



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

**November 5, 2008**

# Pareto Corporation

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

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Management's Discussion and Analysis of Results of Operations and Financial Position ("MD&A") of Pareto Corporation ("the Company" or "Pareto"), dated November 5, 2008, summarizes the significant factors affecting the consolidated operating results, financial condition, liquidity and cash flows of Pareto for the quarter ended September 30, 2008. All amounts are in Canadian dollars. This MD&A should be read in conjunction with consolidated financial statements for the period ended December 31, 2007, which are prepared in accordance with Canadian GAAP. Additional information relating to Pareto, including the Annual Information Form dated March 26, 2008, can be found at the Company's website at [www.pareto.ca](http://www.pareto.ca) and on SEDAR at [www.sedar.com](http://www.sedar.com).

### Forward-looking Statements

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

### Non-GAAP Measures

In this discussion and analysis, management uses "EBITDA" (earnings before amortization, net interest and finance charges, share-based compensation, income taxes, gain on acquisition and non-recurring expenses); a measure not defined under Canadian generally accepted accounting principles ("GAAP"), to discuss Pareto's operating performance. The Company cautions readers 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. 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 net debt (long-term debt plus acquisition notes payable, less cash), EBITDA margin and cash interest expense.

The Company's non-GAAP financial measures, particularly EBITDA, are measures used by investors, financial analysts and lenders, who may use EBITDA and other non-GAAP financial measures to value the Company and assess the Company's ability to service its debt.

### Business Overview

Pareto is a marketing services company that provides marketing execution services to its clients. Pareto's focus is on the details of marketing programs, utilizing technology to drive efficient and effective marketing execution. The Company provides value to its clients by sourcing, designing and coordinating the many elements that go into delivery a successful campaign, event or loyalty program. Pareto provides measurable, quantifiable services that complement and support its clients' marketing and sales departments. The Company endeavors to sell, to each client, as many of its operational services and products as possible and while the Company markets a number of distinct "solutions", most client projects typically involve contributions from several of Pareto's service offerings. The specific products and services which Pareto offers to its clients include:

- ❖ Design, production and fulfillment of in-store marketing materials.
- ❖ Design and production of direct marketing materials.
- ❖ Corporate events.
- ❖ Field services.
- ❖ Incentive programs.
- ❖ Outsourced marketing program management.

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Pareto sells its products and services, other than incentive programs which are based on reward unit resale (described in more detail below), either on a project or deliverable fixed fee basis or on a time and materials basis. Pareto services typically sold on a fixed fee basis include design, production and fulfillment of in-store marketing materials and direct marketing services and, corporate events. For example, the Company may sell finished goods (such as in-store signage and direct mail) bundled with a management system (which may include web or data management and distribution) for a fixed price per unit. The value proposition to the client in these circumstances is reduced cost and the benefits of Pareto's management system in terms of reduced cycle times, program effectiveness, and data availability. Profitability in the project or deliverable fixed fee business model is driven by Pareto's success in accurately projecting its costs in pricing products and services and by effective project management.

Outsourced marketing program management and field services are typically sold on a time and materials basis. In this application Pareto often acts as the client's representative. The Company's personnel are positioned as an extension of, and support for, the client's sales or marketing department. In addition to offering support, Pareto adds value in these situations through program management where it administers and manages an ongoing marketing program to specified objectives. These services may also be sold on a fixed fee basis. In the time and materials based business model profitability is driven by establishing appropriate billing rates for services rendered, and by ensuring that each billable employee is engaged in an appropriate level of billable activity.

Certain incentive programs are based upon the resale of reward units at prices in excess of the cost of the unit to Pareto. Profitability in this business model is dependent on the successful achievement by Pareto's clients of the sales and other business objectives for which the reward units are used as an incentive as well as the number of participants registered in the program. This drives the volume of reward units resold by the Company. These programs are also characterized by significant start-up costs incurred to put the program into place and to sign up participants. As revenues directly reflect our clients' sales volume, the timing of those revenues trends toward the end of the year, as client companies are working to ensure they meet their annual sales targets and accordingly offer attractive incentives to their sales channel during this time. The attractiveness of the reward units resold is also a factor in the overall performance and growth potential of the Company's loyalty and incentive business.

