

Pareto Corporation

Consolidated Financial Statements
For the years ended December 31, 2007 and 2006

**To the Shareholders of
Pareto Corporation**

We have audited the consolidated balance sheets of Pareto Corporation as at December 31, 2007 and 2006 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, 2007 and 2006 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, Licensed Public Accountants

Toronto, Ontario
March 25, 2008

Pareto Corporation Consolidated Balance Sheets

For the years ended	December 31 2007	December 31 2006
Assets		
Current assets		
Cash	\$ -	\$ 5,020,127
Accounts receivable	17,321,405	12,399,746
Inventory and work in progress	2,204,311	2,457,361
Prepaid expenses	659,683	540,698
Current future income tax assets (note 14)	950,026	2,903,293
	21,135,425	23,321,225
Loans receivable (note 18)	486,250	616,667
Long-term future income tax assets (note 14)	732,603	850,590
Deferred costs (note 5)	335,956	513,708
Capital assets (note 6)	3,283,105	1,722,298
Intangible assets (note 7)	1,554,607	1,765,720
Goodwill (note 8)	19,058,577	16,017,153
	\$ 46,586,523	\$ 44,807,361
Liabilities and Shareholders' Equity		
Current liabilities		
Bank indebtedness (note 9)	\$ 368,291	\$ -
Accounts payable and accrued liabilities	13,836,117	14,059,056
Deferred revenue	1,897,999	2,607,264
Income taxes payable	120,022	275,091
Current future income tax liabilities (note 14)	119,541	131,225
Current portion of acquisition notes payable (note 10)	3,066,668	1,350,000
Current portion of long-term debt (note 11)	-	500,000
Current portion of capital lease obligations (note 12)	281,666	264,295
	19,690,304	19,186,931
Long-term future income tax liabilities (note 14)	484,667	625,772
Long-term debt (note 11)	-	165,992
Long-term capital lease obligations (note 12)	709,279	992,060
Long-term acquisition notes payable (note 10)	-	100,000
Total liabilities	20,884,250	21,070,755
Shareholders' equity		
Share capital (note 13(b))	16,872,129	17,176,172
Contributed surplus (note 13(g))	706,513	268,895
Retained earnings	8,123,631	6,291,539
Total shareholders' equity	25,702,273	23,736,606
	\$ 46,586,523	\$ 44,807,361

On behalf of the Board:

(signed) David Atkins - Director _____

(signed) Kerry Shapansky - 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 2007	December 31 2006
Revenue	\$ 74,340,013	\$ 51,080,008
Operating and administrative expenses	67,486,077	48,330,272
	6,853,936	2,749,736
Amortization of capital assets	556,864	361,174
Amortization of intangible assets	211,111	118,599
Amortization of deferred costs	188,124	149,751
Interest and finance charges, net	431,404	82,617
Gain on acquisition (note 4(b))	-	(192,042)
Share-based compensation	480,623	134,210
	1,868,126	654,309
Earnings before income taxes	4,985,810	2,095,427
Income taxes (note 14)	1,855,313	545,632
Net earnings and comprehensive income for the year	3,130,497	1,549,795
Retained earnings, beginning of year	6,291,539	5,409,564
Excess price paid over carrying value on repurchase of common shares	(1,298,405)	(667,820)
Retained earnings, end of year	\$ 8,123,631	\$ 6,291,539
Basic and diluted earnings per share (note 15)	\$ 0.07	\$ 0.04
Weighted average number of common shares outstanding:		
Basic	44,564,041	42,554,794
Diluted	45,931,882	44,130,278

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 2007	December 31 2006
Operating activities		
Net earnings for the year	\$ 3,130,497	\$ 1,549,795
Items not involving cash:		
Amortization of capital assets	556,864	361,174
Amortization of intangible assets	211,111	118,599
Amortization of deferred costs	188,124	149,751
Non-cash interest and finance charges	6,347	13,124
Share-based compensation	480,623	134,210
Gain on acquisition	-	(192,042)
Future income tax provision	1,918,465	435,970
	<u>6,492,031</u>	<u>2,570,581</u>
Changes in non cash operating accounts (note 16)	<u>(5,874,867)</u>	<u>(3,670,423)</u>
	<u>617,164</u>	<u>(1,099,842)</u>
Investing activities		
Capital asset additions	(2,117,671)	(927,724)
Other asset additions	(21,719)	(66,792)
Acquisitions, net of cash acquired	(36,422)	(4,861,098)
	<u>(2,175,812)</u>	<u>(5,855,614)</u>
Financing activities		
Proceeds from loans receivable	366,667	683,333
Repayment of acquisition notes payable	(1,383,332)	(335,000)
Repayment of long-term debt	(665,992)	(667,004)
Repayment of capital lease obligations	(265,410)	(103,690)
Issuance of shares	143,500	8,724,405
Share issue costs	(22,796)	(652,097)
Repurchase of common shares	(2,002,407)	(753,291)
	<u>(3,829,770)</u>	<u>6,896,656</u>
Decrease in cash for the year	(5,388,418)	(58,800)
Cash, beginning of year	5,020,127	5,078,927
(Bank Indebtedness)/Cash, end of year	\$ (368,291)	\$ 5,020,127

