



## Consolidated Financial Statements

For the quarter ended March 31, 2009

# Pareto Corporation

## Consolidated Balance Sheets

As at	March 31 2009 (unaudited)	December 31 2008 (audited)– note3
<b>Assets</b>		
<b>Current assets</b>		
Accounts receivable	\$ 13,607,256	\$ 16,460,617
Inventories (note 4)	2,209,544	1,746,355
Prepaid expenses	707,957	466,040
Current future income tax assets	44,604	38,167
	<u>16,569,361</u>	<u>18,711,179</u>
<b>Loans receivable and other assets (note 5)</b>	<b>1,301,830</b>	<b>1,299,045</b>
<b>Long-term future income tax assets</b>	<b>429,479</b>	<b>258,209</b>
<b>Capital assets (note 6)</b>	<b>3,233,170</b>	<b>3,340,697</b>
<b>Intangible assets (note 7)</b>	<b>1,290,714</b>	<b>1,343,493</b>
<b>Goodwill (note 8)</b>	<b>21,058,577</b>	<b>21,058,577</b>
	<u>\$ 43,883,131</u>	<u>\$ 46,011,200</u>
<b>Liabilities and Shareholders' Equity</b>		
<b>Current liabilities</b>		
Bank indebtedness (note 9)	\$ 2,029,277	\$ 654,573
Accounts payable and accrued liabilities	9,391,236	12,032,039
Dividends payable	643,967	1,717,246
Deferred revenue	1,693,685	2,023,252
Income taxes payable	1,291,592	983,915
Current portion of capital lease obligations (note10)	327,231	314,275
Current portion of lease inducements (note11)	42,482	42,482
	<u>15,419,470</u>	<u>17,767,782</u>
<b>Long-term future income tax liabilities (note 3)</b>	<b>325,920</b>	<b>194,192</b>
<b>Long-term capital lease obligations (note 10)</b>	<b>306,678</b>	<b>395,004</b>
<b>Deferred lease inducements (note 11)</b>	<b>332,121</b>	<b>342,742</b>
<b>Total liabilities</b>	<u>16,384,189</u>	<u>18,699,720</u>
<b>Shareholders' equity</b>		
Share capital (note 12(b))	16,501,855	16,501,855
Contributed surplus (note 12(f))	1,667,206	1,492,547
Retained earnings and accumulated other comprehensive income (note 3)	9,329,881	9,317,078
<b>Total shareholders' equity</b>	<u>27,498,942</u>	<u>27,311,480</u>
	<u>\$ 43,883,131</u>	<u>\$ 46,011,200</u>

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

# Pareto Corporation

## Consolidated Statements of Operations and Retained Earnings

For the three months ended (unaudited)	March 31, 2009	March 31, 2008 (note 3)
<b>Revenue</b>	<b>\$ 16,182,996</b>	<b>\$ 16,453,170</b>
<b>Operating and administrative expenses</b>	<b>14,771,869</b>	<b>15,274,092</b>
	<b>1,411,127</b>	<b>1,179,078</b>
Amortization of capital assets	167,050	158,952
Amortization of intangible assets	52,779	52,778
Interest, net	12,409	106,993
Share-based compensation (note 12(f))	189,659	207,780
	<b>421,897</b>	<b>526,503</b>
Earnings before income taxes	989,230	652,575
Income taxes (notes 3 and 13)	332,460	195,802
<b>Net earnings and comprehensive income for the period</b>	<b>656,770</b>	<b>456,773</b>
Retained earnings, beginning of period (note 3)	9,317,078	7,877,806
Dividends declared	(643,967)	-
Excess price paid over carrying value on repurchase of common shares	-	(394,256)
<b>Retained earnings, end of period</b>	<b>\$ 9,329,881</b>	<b>\$ 7,940,323</b>
Basic and diluted earnings per share (note 14)	<b>\$ 0.015</b>	<b>\$ 0.01</b>
<b>Weighted average number of common shares outstanding:</b>		
Basic	42,931,148	43,408,981
Diluted	44,860,685	45,036,864