In all of Pareto's businesses it is critical that the Company have and retain the highest quality of personnel having the capabilities and expertise required to deliver the services and products required by Pareto's clients. Personnel development and retention is a key focus of Pareto management and the Company believes that its personnel systems and processes are a key component of its achievements in terms of growth and profitability to date.

Pareto is managed and operated as a single business. The Company endeavors to sell, to each client, as many of its operational services and products as possible and while the Company markets a number of distinct "solutions", in reality a particular project typically involves contributions from several service offerings. Senior management also participates directly in the sales and delivery of products and services to the Company's clients. Accordingly, the Company has determined that it is not practical to prepare and provide meaningful profitability information for individual components of Pareto's business, nor is it meaningful to present a measure of profitability for the business, which includes all direct costs incurred in respect of sales and operational execution other than EBITDA.

Pareto endeavors to enter into long-term contracts with its clients in order to deliver the most cost effective outsourcing of the client's marketing execution as possible. Customer contracts are often annual with certain contracts being 2 to 3 years in length. Long-term contracts allow Pareto to develop and execute longer-term performance improvement and cost reduction programs. The contracts also allow Pareto to achieve a seamless interaction with the client personnel and have been 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

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towards consolidation. While many companies may provide services which are similar to the Company's, Pareto's focus on marketing execution as opposed to strategy is often a differentiator. As such, the Company often acts as a complement to, rather than in competition with, existing client marketing and agency resources.

All of the Company's operations are located in Canada with minimal purchasing done outside of Canada and as such, the Company has minimal exposure to changes in currency.

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

	2008	2007	\$ Change	% Change
Revenue	\$ 18,126,430	\$ 14,345,259	\$ 3,781,171	26%
Operating and administrative expenses <sup>(1)</sup>	16,354,563	13,744,123	(2,610,440)	-19%
EBITDA <sup>(2)</sup>	\$ 1,771,867	\$ 601,136	\$ 1,170,731	195%
	9.8%	4.2%	5.6%	
Amortization of long-term assets	\$ 272,571	\$ 225,772	\$ (46,799)	-21%
Non-recurring expenses <sup>(1)</sup>	182,391	-	(182,391)	0%
Interest and finance charges, net	113,855	135,096	21,241	16%
Share-based compensation	203,214	125,764	(77,450)	-62%
	772,031	486,632	(285,399)	-59%
Earnings before income taxes	999,836	114,504	885,332	773%
Income taxes	341,684	38,290	(303,394)	-792%
Net earnings	\$ 658,152	\$ 76,214	\$ 581,938	764%
Basic and Diluted earnings per share	\$ 0.02	\$ 0.00	\$	

<sup>(1)</sup> Operating and administration expenses exclude non-recurring expenses totaling \$182,391 for costs incurred during the third quarter by the Company for its substantial issuer bid announced August 7, 2008 and subsequently terminated on September 18, 2008.

<sup>(2)</sup> See "Non-GAAP Measures"

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### Operating Results for the nine months ended September 30:

	2008	2007	\$ Change	% Change
Revenue	\$ 55,433,452	\$ 53,408,608	\$ 2,024,844	4%
Operating and administrative expenses <sup>(1)</sup>	50,488,299	49,638,232	(850,067)	-2%
EBITDA <sup>(2)</sup>	\$ 4,945,153	\$ 3,770,376	\$ 1,174,777	31%
	8.9%	7.1%	1.8%	
Amortization of long-term assets	\$ 765,591	\$ 623,275	\$ (142,316)	-23%
Non-recurring expenses <sup>(1)</sup>	182,391	-	(182,391)	0%
Interest and finance charges, net	390,307	320,642	(69,665)	-22%
Share-based compensation	604,805	310,121	(294,684)	-95%
	1,943,094	1,254,038	(689,056)	55%
Earnings before income taxes	3,002,059	2,516,338	485,721	19%
Income taxes	1,025,099	822,326	(202,773)	-23%
Net earnings	\$ 1,976,960	\$ 1,694,012	\$ 282,948	17%
Basic and Diluted earnings per share	\$ 0.04	\$ 0.04	\$	

<sup>(1)</sup> Operating and administration expenses exclude non-recurring expenses totaling \$182,391 for costs incurred during the third quarter by the Company for its substantial issuer bid announced August 7, 2008 and subsequently terminated on September 18, 2008.