Supplementary cash flow information (note 16)

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

Pareto Corporation

Summary of Significant Accounting Policies

December 31, 2007 and 2006

1. 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.

2. Summary of significant accounting policies

Basis of consolidation

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

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.

Inventory and work in progress

Inventory includes total costs incurred for print materials that the company holds for future distribution under its fulfillment and distribution client agreements. Work in progress and inventory are carried at the lower of cost and net realizable value. Work in process includes costs incurred on projects for which revenue has not yet been recognized for accounting purposes. The cost of inventory and work in progress includes time and materials.

Deferred costs

Deferred start-up costs, the incremental costs directly related to placing a new business operation into service are recorded at cost, less accumulated amortization and 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

Intangible assets

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

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, 2007 and 2006

2. Summary of significant accounting policies (continued)

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 capitalized cash flow approach for determining the fair value of its goodwill. When the fair value is in excess of its carrying amount, the goodwill is not considered impaired, and the second step of the impairment test is not necessary. An impairment loss is recognized when the carrying amount of the goodwill exceeds its fair value. It is not reversed in the event that the fair value subsequently increases. During the fourth quarter of 2007, the Company completed the annual assessment and found no impairment of goodwill.

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 enacted, resulting in adjustments to the current period's consolidated statement of operations.

Revenue recognition

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

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, have vendor specific objective evidence of undelivered goods and when delivery is probable and substantially controlled by the vendor.

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.

Pareto Corporation

Summary of Significant Accounting Policies

December 31, 2007 and 2006

2. Summary of significant accounting policies (continued)

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. 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.

Foreign currencies

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

3. Changes in accounting policies

CICA Handbook Section 1506, Accounting Changes, prescribes expanded disclosure for changes in accounting policies, accounting estimates and accounting for errors. Under the new standard, accounting changes should be applied retrospectively unless otherwise permitted or where it is deemed impractical. The new standard also requires that the Company disclose new primary sources of GAAP that have been issued, but are not yet effective and have not been adopted by the Company.

a) New accounting policies

Financial instruments - Effective January 1, 2007, the Company adopted Sections 1530 "Comprehensive Income", 3251 "Equity", 3855 "Financial Instruments – Recognition and Measurement", 3861 "Financial Instruments – Disclosure and Presentation" and 3865 "Hedges" issued by the Canadian Institute of Chartered Accountants.

In accordance with the transitional provisions in these new standards, these policies were adopted retroactively without restatement of prior year figures. The adoption of these policies has no material change to the prior year figures. The methods by which the Company determines the fair value of its financial instruments have also not changed as a result of adopting this standard.

Financial Assets and Financial Liabilities – Under the new standards, all financial instruments are classified into one of the following five categories: held for trading, held to maturity investments, loans and receivables, available for sale financial assets and other financial liabilities. All financial instruments, including derivatives, are included in the consolidated balance sheet and are measured at fair value except for held to maturity investments, loans and receivables and other financial liabilities which are measured at amortized cost.

Under the new standards, financial assets and financial liabilities are initially recognized at fair value and are subsequently accounted for based on their classification described below. The classification depends on the purpose for which the financial instruments were acquired and their characteristics. Except in very limited circumstances, the classification is not changed subsequent to initial recognition. Transaction costs are recognized immediately in income or are capitalized, depending upon the nature of the transaction and the associated product.

Pareto Corporation

Summary of Significant Accounting Policies

December 31, 2007 and 2006

3. Changes in accounting policies (continued)

Upon adoption of these new standards, the Company's significant financial asset and liabilities are classified as follows:

Cash (Bank indebtedness)	Held for trading
Accounts receivable	Loans and receivables
Loans receivable	Loans and receivables
Accounts payable and accrued liabilities	Other financial liabilities
Acquisition notes payable	Other financial liabilities

Held for trading – financial assets and financial liabilities that are purchased and incurred with the intention of generating profits in the near term are classified as held for trading. These instruments are accounted for at fair value with the change in the fair value recognized in net earnings.