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

# Pareto Corporation

## Consolidated Statements of Cash Flows

For the three months ended (unaudited)	March 31, 2009	March 31, 2008 ( note 3)
<b>Operating activities</b>		
Net earnings for the period	\$ 656,770	\$ 456,773
Items not involving cash:		
Amortization of capital assets	167,050	158,952
Amortization of intangible assets	52,779	52,778
Amortization of lease inducement (note 11)	(10,621)	-
Non-cash interest	(27,785)	-
Share-based compensation (note 12 (f))	189,659	207,780
Future income tax provision (notes 3 and 13)	(45,979)	206,061
	<u>981,873</u>	<u>1,082,344</u>
Changes in non cash operating accounts (note 15)	(504,440)	(851,149)
	<u>477,433</u>	<u>231,195</u>
<b>Investing activities</b>		
Capital asset additions	(59,521)	(52,459)
Loans receivable and other assets	-	(550,000)
Acquisitions, net of cash (note 8 (a))	-	(3,000,000)
	<u>(59,521)</u>	<u>(3,602,459)</u>
<b>Financing activities</b>		
Dividends Paid	(1,717,246)	-
Repayment of capital lease obligations	(75,370)	(67,552)
Share issue costs	-	(2,051)
Repurchase of common shares	-	(760,979)
	<u>(1,792,616)</u>	<u>(830,582)</u>
<b>Decrease in cash for the period</b>	<b>(1,374,704)</b>	<b>(4,201,846)</b>
<b>(Bank Indebtedness) / Cash, beginning of period</b>	<b>(654,573)</b>	<b>(368,291)</b>
<b>Bank Indebtedness, end of period</b>	<b>\$ (2,029,277)</b>	<b>\$ (4,570,137)</b>

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

**1. Nature of Operations**

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

**2. Significant Accounting Policies**

**Basis of Consolidation**

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

**Use of Estimates**

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amount of revenues and expenses during the reporting period. These estimates principally relate to valuation of accounts receivable, impairment testing of goodwill and stock compensation. Actual results could differ from management's best estimates as additional information becomes available in the future.

**Accounts Receivable**

Collectability of accounts receivable is reviewed on an ongoing basis. An allowance account is used when there is objective evidence that it is impaired. The factors that are considered in determining if an accounts receivable is impaired include whether a customer is in bankruptcy, under administration or if payments are in dispute. The offsetting expense is recognized in earnings within operating expenses. When an accounts receivable for which an impairment allowance had been recognized becomes uncollectible in a subsequent period, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against operating expenses in earnings.

**Financial Instruments**

Financial instruments are measured at fair value on initial recognition. After initial recognition, financial instruments are measured at their fair values, except for financial assets classified as held-to-maturity or loans and receivables and other financial liabilities, which are measured at amortized cost.

Amortized cost related to financial assets classified as held-to-maturity or loans and receivables and other financial liabilities is calculated using the effective interest method with changes recognized as income or expense in earnings.

Gains and losses related to financial assets and financial liabilities classified as held for trading are recorded in earnings in the period in which they arise. The Company designates financial assets and financial liabilities as held for trading if it is acquired or incurred principally for the purpose of selling or repurchasing in the near term.

If a financial asset is classified as available-for-sale, the cumulative unrealized gain or loss is recognized in accumulated other comprehensive income and recognized in earnings upon sale or other-than-temporary impairment. The Company assesses whether a financial asset is other-than-temporarily impaired by assessing whether there is a significant or prolonged decline in fair value and objective evidence of impairment exists such as financial difficulty, breach or default of contracts, probability of bankruptcy or other financial reorganization.

The Company applies trade date accounting for its purchases and sales of financial assets.

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

**i. Transaction Costs**

Transaction costs directly attributable to financial assets and liabilities that are not classified as held-for-trading are included in the amortized cost of the related asset or liability and recognized in earnings through the effective interest method. Transaction costs related to held-for-trading financial assets and liabilities are expensed as incurred.

**ii. Derivative Financial Instruments**

All derivative financial instruments are measured at fair value, even when they are part of an effective hedging relationship. An embedded derivative is a component of a hybrid instrument that also includes a non-derivative host contract, with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. If certain conditions are met, an embedded derivative is bifurcated from the host contract and accounted for as a derivative in the consolidated balance sheet, and measured at fair value.

The Company does not enter into derivative financial instruments for trading or speculative purposes.