<sup>(2)</sup> See "Non-GAAP Measures"

### Third Quarter Results

#### Revenue

In the third quarter of 2008, the Company generated \$18.1 million of revenue compared to \$14.3 million in 2007, an increase of \$3.8 million or 26%. Revenue increased this quarter in the field services business, up \$0.6 million or 19% over the previous year, in the event business, up \$1.8 million or 200% over the previous year, and up \$1.6 million or 24% in the direct marketing and retail in-store marketing business, offset somewhat by a decline of program management services, down \$0.2 million or 8% over the previous year.

Increased revenues from the field services business and the event business are driven primarily from timing of new business that we have won to replace large non-recurring projects done during the second quarter of 2007. Our retail in-store marketing business increase is driven by both new customers as well as increasing volumes with our existing customers. One of our customers within the automotive sector cancelled a \$1.5 million incentive based travel program originally scheduled for the third quarter and reduced programs within our managed service business this quarter. While event revenue was decreased due to this cancellation, overall program margins were maintained as significant planning efforts had been completed and additional resources were required to manage the cancellation.

For the nine month period ended September 30, 2008, revenues increased by 4% or \$2.0 million to \$55.4 million from \$53.4 million in the same period last year. Revenue increased in retail in-store marketing materials, up \$1.7 million or 8% over the previous year, in the event business, up \$0.4 million or 4% over the previous year, and in program management services,

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up \$0.9 million or 19% over the previous year, offset by a decrease in field services, down \$1.0 million or 9% over the previous year.

Our retail in-store marketing business increase is driven by both new customers as well as increasing volumes in our existing customers. Our event business revenue increase is the result of overall timing of events. Program management service revenue has increased due mainly to new customer wins late in 2007. The field services revenue decline is due to timing of one large project that was completed in the second quarter of 2007. New business has already been won and we expect the overall business to grow this year, however, the new business is spread through the year rather than concentrated in one quarter.

We continue to be confident about our ability to generate organic growth in 2008. Our revenues are smoother in 2008 than in the past. In 2007, we experienced two very low quarters, 1<sup>st</sup> and 3<sup>rd</sup> each with approximately \$14million in revenues, and two very high quarters, 2<sup>nd</sup> and 4<sup>th</sup> each with \$24 million and \$21 million respectively. To date in 2008, our first three quarters' revenues are \$17 million, \$21 million and \$18 million respectively. We expect the fourth quarter revenue to marginally exceed the revenue of the related quarter of the previous year, but EBITDA margin may be somewhat lighter than the prior year due to mix in business lines.

To date, we have experienced minimal impact from the economic downturn within the field service and retail sectors, the largest components of our business, but are experiencing more squeezing of spending within the event and incentive services. Overall, we expect to see the event and incentive business flat to prior year, with growth expected in the field service and retail sectors.

In the first three quarters of 2008 the Company's mix of revenues by business model was as follows:

- ❖ Fixed fee basis - \$ 32.3 million or 58% ( \$30.7 million or 57% in 2007)
- ❖ Time and materials basis - \$17.8 million or 32% (\$17.5 million or 33% in 2007)
- ❖ Resale of reward units - \$5.3 million or 10% (\$5.2 million or 10% in 2007)

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### Operating and Administrative Expenses

In the third quarter of 2008, the Company incurred \$16.3 million in operating and administrative expenses compared to \$13.7 million in 2007, an increase of \$2.6 million or 19%. As a percentage of revenue, operating and administrative expenses represented 90% in the third quarter of 2008 as compared to 95% 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.