Available for sale – financial assets classified as available for sale are carried at fair value with the changes in fair value recorded in other comprehensive income. Gains and losses realized on disposal of available for sale financial assets, which are calculated on an average cost basis, are recognized in earnings.

Held to maturity – Securities that have a fixed maturity date, where the Company intends and has the ability to hold to maturity, are classified as held to maturity and accounted for at amortized cost using the effective interest rate method.

Loans and receivables – Loans and receivables are accounted for at amortized cost using the effective interest rate method.

Other financial liabilities – Other financial liabilities are recorded at amortized cost using the effective interest rate method, and include all liabilities, other than derivatives.

b) Future Accounting Policy Changes

Financial Instruments Disclosure and Presentation – Under CICA Handbook section 3862 “Financial Instruments - Disclosure” and section 3863 “Financial Instruments – Presentation”, disclosure requirements are revised and enhanced, while presentation requirements remain essentially unchanged. The new disclosure requirements will expand discussion around the significance of financial instruments for the Company's financial positions and performance, and the nature and extent of risk arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and how the entity manages those risks. These standards are effective for fiscal years beginning on or after October 1, 2007. The Company is currently assessing the potential impact.

Capital Disclosures – Under CICA Handbook Section 1535 “Capital Disclosures”, the Company will disclose its objectives, policies and procedures for managing capital, any summary quantitative data about what the Company manages as capital, whether the Company has complied with any externally imposed capital requirements and, if the Company has not complied with them, any consequences of non-compliance. This standard is effective for fiscal years beginning on or after October 1, 2007. The Company is currently assessing the potential impact.

Pareto Corporation

Summary of Significant Accounting Policies

December 31, 2007 and 2006

3. Changes in accounting policies (continued)

Inventories – Under CICA Handbook Section 3031 “Inventories”, effective for fiscal years beginning on or after January 1, 2008, aligns accounting for inventories under Canadian GAAP with International Financial Reporting Standards (IFRS) and provides additional guidance on the measurement and disclosure requirements for inventories. Specifically, this section requires inventories to be measured at lower of cost and net realizable value. This standard will not materially impact the Company’s financial statements and will be adopted effective January 1, 2008.

International Financial Reporting Standards - In 2006, Canada’s Accounting Standards Board ratified a strategic plan that will result in Canadian generally accepted account principles (Canadian “GAAP”), as used by public companies, being evolved and converged with International Financial Reporting Standards (“IFRS”) over a transitional period currently expected to be complete by 2011. The precise timing of convergence will depend on an Accounting Standards Boards “progress review” to be undertaken and released by March 31, 2008. Canadian GAAP will be converged with IFRS through a combination of two methods: as current joint-convergence projects of the United States’ Financial Accounting Standards Board and the International Accounting Standards Board are agreed upon, they are expected to be adopted by Canada’s Accounting Standards Board and may be introduced in Canada before the complete changeover to IFRS; and standards not subject to a joint-convergence project will be exposed in an omnibus manner for introduction at the time of the complete changeover to IFRS. The Company will convert to these new standards according to the timetable set with these new rules. The Company will closely monitor changes arising from this convergence.

Pareto Corporation
Notes to Consolidated Financial Statements

December 31, 2007 and 2006

4. 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.

Additional contingent consideration of \$3,000,000 of acquisition notes payable and additional transaction costs of \$12,429 were recorded in 2007. 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 notes payable (note 5(c))	1,250,000
Acquisition notes payable (note 5(c))	3,000,000
Integration costs	75,000
Transaction costs	443,352
Share capital issued (450,450 common shares)	500,000
	<u>8,518,352</u>
Excess of purchase price consideration allocated to goodwill	<u>\$ 7,837,453</u>

Additional cash consideration of \$2,000,000 is payable to the previous owners in October 2008 based on satisfaction of remaining contingent events. This amount will be accounted for as an increase in goodwill.

The Company determined that approximately \$75,000 of the above goodwill is deductible for income tax purposes.

Pareto Corporation
Notes to Consolidated Financial Statements

December 31, 2007 and 2006

4. 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>
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- 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.

