per Share	Expiry Date
108,571	\$ 0.35	February 15, 2007
195,000	\$ 0.20	August 1, 2007
45,000	\$ 0.20	November 4, 2007
300,000	\$ 0.25	June 23, 2008
166,667	\$ 0.43	February 10, 2009
35,000	\$ 0.86	July 19, 2009
30,000	\$ 0.88	December 13, 2009
34,167	\$ 0.90	March 7, 2010
40,000	\$ 0.90	April 26, 2010
111,111	\$ 1.30	October 11, 2010
50,000	\$ 1.53	March 30, 2011
90,000	\$ 1.47	May 15, 2011
100,000	\$ 1.21	August 8, 2011
30,000	\$ 1.15	August 11, 2011
50,000	\$ 1.15	October 3, 2011

d) Restricted stock units:

During 2005, the Company implemented a long-term incentive plan (LTIP) for employees, consultant, directors and officers of the Company. Pursuant to the LTIP, a total of 1,000,000 of the Company's common shares have been reserved for issue through the redemption of restricted stock units into common shares on a one to one basis. Restricted stock units are redeemable upon the third anniversary of the date of grant. At December 31, 2006, 238,333 restricted stock units were outstanding pursuant to the LTIP (333,333 to December 31, 2005)

e) Common share purchase warrants:

- (i) In 2004, the Company issued 800,000 common share purchase warrants (the "warrants"), each of which provide the holder with the right to purchase one common share of the Company for \$1.00. The warrants expired on October 13, 2006. All of the warrants were exercised prior to expiry. The fair value of the warrants at the date of issuance was \$131,040, which was included in shareholder's equity as common share purchase warrants.

Pareto Corporation
Notes to Consolidated Financial Statements

December 31, 2006 and 2005

8. Share capital (continued)

- (ii) In 2006, pursuant to the acquisition of Trajectory, the Company issued 258,065 common share purchase warrants, each of which provide the holder with the right to purchase one common share of the Company for \$1.55. The warrants expire on May 20, 2008. The exercise of the warrants is conditional upon the future operating results of Trajectory. All of the warrants are outstanding at December 31, 2006.

f) Share-based compensation:

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

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

The fair value of stock options granted in 2005 was estimated using the Black-Scholes option-pricing model with the following assumptions:

- Dividend yield 0%
- Expected volatility 40%
- Risk-free interest rate 3.0% to 3.6%
- Expected option life 2 to 4 years

The fair value of restricted stock units granted in 2006 and 2005 was estimated to equal the market price of a Pareto common share on the date of grant.

In 2006, \$134,210 (2005: \$101,867) of share based compensation was added to contributed surplus with \$119,507 (2005: \$33,489) of contributed surplus reallocated to share capital as a result of options exercised in the year.

Pareto Corporation

Notes to Consolidated Financial Statements

December 31, 2006 and 2005

9. Income taxes

The significant components of future income tax assets and liabilities consist of the following:

	2006	2005
Future income tax assets		
Loss carry forwards	\$ 2,268,846	\$ -
Capital assets	1,485,037	97,854
	<u>3,753,883</u>	97,854
Valuation allowance	-	-
Current future income tax assets	<u>2,903,293</u>	97,854
Long-term future income tax assets	<u>850,590</u>	-
Future income tax liabilities		
Intangible assets	644,835	282,657
Deferred costs	112,162	206,035
	<u>756,997</u>	488,692
Current future income tax liabilities	<u>131,225</u>	90,551
Long-term future income tax liabilities	<u>\$ 625,772</u>	<u>\$ 398,141</u>

A reconciliation between income taxes provided at actual rates and at the basic rate of 36.12% (2005 – 36.12%) for federal and provincial taxes is as follows:

	2006	2005
Earnings before income taxes and non-controlling interest	\$ 2,095,427	\$ 4,564,747
Income tax at statutory rates	756,868	1,648,787
Tax differences resulting from:		
Income taxed in a different jurisdiction	(8,938)	-
Non-deductible items	60,509	55,351
Non-taxable items	(69,366)	-
Change in valuation allowance on acquired tax assets	-	(110,349)
Change in future income taxes due to changes in future enacted rates	(55,304)	-
Other	(138,137)	66,559
Provision for income taxes	<u>\$ 545,632</u>	<u>\$ 1,660,348</u>

The Company has approximately \$6.3 million of non-capital losses to apply against future taxable income. These losses expire in 2014.