The improvement in expenses as a percentage of revenue in the third quarter is due to improved operating efficiencies, procurement savings, and economies of scale, offset somewhat by reduced customer pricing from material customer contract renegotiation. The loss of small low margin customers and the implementation of our Business Management System process have improved both direct material usage and labour efficiencies during 2008. Additionally, a procurement process has been undertaken where similar to our customers pushing us for ways to save costs, we have asked our suppliers to reduce costs. The resulting savings have been recognized providing reduced costs over the previous year. Additionally, improved margins have been seen as our costs are spread over higher volumes. Facilities costs and selling, general and administrative costs declined as a percentage of revenue by 2% in 2008 when compared to the prior year due to organizational savings realized with the integration of acquisitions which have reduced facility charges and reduced redundant administrative costs.

For the nine month period ended September 30, 2008, operating and administrative expenses increased by 2% to \$50.4 million compared to \$49.6 million in the same period last year. As a percentage of revenue, operating and administrative expenses represented 91% in 2008 as compared to 93% in 2007.

Direct project costs declined as a percentage of revenue by 1% in 2008 as compared to the prior year. This improvement is due to the mix of services sold, improved efficiencies and procurement savings. Wages and salaries remained unchanged as a percentage of revenue in 2008 when compared to the prior year. Facilities costs and selling, general and administrative costs declined as a percentage of revenue by 1% in 2008 when compared to the prior year due to organizational savings realized with the integration of acquisitions which have reduced facility charges and reduced redundant administrative costs.

### EBITDA

In the third quarter of 2008, the Company generated \$1.7 million of EBITDA (see "Non-GAAP Measures") compared to \$0.6 million in 2007, an increase of \$1.2 million or 195%. EBITDA as a percentage of revenue represented 9.8% in 2008 compared to 4.2% in 2007. The EBITDA percentage has grown steadily over the first three quarters of 2008, improving from 7.2% in the first quarter to 9.4% with higher revenues in the second quarter and to 9.8% on reduced revenues in the third quarter. This increase in percentage is the result of greater efficiencies realized through the integration of acquisitions and operational improvements

For the nine month period ended September 30, 2008, the Company generated \$4.9 million of EBITDA, compared to \$3.7 million in 2007. EBITDA as a percentage of revenue represented 8.9% in 2008 compared to 7.1% in 2007. EBITDA percentage has improved as a percentage of revenue due to improved mix of business, greater efficiencies realized from integration of acquisitions and operational improvements.

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

In the third quarter of 2008, the Company incurred amortization, interest and share-based compensation expenses of \$0.8 million compared to \$0.5 million in 2007, an increase of \$0.3 million or 59%. This increase was driven primarily by one-time non-recurring costs totaling \$0.2 million resulting from the Substantial Issuer Bid the Company announced on August 7, 2008 and subsequently terminated on September 18, 2008. Additionally, share-based compensation expense increased by \$0.1 million or 62% reflecting the impact of the options and restricted stock units granted under the Company's plans as well as those granted for incentive purposes in 2007 for the hiring of three new senior executives. Capital asset amortization

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increased slightly due to amortization related to capital assets acquired in 2007 and 2008. Interest and finance charges decreased slightly this quarter as compared to the prior year as a result of lower debt balances.

For the nine month period ended September 30, 2008, similar factors affected these costs with total amortization, interest and share-based compensation expenses increasing \$0.7 million or 55% compared to the same period last year.

### Income Taxes

In the third quarter of 2008, the Company incurred income tax expenses of \$0.3 million compared to nil in 2007, an increase of \$0.3 million. Income taxes represented 34% of earnings before tax compared to 33% in 2007. For the nine month period, the overall tax rate remained consistent at 34%. At September 30, 2008 the Company has \$0.3 million of net future income tax assets still to be utilized, with no further amounts expected to be utilized during the remainder of 2008. The Company expects to incur an effective tax rate of approximately 34% during the remainder of 2008.