Additional contingent cash consideration of \$23,333 and additional transaction costs of \$5,662 were paid on June 1, 2007 based on the operating results of the business. 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	423,333
Acquisition notes payable (note 5 (b))	200,000
Integration costs	196,769
Transaction costs	66,925
	<u>887,027</u>

Excess of purchase price consideration allocated to goodwill	\$ <u>524,563</u>
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Pareto Corporation
Notes to Consolidated Financial Statements

December 31, 2007 and 2006

4. Business combinations (continued)

Under the agreement additional contingent cash consideration was payable based on future operating results of \$325,000 and \$125,000 in 2007 and 2008 respectively. Based on the actual operating results additional consideration of \$23,333 was paid and has been accounted for as an increase in goodwill. There are no further amounts owing in 2008.

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. In 2007, it was determined that no warrants will be exercisable under the agreement and all outstanding warrants were cancelled.

The Company determined the Goodwill amount to be deductible for income tax purposes.

5. Deferred costs

	2007	2006	
Deferred costs	\$ 65,038	\$ 93,039	
Deferred start-up costs	270,918	420,669	
	\$ 335,956	\$ 513,708	

6. Capital assets

2007

	Cost	Accumulated Amortization	Net Book Value
Computer software	\$ 1,561,993	\$ 784,014	\$ 777,979
Computer hardware	936,981	545,778	391,203
Furniture and fixtures	1,928,629	700,222	1,228,407
Leasehold improvements	1,228,787	343,271	885,516
	\$ 5,656,390	\$ 2,373,285	\$ 3,283,105

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

Pareto Corporation
Notes to Consolidated Financial Statements

December 31, 2007 and 2006

7. Intangible assets

2007			
	Cost	Accumulated Amortization	Net Book Value
Intangible assets – customer relationships	\$ 2,111,106	\$ 556,499	\$ 1,554,607
2006			
	Cost	Accumulated Amortization	Net Book Value
Intangible assets – customer relationships	\$ 2,111,106	\$ 345,386	\$ 1,765,720

8. Goodwill

	2007	2006
Balance, beginning of year	\$ 16,017,153	\$ 10,696,561
Acquisition of Secom Plus Inc. (note 4(a))	3,012,429	4,825,024
Acquisition of Trajectory Business Performance Inc. (note 4(c))	28,995	495,568
Balance, end of year	\$ 19,058,577	\$ 16,017,153

9. Bank indebtedness

At December 31, 2007, the Company has a line of credit available in the amount of \$9,000,000 (2006 – \$5,500,000) secured by a general security agreement over the assets of the Company. The line of credit bears interest at prime plus 1% (2006 – 1.5%) and is repayable on demand. As at December 31, 2007, the prime rate was 6% (6% as of December 31, 2006). At December 31, 2007 \$1,805,000 was drawn under this facility.

10. Acquisition notes payable

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

	2007	2006
Trajectory (a)	66,668	200,000
Secom (b)	3,000,000	1,250,000
	3,066,668	1,450,000
Less current portion	3,066,668	1,350,000
	\$ -	\$ 100,000

- a) The notes are non-interest bearing and are repayable in four equal installments ending July 1, 2008.
- b) The note is non-interest bearing. In January 2008, \$3,000,000 was paid out of existing cash resources.

Pareto Corporation
Notes to Consolidated Financial Statements

December 31, 2007 and 2006

11. Long-term debt

	<u>2007</u>	<u>2006</u>
Subordinated debt, interest at bankers acceptance rates plus 3.5%, monthly payments of \$41,667 plus \$6,000 fees plus interest, paid in full during 2007	\$ -	\$ 665,992
Installments due within one year	-	500,000
	\$ -	\$ 165,992

12. Capital Lease Obligations

Future minimum annual lease payments, including imputed interest, under capital leases for machinery leases are as follows:

2008	\$ 377,239
2009	377,239
2010	377,239
2011	<u>45,197</u>
	1,176,914
Less: imputed interest	<u>185,969</u>
	990,945
Less: current portion of capital lease obligation	<u>281,666</u>
	<u>\$ 709,279</u>

The leases bear interest at rates between 10% and 12% and expire between 2008 and 2011. The leases are secured by the machinery.

Pareto Corporation
Notes to Consolidated Financial Statements

December 31, 2007 and 2006

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, 2005	37,328,102	\$ 7,576,707
Shares issued pursuant to private placement (i)	5,666,667	8,366,667
Shares issued on acquisition of Secom (note 4(a))	450,450	500,000
Shares issued upon conversion of common share purchase warrants (note 13 (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	45,058,204	\$ 17,176,172
Shares issued pursuant to private placement (ii)	225,000	236,250
Shares issued on exercise of stock options	573,571	186,505
Shares repurchased for cancellation	(1,862,127)	(703,822)
Shares issue costs	-	(22,976)
Balance, December 31, 2007	43,994,648	\$ 16,872,129

(i) 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.