The Company's significant financial asset and liabilities are classified as follows:

Bank indebtedness	Held for trading
Accounts receivable	Loans and receivables
Loans receivable	Loans and receivables
Other assets	Held to maturity
Accounts payable and accrued liabilities	Other financial liabilities
Acquisition notes payable	Other financial liabilities

**Inventories**

Inventories include work in progress, finished goods and loyalty reward units. Work in progress includes costs incurred on non-manufacturing projects for which revenue has not yet been recognized for accounting purposes. Finished goods inventory includes total costs incurred for print materials that the company holds for future distribution under its fulfillment and distribution client agreements. Loyalty reward units include the cost of units purchased that the company holds for resale under its incentive service agreements. Inventory is carried at the lower of cost and net realizable value. The cost of work in progress inventory and loyalty reward units is determined through specific identification by project and includes direct costs and labour. The cost of finished goods inventory is determined using the retail method of accounting.

**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.

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

**Impairment of Long Lived Assets**

The Company monitors events and changes in circumstances which may require an assessment of the recoverability of its long lived assets. The Company assesses recoverability using estimated undiscounted future operating cash flows expected from the use and eventual disposition of the asset. If the carrying amount of an asset is not recoverable, an impairment loss is recognized in operations, measured by comparing the carrying amount of the asset to its fair value.

**Goodwill**

Goodwill represents the consideration paid for acquisitions in excess of the fair market value of the net identifiable assets acquired. Goodwill is carried at cost, less impairment losses, if any.

The Company uses a two-step impairment test on an annual basis, or when significant business changes have occurred that may have had an adverse impact on the fair value of the goodwill. To determine whether impairment has occurred, the fair value of the reporting unit is compared to its carrying amounts, including goodwill. The Company uses a present value of future cash flow approach for determining the fair value of its reporting units. Future cash flows are based on management's best estimates considering historical and expected operating plans, economic conditions and general outlook for the industry and markets in which the reporting unit operates. The discount rates used by the Company are based on an optimal debt to equity ratio and consider the risk free rate, market equity risk premium, size premium and operational risk premium for possible variations from management's projections. The terminal value is the value attributed to the reporting unit's operations beyond the projected period of growth prospects.

The Company's assumptions are affected by current market conditions which may affect expected revenues. In addition, while the Company plans to limit increases in costs, operating costs may increase more significantly than expected. The Company has made certain assumptions for the discount and terminal growth rates to reflect possible variations in the cash flows; however the risk premiums expected by market participants related to uncertainties may differ or change quickly depending on economic conditions or events.

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.

**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 substantially enacted, resulting in adjustments to that period's earnings. A valuation allowance is recorded against future tax assets for amounts that are not more likely than not to be realized. Tax reserves are established for uncertain tax positions based on management's best estimates.

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

**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 receipts in advance of a project's completion are recorded as deferred revenue. For program management and field merchandising services, revenues are recognized as services are rendered.

The Company has arrangements to provide multiple products and services to certain of its customers. The Company has accounted for the activities within such arrangements as separate accounting units based on the relevant revenue recognition criteria for each revenue type described above. These arrangements include delivered items with stand-alone value, and undelivered items with objective and reliable evidence of fair value where delivery is probable and substantially controlled by the vendor.

Revenue from sales of third party services is recorded net of costs when the Company is acting as an agent between the customer and the vendor and recorded gross when the Company is a principal to the transaction. Several factors are considered to determine whether the Company is an agent or a principal, including whether the Company is the primary obligor to the customer, has inventory risk or adds meaningful value to the service. Consideration is also given to whether the Company was involved in the selection of the vendor's service, has latitude in establishing the sales price or has credit risk.

**Earnings per Share**

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

**Stock-based Compensation**

The compensation cost for options granted to employees and officers is determined using the fair value method. The fair value of the options at the grant date is estimated using the Black-Scholes option pricing model, and recognized over the vesting period of the options as an expense, using the graded vesting method with a corresponding amount included in equity as contributed surplus. Any consideration received by the Company on the exercise of stock options is credited to share capital and the contributed surplus component of the stock-based compensation is transferred to share capital upon the issuance of shares.

**Long-term Incentive Plans**

Eligible employees, consultants, directors and officers of the Company participate in a long-term incentive plan, being restricted stock units (RSUs). Compensation cost for RSUs granted is recorded as an expense with a corresponding increase in contributed surplus. Compensation cost is measured based on the common share price on the grant date and recognized over the vesting period using the straight-line method.