### Net earnings

In the third quarter of 2008, the Company generated \$0.7 million of net earnings compared to \$0.1 million in 2007, an increase of \$0.6 million. For the nine month period ended September 30, 2008, net earnings of \$2.0 million represented a 17% increase compared to \$1.7 million in the same period last year. This increase is the result of increased revenues and improved EBITDA margins, offset somewhat by increased amortization, interest and share-based compensation costs. Excluding the tax effected impact of the non-recurring substantial issuer bid expenses, net earnings totals \$0.8 million for the third quarter and \$2.1 million for the first nine months, representing a 900% increase and 24% increase respectively over the prior year. Net earnings as a percentage of revenue was 3.6% for the third quarter compared to 0.5% in 2007 and 3.6% for the nine month period compared to 3.2% in 2007. Excluding the effect of income taxes, earnings before income taxes were 6.7% of revenue for the quarter compared to 7.9% in 2007, and 5.4% of revenue for the nine month period compared to 6.1% in 2007.

### Earnings per share

Pareto's basic and diluted earnings per share in the third quarter of 2008 were \$0.02 versus nil in 2007. For the nine month period ended September 30, basic and diluted earnings per share were \$0.04 for both years.

## Liquidity and Capital Resources

### Financial Position

	September 30, 2008	December 31, 2007	\$ Change	% Change
Bank Indebtedness	2,956,121	368,291	2,599,830	1142%
Acquisition notes payable	2,000,000	3,066,668	(1,066,668)	-100%
Long-term capital leases	782,613	990,945	(514,118)	-14%
Total debt	5,738,734	4,425,904	1,007,044	23%
Shareholders' equity	27,354,057	25,702,273	1,651,784	3%
Total capitalization	\$ 33,092,791	\$ 30,128,177	\$ 2,658,828	6%
Working capital position	\$ 735,281	\$ 1,445,121	\$ (672,219)	9%

Net debt:Shareholders' equity	0.21:1	0.17:1
Net debt:Total Capitalization	0.17:1	0.15:1
Total debt:EBITDA	0.7:1	0.6:1

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Pareto's sources of short-term liquidity include cash provided by operating activities and a \$9 million operating line of credit secured by a general security agreement over the assets of Pareto and its subsidiaries, and which is repayable on demand.

Management considers the Company's capital resources adequate to meet the Company's operating, capital expenditure, and financing requirements. The Company has access to capital and is currently reviewing its options. The Company may consider reintroducing its Substantial Issuer Bid announced August 7, 2008 and subsequently terminated on September 18, 2008, or 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.

### Operating activities

In the third quarter of 2008, Pareto's operating activities generated \$1.7 million of cash flow compared to a use of \$2.7 million of cash flow in 2007, an increase of \$4.4 million. Operating activities before changes in non-cash operating accounts generated \$1.3 million of cash flow in 2008 compared to \$0.9 million in 2007, an increase of \$0.4 million. Non-cash operating accounts generated \$0.4 million of cash flow in 2008 compared to utilizing \$3.5 million in 2007, an increase of \$3.9 million.

For the nine month period ended September 30, 2008, operating activities generated \$2.8 million of cash flow compared to a utilization of \$4.0 million of cash flow in 2007, an increase of \$6.8 million. Operating activities before changes in non-cash operating accounts generated \$4.4 million of cash flow in 2008 compared to \$3.6 million in 2007, an increase of \$0.8 million. Non-cash operating accounts utilized \$1.6 million of cash flow in 2008 compared to \$7.6 million in 2007, an increase of \$6.0 million.

Our accounts receivable balance showed a slight decrease during the first nine months of the year to \$16.8 million from \$17.3 million at December 31, 2007. This figure represents an average Days Sales Outstanding of 71 days compared to 75 days at December 31, 2007. While this marks an improvement of 5%, it is still above the level we are targeting. However, the aging schedule is better than it has ever been at Pareto. The percentage of receivables that are more than 60 days old reached a new low this year. The significance of this is not related to the risk of bad debts. Our clients are mostly large, stable organizations. Our focus is in the area of managing our working capital. We have begun implementing a plan to improve cash management, with some early success, and we believe there is further leverage available.