(ii) On April 5, 2007, Pareto issued 225,000 common shares pursuant to an employee private placement at an issue price of \$1.05 per common share.

- c) Stock options

The Company has a stock option plan (the "Plan") for employees, consultants, directors and officers of the Company and was amended in May 2007. Pursuant to the amended Plan, the lesser of 10 per cent of the outstanding and 3,500,000 (2006 – 3,500,000) common shares of the Company have been reserved for issue. In addition, subject to regulatory approval, the Company grants options which are not included under the Plan to new employees as an incentive of employment. Currently, there are no options awaiting regulatory approval. One-third of granted options vest on each of the anniversary dates of the grant and expire after five years

Pareto Corporation
Notes to Consolidated Financial Statements

December 31, 2007 and 2006

13. Share capital (continued)

Stock option transactions under the Plan, including options issued as incentives, 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
Granted in 2007	1,263,334	1.08
Exercised in 2007	(573,571)	0.25
Forfeited in 2007	(171,111)	1.10
Options outstanding, December 31, 2007	1,904,168	\$ 1.02
Number of options exercisable		
Options exercisable, December 31, 2007	429,440	\$ 0.74
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 2007 was \$0.34 (2006 – \$0.41)

The range of exercise prices for options outstanding and exercisable options at December 31, 2007 are as follows:

Exercise Price	Number Outstanding	Weighted Average Contractual Life	Number Exercisable	Weighted Average Contractual Life
\$0.25 - \$0.85	216,667	0.97	216,667	0.97
\$0.86 - \$1.10	892,501	4.12	114,442	1.96
\$1.11 - \$1.25	655,000	4.25	51,666	3.63
\$1.26 - \$1.53	140,000	3.33	46,665	3.33
	1,904,168	3.75	429,440	1.81

d) Restricted stock units:

The Company has a long-term incentive plan (LTIP) for employees, consultant, directors and officers of the Company which was amended in May 2007. Pursuant to the amended LTIP, a total of 2,000,000 (2006 – 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. 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. Restricted stock units are redeemable upon the third anniversary of the date of grant. At December 31, 2007, 682,619 restricted stock units were outstanding pursuant to the LTIP (238,333 at December 31, 2006) and 833,333 restricted stock units were outstanding outside of the LTIP as issued as incentives (nil at December 31, 2006). The weighted average grant date fair value of restricted stock units granted in 2007 was \$1.08 (2006 - \$1.24)

Pareto Corporation
Notes to Consolidated Financial Statements

December 31, 2007 and 2006

13. Share capital (continued)

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.
- (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, conditional upon future operating results. In 2007 it was determined that no warrants will be exercisable under the agreement and all outstanding warrants were cancelled.

f) Share-based compensation:

The fair value of stock options granted in 2007 was estimated using the Black-Scholes option-pricing model with the following assumptions:

Dividend yield 0%
Expected volatility 40%
Risk-free interest rate 4.0% to 4.7%
Expected option life 2 to 4 years

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 restricted stock units granted in 2007 and 2006 was estimated to equal the market price of a Pareto common share on the date of grant.

g) Contributed Surplus

In 2007, \$480,623 (2006: \$134,210) of share based compensation was added to contributed surplus with \$43,005 (2006: \$119,507) 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, 2007 and 2006

14. Income taxes

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

	2007	2006
Future income tax assets		
Loss carry forwards	\$ 640,204	\$ 2,268,846
Capital assets	871,399	1,485,037
Share issuance costs	171,026	-
	<u>1,682,629</u>	<u>3,753,883</u>
Valuation allowance	-	-
Current future income tax assets	950,026	2,903,293
Long-term future income tax assets	<u>732,603</u>	<u>850,590</u>
Future income tax liabilities		
Intangible assets	514,077	644,835
Deferred costs	90,131	112,162
	<u>604,208</u>	<u>756,997</u>
Current future income tax liabilities	<u>119,541</u>	<u>131,225</u>
Long-term future income tax liabilities	<u>\$ 484,667</u>	<u>\$ 625,772</u>

A reconciliation between income taxes provided at actual rates and at the basic rate of 36.12% (2006 – 36.12%) for federal and provincial taxes is as follows:

	2007	2006
Earnings before income taxes	\$ 4,985,810	\$ 2,095,427
Income tax at statutory rates	1,800,875	756,868
Tax differences resulting from:		
Income taxed in a different jurisdiction	(16,085)	(8,938)
Non-deductible items	229,089	60,509
Non-taxable items	(263,380)	(69,366)
Change in future income taxes due to changes in future enacted rates	351,799	(55,304)
Other	(246,985)	(138,137)
Provision for income taxes	<u>\$ 1,855,313</u>	<u>\$ 545,632</u>

The Company has approximately \$1.8 million of non-capital losses to apply against future taxable income. These losses expire in 2014.

	2007	2006
Provision for income taxes consists of:		
Current	\$ (63,152)	\$ 109,662
Future	1,918,465	435,970
	<u>\$ 1,855,313</u>	<u>\$ 545,632</u>

Pareto Corporation
Notes to Consolidated Financial Statements

December 31, 2007 and 2006

15. Earnings per share

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

	2007	2006
Net earnings	\$ 3,130,497	\$ 1,549,795
Weighted average number of common shares outstanding	44,564,041	42,554,794
Stock options	381,743	1,037,001
Common share purchase warrants	-	123,345
Restricted stock units	986,098	415,138
Weighted average number of diluted common shares outstanding	45,931,882	44,130,278
	\$ 0.07	\$ 0.04

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 (2007: \$1.08; 2006: \$1.35), meaning their inclusion would increase diluted earnings per share. In 2007, 586,781 stock options were excluded because their effect would be anti-dilutive. In 2006, 140,000 stock options and 258,065 common share purchase warrants were excluded because their effect would be anti-dilutive.

16. Supplementary cash flow information

	2007	2006
Changes in non-cash operating accounts:		
Accounts receivable	\$ (4,921,659)	\$ 3,524,402
Income and other taxes payable	(155,069)	(901,914)
Inventory and work in progress	253,050	(220,929)
Prepaid expenses	(118,985)	257,692
Accounts payable and accrued liabilities	(222,939)	(4,276,181)
Deferred revenue	(709,265)	(2,053,493)
	\$ (5,874,867)	\$ (3,670,423)
Supplemental cash flow information:		
Interest paid	\$ 488,954	\$ 252,828
Income taxes paid	136,311	1,239,821
Supplemental disclosure of non-cash transactions:		
Shares issued for non-cash consideration	236,250	1,366,667
Increase in goodwill and acquisition notes payable	3,000,000	1,450,000

Pareto Corporation
Notes to Consolidated Financial Statements

December 31, 2007 and 2006

17. Commitments

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

2008	\$	861,520
2009		682,403
2010		616,464
2011		566,770
2012		409,252
2013 and thereafter	\$	2,002,701

18. Related party transactions

- (a) 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.
- (b) In May 2006, the Company issued loans totalling \$866,667 to executives of the Company. The loans were carried at the carrying amount 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. During 2007, loans totalling \$366,667 were repaid. During 2006, loans totalling \$250,000 were repaid. The loans are full recourse, and the Company has received pledges of the purchased common shares as security for the loans.

During 2007, \$46,873 (2006 - \$32,036) of interest was received pursuant to these loans, measured at the exchange amount.

19. 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 2007, one customer represented greater than 10% of the Company's revenue (30%). In 2006, two customers represented greater than 10% of the Company's revenue (23% and 17% respectively). As at December 31, 2007, amounts due from these customers accounted for 22% of accounts receivable (December 31, 2006: 22%, and 11% respectively). All of the Company's operations are located in Canada.

20. Financial Instruments

Credit risk

The Company's financial instruments that are exposed to credit risk include cash and accounts receivable. The Company mitigates its credit risk by dealing with large, credit worthy clients and by billing whenever possible in advance of the provision of services.

Pareto Corporation
Notes to Consolidated Financial Statements

December 31, 2007 and 2006

20. Financial Instruments (continued)

Interest rate risk

The Company's principal exposure to interest rate fluctuations is limited to bank indebtedness and long-term debt (as described in note 9) which bears interest at floating interest rates.

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.

21. Comparative figures

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

22. Subsequent events

On February 27, 2008, the Company announced a strategic investment in Ontogenix Inc, a technology company focused in online marketing. The Company invested \$550,000 in a three year convertible debenture bearing interest at a rate of 16%, accrued annually. When converted, ownership would equate to less than 20%. The investment was funded out of existing cash resources.