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

**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**

**a) New Accounting Policies**

**Goodwill and Intangible Assets** – In February 2008, the CICA issued Handbook Section 3064, Goodwill and Intangible Assets, replacing the existing guidance on goodwill and other intangible assets and research and development costs. The standard is effective for interim and annual financial statements for fiscal years beginning on or after October 1, 2008. The new standard established revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets and provides guidance for the treatment of various preproduction and start-up costs, and requires that these costs be expensed as incurred.

The Company applied the new accounting standard retrospectively at the beginning of its current fiscal year, with restatement of prior periods. Certain assets, notably, start-up and other deferred costs previously included on the Company's balance sheet as Deferred Costs prior to the Company's current fiscal year no longer meet the new recognition or measurement criteria and the definition of an asset were removed from the consolidated balance sheets in accordance with CICA Handbook Section 1506, Accounting Changes. The balance of any such Deferred Costs as at the end of the Company's 2008 fiscal year was reflected as a charge to opening retained earnings.

**Net Earnings Impact** – for the three months ending March 31, 2009, the implementation of the new standard resulted in an increase to the Company's pre-tax net earnings of \$39,789 and an increase to income taxes of \$13,131.

**Balance Sheet Adjustments** – the impact on balances as at December 31, 2008 was a non-cash reduction of \$118,490 to opening retained earnings (\$245,825 at January 1, 2008), a \$159,838 reduction in deferred costs (\$335,956 at January 1, 2008), and a \$41,348 reduction in long-term future income tax liabilities (\$90,131 at January 1, 2008).

**b) Future Accounting Policy Changes**

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

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

The Company has used internal resources to understand, identify and assess the overall effort required to adopt IFRS and has met with an external consultant to proceed in 2009 preparing for the change. The Company has established a changeover plan that consists of three phases: initiation, a detailed assessment, and design and implementation. The plan will cover various areas including:

- Changes to accounting policies and implementation decisions;
- Disclosure requirements
- Changes to information systems and accounting processes
- Changes to internal control over financial reporting and disclosure controls and procedures
- Training requirements; and
- External stakeholder communications

The impact of the adoption of IFRS on the Company's financial reporting is not yet determinable. As the Company assesses the impact of adopting IFRS, it will update its MD&A disclosures quarterly to report on the progress of its IFRS changeover plan.

The Company plans to adopt IFRS according to the schedule recommended by the AcSB.

**Business Combinations and Minority Interest** - In October of 2008, the CICA issued Handbook Section 1582, Business Combinations (CICA 1582), concurrently with Handbook Sections 1601, Consolidated Financial Statements (CICA 1601), and 1602, Non-controlling Interests (CICA 1602). CICA 1582, which replaces Handbook Section 1581, Business Combinations, establishes standards for the measurement of a business combination and the recognition and measurement of assets acquired and liabilities assumed. CICA 1601, which replaces Handbook Section 1600, carries forward the existing Canadian guidance on aspects of the preparation of consolidated financial statements subsequent to acquisition other than non-controlling interests. CICA 1602 establishes guidance for the treatment of non-controlling interests subsequent to acquisition through a business combination. These new standards are effective for the Company's interim and annual consolidated financial statements commencing on September 1, 2011 with earlier adoption permitted as of the beginning of a fiscal year. The Company is assessing the impact of the new standards on its consolidated financial statements.

**4. Inventories**

	March 31 2009	December 31 2008
Work in progress	\$ 1,448,445	\$ 623,226
Finished goods	15,693	73,129
Loyalty reward units	745,406	1,050,000
	<b>\$ 2,209,544</b>	<b>\$ 1,746,355</b>

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

**5. Loans Receivable and Other Assets**

	March 31 2009	December 31 2008
Employee loans receivable (a)	\$ 225,000	\$ 250,000
Employee loan receivable (b)	236,250	236,250
Employee loan receivable(c)	188,500	188,500
Convertible debenture (d)	652,080	624,295
	<b>1,301,830</b>	<b>1,299,045</b>