### Investing activities

In the third quarter of 2008, Pareto's investing activities, comprised of capital asset additions and investment loans, utilized \$0.1 million of cash flow, a decrease of \$0.8 compared to 2007. For the nine month period ended September 30, 2008, investing activities utilized \$1.1 million of cash flow compared to \$1.7 million for the same period last year. In 2008, \$0.6 million has been utilized on capital additions, \$0.3 million resulting from leasehold improvements incurred as the field service division moved into a new facility during the third quarter, and the remaining \$0.3 million on maintenance capital requirements. In 2008, cash from lease inducements was received totaling \$0.2 million relating to the new field service facility lease. In 2008, cash utilized for investments includes \$0.55 million of cash flow for a strategic investment loan to Ontogenix Inc, a technology company focused in online marketing, and \$0.2 million for an employee loan for the purchase of shares. The investment loan consists of a three year convertible debenture bearing interest at a rate of 16%, accrued annually. When converted, ownership is expected to be treated on a cost basis. The loan was funded out of existing cash resources.

### Financing activities

In the third quarter of 2008, Pareto's financing activities, comprised of payment of acquisition notes payable, capital lease obligations and share repurchase, utilized no cash compared to a use of \$0.7 million of cash flow, last year. For the nine month period ended September 30, 2008, financing activities utilized \$4.2 million of cash flow compared to \$3.5 million in the same period last year, an increase of \$0.7 million. In 2008, \$3.0 million was utilized for payment of outstanding

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acquisition notes payable from the Secom Plus Inc. acquisition in the prior year compared to \$1.4 million in 2007, \$0.2 million was utilized as payment of capital lease obligations and \$1.0 million was utilized to repurchase 1.3 million common shares of the Company pursuant to its normal course issuer bid. The bid expired on July 11, 2008 and the Company purchased a total of 1.3 million shares, approximately 24,000 shares short of the total level authorized.

As part of the Secom Plus Inc. purchase completed in October 2006, additional cash consideration of \$2.0 million is payable to the previous owners in October 2008 based on the satisfaction of remaining conditions precedent. These conditions have been met during this quarter and as such, this transaction was recorded as an addition to Goodwill (note 5). Subsequent to the quarter, the payment was made on October 2, 2008. This payment was financed out of existing cash resources

### Contractual Obligations

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

	Payments due by period				
	Total	Less than 1 year	1-3 years	4-5 years	After 5 years
Capital leases	\$ 893,985	\$ 377,239	\$ 516,746	\$ -	\$ -
Operating leases	6,513,964	922,114	814,631	785,993	3,991,226
Total contractual obligations	\$ 7,407,949	\$ 1,299,353	\$ 1,331,377	\$ 785,993	\$ 3,991,226

### Outstanding Share Data

At November 5, 2008 an unlimited number of common shares were authorized and 42,931,148 (December 31, 2007 - 43,994,648) common shares were outstanding. The Company has 1,973,689 options currently outstanding to acquire common shares pursuant to its Option Plan of which 643,605 are exercisable. No options are currently exercisable at a value lower than the average trading value of \$0.73 this quarter. The Company also has 993,285 restricted stock units currently outstanding, all convertible to common shares on a one to one basis. See note 10 to the consolidated financial statements for further information on the Company's share capital.

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### Non-GAAP Earning Measures

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

	Three months ending September 30, 2008	Three months ending September 30, 2007
Net earnings	658,152	\$ 76,214
Income Taxes	341,684	38,290
Amortization of capital assets, intangible assets and deferred costs	272,571	225,772
Non-recurring expenses re substantial issuer bid	182,391	-
Interest and financing charges	113,855	135,096
Share-based compensation	203,214	125,764
EBITDA	\$ 1,771,867	\$ 601,136

	Nine months ending September 30, 2008	Nine months ending September 30, 2007
Net earnings	1,976,960	\$ 1,694,012
Income Taxes	1,025,099	822,326
Amortization of capital assets, intangible assets and deferred costs	765,591	623,275
Non-recurring expenses re substantial issuer bid	182,391	-
Interest and financing charges	390,307	320,642
Share-based compensation	604,805	310,121
EBITDA	\$ 4,945,153	\$ 3,770,376

### Transactions with Related Parties

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.