	2006	2005
Provision for income taxes consists of:		
Current	\$ 109,662	\$ 1,441,338
Future	435,970	219,010
	<u>\$ 545,632</u>	<u>\$ 1,660,348</u>

Pareto Corporation

Notes to Consolidated Financial Statements

December 31, 2006 and 2005

10. Earnings per share

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

	2006	2005
Net earnings	\$ 1,549,795	\$ 2,975,032
Average number of common shares outstanding	42,554,794	36,570,640
Stock options	1,037,001	2,073,913
Special warrants	-	153,293
Common share purchase warrants	123,345	31,126
Restricted stock units	415,138	83,333
Average number of diluted common shares outstanding	44,130,278	38,912,305
	\$ 0.04	\$ 0.08

The calculation of the dilutive impact of the exercise of options and warrants excludes those securities considered anti-dilutive because their exercise price exceeded the average market price of Pareto's common shares during the period (2006: \$1.35; 2005: \$1.04), meaning their inclusion would increase diluted earnings per share. In 2006, 140,000 stock options and 258,065 common share purchase warrants were excluded because their effect would be anti-dilutive. In 2005, no securities were excluded because their effect would be anti-dilutive.

11. Supplementary cash flow information

	2006	2005
Changes in non-cash operating accounts:		
Accounts receivable	\$ 3,524,402	\$ (2,494,678)
Income and other taxes payable	(901,914)	1,441,167
Inventory and work in progress	(220,929)	(785,027)
Other current assets	257,692	17,913
Accounts payable and accrued liabilities	(4,276,181)	2,837,025
Deferred revenue	(2,053,493)	(543,140)
	\$ (3,670,423)	\$ 473,260
Supplemental cash flow information:		
Interest paid	\$ 252,828	\$ 231,763
Income taxes paid	1,239,821	1,383,600
Supplemental disclosure of non-cash transactions:		
Shares issued for non-cash consideration	1,366,667	433,333
Increase in goodwill and acquisition notes payable	1,450,000	335,000

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12. Commitments

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

2007	\$ 1,258,746
2008	856,734
2009	674,198
2010	605,219
2011	549,447
2012 and thereafter	\$ 2,192,333

13. Related party transactions

- (a) In May 2006 the Company issued loans totalling \$866,667 to executives of the company. The loans were carried at an asset value of \$866,667 which approximates the fair value. The loans bear interest at Prime Rate plus ½% with interest payable quarterly. The loans are repayable on May 16, 2011, with \$250,000 of the loans being repaid in November 2006. The loans are full recourse, and the Company has received pledges of the purchased common shares as security for the loans. During 2006, \$32,036 of interest was charged pursuant to these loans.
- (b) In January 2005, the Company issued 1,000,000 common shares at \$1.00 per share for gross proceeds of \$1,000,000. The common shares were issued in a private placement transaction to a private equity investment corporation. One of the directors of the Company is also an officer and director of the investing corporation.
- (c) In October 2005 the Company issued a loan of \$433,333 to an executive of the Company. This loan was carried as an asset with a value of \$433,333 which approximates its fair value. The loan bears interest at the Prime Rate plus ½%, with interest payable quarterly. The loan was repaid in December 2006. The loan was full-recourse, and the Company received a pledge of the purchased common shares as security for the loan. During 2006, \$25,278 (2005:\$4,310) of interest was charged pursuant to the loan.
- (d) During 2005, a loan of \$200,000 to the chief executive officer of the Company, who is also a director of the Company, was outstanding. This loan was carried as an asset with a value of \$200,000, which approximated its fair value. The loan was interest bearing at the Prime Rate plus ½%, with interest payable quarterly. The loan was repaid in October 2005. The loan was full-recourse, and the Company received a pledge of the purchased common shares as security for the loan. During 2005, \$7,231 of interest was charged pursuant to the loan.

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14. Segmented information

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

In 2006, two customers represented greater than 10% of the Company's revenue (23% and 17% respectively). In 2005, two customers represented greater than 10% of the Company's revenue (23% and 22% respectively). As at December 31, 2006, amounts due from these customers accounted for 22% and 11% of accounts receivable respectively (December 31, 2005: 23%, and 22% respectively). All of the company's operations are located in Canada.

15. Comparative figures

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