In September 2008, the Company issued a loan totalling \$188,500 to an executive of the Company for the purchase of 300,000 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.

During 2008, \$20,559 of interest was received pursuant to the loans receivable from executives.

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### 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.

#### Competition

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

#### Dependence Upon a Limited Number of Clients

Although the Company has a significant number of clients, a relatively small number of them contribute the majority of the Company's revenue and gross profit. During the nine month period ending September 30, 2008 Pareto generated revenues from one client represented greater than 10% of revenues (26%, 2007 – 30%). The Company's current contract with this customer has a term ending July 31, 2012.

The Company's dependence on a limited number of clients may increase in the future, should the Company continue to achieve improved relationships with key clients and succeed in providing new services to them.

The Company endeavors to reduce the risk of key client dependence by entering into multi-year contractual arrangements with its key clients and by developing multiple relationships within the client organization. The Company also reduces the risk of key client dependence by winning new clients through strategic acquisitions and internal growth.

#### Credit Risk

Accounts receivable represented 35% of consolidated assets at September 30, 2008 (2007 – 32%). Accordingly, the Company could be adversely affected by the bankruptcy of a customer. The Company mitigates its credit risk with respect to accounts receivable by dealing with large, creditworthy clients and also by billing whenever possible in advance of the provision of services.

#### Dependence on Key Personnel

The Company's success is dependent on the leadership of a number of key executive and management personnel. If any of these key individuals leave the Company, the relationships they have with certain of the Company's clients could be lost. In addition, the Company's ability to generate revenue is dependent upon the number and expertise of individuals who perform project work. The competition for the most experienced and able employees is intense, even during cyclical

# Pareto Corporation

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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 Pareto's senior management team have entered into employment contracts that include non-competition and non-solicitation agreements, those agreements may not be effective in retaining key personnel. All key employees are shareholders of the Company.

### Consolidation of Accounts

Large business organizations have shown a tendency towards consolidating their marketing services providers so that one firm provides these services to all national and international locations. While the Company could benefit from this trend, it is also possible that the Company could lose client relationships if certain clients elected to consolidate their marketing services relationship with another supplier. To the extent that Pareto loses revenue as a result of this trend, the Company's business, financial condition and operating results may be affected in a material adverse manner.

## Critical Accounting Estimates

### Overview

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates that affect the amounts reported and disclosed in the consolidated financial statements. Management bases estimates on historical experience and various other assumptions that are believed to be reasonable in the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. On an ongoing basis, management evaluates its estimates. However, actual results could differ from estimated results. The Company's significant accounting policies are included in note 2 to the 2008 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.

### 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. In the first quarter of 2008, 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. 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.

## Financial Instruments and Other Instruments

Pareto engages in transactions in foreign currencies, most commonly involving the U.S. dollar and the euro. From time to time, Pareto will use currency forward contracts to fix the exchange rate for known future transactions. No such contracts were outstanding at September 30, 2008.

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### 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 September 30, 2008 and in respect of the year ending. 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

The Chief Executive Officer and Chief Financial Officer have designed a system of internal control over financial reporting which provides reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with the generally accepted accounting principles.

During the quarter ended September 30, 2008, 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. The Company is continuing with its efforts in formalizing and documenting various elements of its system of internal control over financial reporting in preparation for the evaluation of the operating effectiveness of its internal control system within the timelines to be prescribed by the Canadian Securities Administrators.

### Recent Accounting Developments

#### a) New accounting policies

Financial Instruments Disclosure and Presentation – CICA Handbook section 3862 “Financial Instruments - Disclosure” and section 3863 “Financial Instruments – Presentation”, replace Handbook Section 3861, Financial Instruments – Disclosure and Presentations, revising and enhancing disclosure requirements to provide additional information on the nature and extent of risks arising from financial instruments to which the Company is exposed and how it manages those risks.

Capital Disclosures –CICA Handbook Section 1535 “Capital Disclosures”, specifies the disclosure of the Company's objectives, policies and processes for managing capital, including: a description of what components of liabilities and shareholders' equity the Company defines as capital and their balances, and the nature of any externally imposed capital restrictions, how those are managed and the consequence of any non-compliance, if any.

Inventories – CICA Handbook Section 3031 “Inventories”, provides guidance on the measurement of inventories, with an expanded definition of cost, and the requirement that inventory must be measured at the lower of cost and net realizable value. In addition, the section has additional disclosure requirements, including accounting policies, carrying values, and the amount of any inventory write downs. The adoption of this new standard had no financial effect on the consolidated financial statements of the Company. .

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### b) Future Accounting Policy Changes

International Financial Reporting Standards – In February 2008, The Canadian Accounting Standards Board confirmed that the use of International Financial Reporting Standards (IFRS) will be required in Canada for publicly accountable profit-oriented enterprises for fiscal years beginning on or after January 1, 2011. The Company will be required to report using IFRS beginning September 1, 2011. The Company has begun the process of evaluating the impact of the change to IFRS.

Goodwill and Intangible Assets – Effective January 1, 2009, the Company will adopt new CICA Handbook Section 3064, Goodwill and Intangible Assets, which establish revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The new standard also provides guidance for the treatment of various preproduction and start-up costs and requires that these costs be expensed as incurred. The Company is evaluating the full impact of this standard on its consolidated financial statements.

## SUMMARY OF QUARTERLY AND ANNUAL RESULTS

Year ended 30 September, 2008	Mar 31	Jun 30	Sep 30	Dec 31	Last 12 months
<b>Quarterly information:</b>					
Revenue	\$ 16,453,170	\$ 20,853,852	\$ 18,126,430		\$ 76,364,857
EBITDA <sup>1</sup>	1,179,078	2,002,222	1,771,867		8,028,713
EBITDA Margin	7.2%	9.6%	9.8%		10.5%
Net earnings	403,853	914,954	658,152		3,413,445
Basic and diluted earnings per share <sup>2</sup>	0.01	0.02	0.02		0.07
<b>Annual information:</b>					
Total assets					
Total long-term financial Liabilities, including current portion					
Cash dividends declared					

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Year Ended 31 December, 2007	Mar 31	Jun 30	Sep 30	Dec 31	Total
<b>Quarterly information:</b>					
Revenue	\$ 14,716,308	\$ 24,347,041	\$ 14,345,259	\$ 20,931,405	\$ 74,340,013
EBITDA <sup>1</sup>	816,693	2,352,547	601,136	3,083,560	6,853,936
EBITDA Margin	5.5%	9.7%	4.2%	14.7%	9.2%
Net earnings	347,544	1,270,254	76,214	1,436,485	3,130,497
Basic and diluted earnings per share <sup>2</sup>	0.01	0.03	0.00	0.03	0.07
<b>Annual information:</b>					
Total assets					46,586,523
Total long-term financial liabilities, including current portion					4,057,613
Cash dividends declared					-

Year Ended 31 December, 2006	Mar 31	Jun 30	Sep 30	Dec 31	Total
<b>Quarterly information:</b>					
Revenue	\$ 9,532,273	\$ 13,036,822	\$ 10,316,477	\$ 18,194,436	\$ 51,080,008
EBITDA <sup>1</sup>	764,547	1,236,293	708,050	40,846	2,749,736
EBITDA Margin	8.0%	9.5%	6.9%	0.2%	5.4%
Net earnings	346,152	713,047	464,347	26,249	1,549,795
Basic and diluted earnings per share <sup>2</sup>	0.01	0.02	0.01	0.00	0.04
<b>Annual information:</b>					
Total assets					44,807,361
Total long-term financial liabilities, including current portion					3,372,347
Cash dividends declared					-

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

<sup>2</sup> The quarterly figures do not add to the annual figure due to rounding and differences in weighted average diluted shares outstanding during the periods.

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### 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 Event business, does not follow a predetermined seasonal pattern though the fourth is traditionally the largest period of client spending in the marketing services industry and can cause material fluctuations in quarterly revenues, EBITDA, and net earnings.

### Additional Information

Other information relating to Pareto, including the Company's Annual Information Form, is available on SEDAR at [www.sedar.com](http://www.sedar.com).