- (a) In May 2006, the Company issued loans totalling \$225,000 to executives of the Company for the purchase of 192,308 common shares of the Company. The loan is carried at the carrying amount of \$225,000 which approximates its fair value. The loan bears interest at Prime Rate plus ½% with interest payable quarterly. The loans are repayable on May 16, 2011. The loans are full recourse and the Company has received a pledge of the purchased common shares as security for the loans.
- (b) In April 2007, the Company issued a loan totalling \$236,250 to an executive of the Company for the purchase of 225,000 common shares of the Company. The loan is carried at the carrying amount of \$236,250 which approximates its fair value. The loan bears interest at Prime Rate plus ½% with interest payable quarterly. The loan is repayable on April 4, 2012. The loan is full recourse and the Company has received a pledge of the purchased common shares as security for the loans.
- (c) In September 2008, the Company issued a loan totalling \$188,500 to an executive of the Company for an initial purchase of 290,000 common shares of the Company in the open market. The loan is carried at the carrying amount of \$188,500 which approximates its fair value. The loan bears interest at Prime Rate plus ½% with interest payable quarterly. The loan is repayable on September 30, 2013. The loan is full recourse and the Company has received a pledge of the purchased common shares as security for the loans.
- (d) On February 26, 2008 the Company provided financing in the amount of \$550,000 to PeerSet Inc. (“Peerset”), formerly Ontogenix Inc., in return for a three year convertible debenture. The debenture bears an annualized interest rate of 16% of the principal, compounded annually. Interest shall be due and payable upon prepayment or repayment of the debenture. The Company has the option to convert the principal and any outstanding interest into equity securities at any time upon a material business change event and/or liquidity event. A material business change event occurs if Peerset becomes insolvent, its board is reduced in size to two or fewer members, or Peerset is in default of any of the terms of the debenture. A liquidity event means an initial public offering or change of control. If converted, ownership is expected to be treated on a cost basis. The debenture is secured by a general security agreement over all the present and future assets of Peerset. The debenture has been classified as held-to-maturity. Management deemed the value of the conversion right to be insignificant at the date of issue and at March 31, 2009 based on an assessment of the conversion rights and term to expiry.

Subsequent to the quarter ended March 31, 2009, an additional loan amount of \$190,250 was provided in return for a two year convertible debenture bearing interest at an annualized interest rate of 12%, with payment and conversion terms similar to the original debenture.

At March 31, 2008, the carrying amount of the loan includes \$102,080 of accrued interest from the issue date of February 26, 2008 and approximates fair value calculated based on the present value of estimated cash flows at current interest rates.

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**6. Capital Assets**

March 31, 2009	Cost	Accumulated Amortization	Net book Value
Computer software	\$ 1,743,760	\$ 1,006,409	\$ 737,351
Computer hardware	991,343	655,491	335,852
Furniture and fixtures	1,935,088	893,725	1,041,363
Leasehold improvements	1,635,596	516,992	1,118,604
	<b>\$ 6,305,787</b>	<b>\$ 3,072,617</b>	<b>\$ 3,233,170</b>

December 31, 2008	Cost	Accumulated Amortization	Net Book Value
Computer software	\$ 1,710,804	\$ 956,603	\$ 754,201
Computer hardware	979,647	628,825	350,822
Furniture and fixtures	1,934,797	841,622	1,093,175
Leasehold improvements	1,621,015	478,516	1,142,499
	<b>\$ 6,246,263</b>	<b>\$ 2,905,566</b>	<b>\$ 3,340,697</b>

**7. Intangible Assets**

Intangible assets – customer relationships	Cost	Accumulated Amortization	Net book Value
<b>Balance at March 31, 2009</b>	<b>\$ 2,111,106</b>	<b>\$ 820,392</b>	<b>\$ 1,290,714</b>
Balance at December 31, 2008	\$ 2,111,106	\$ 767,613	\$ 1,343,493

**8. Goodwill**

Balance at December 31, 2007	\$ 19,058,577
Acquisition of Secom Plus Inc. (a)	2,000,000
<b>Balance at December 31, 2008 and March 31, 2009</b>	<b>\$ 21,058,577</b>

- 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 was recorded in 2007 and paid in 2008. Additional contingent consideration of \$2,000,000 was recorded and paid in 2008 based on the satisfaction of remaining conditions precedent. The acquisition was accounted for as a purchase.

**9. Bank Indebtedness**

At March 31, 2009, the Company has a line of credit available in the amount of \$9,000,000 (December 31, 2008 – \$9,000,000) secured by a general security agreement over the assets of the Company. The line of credit bears interest at prime plus 1.0% and is repayable on demand. As at March 31, 2009, the prime rate was 2.5% (3.5% as of December 31, 2008).

**10. Capital Lease Obligations**

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

2009	\$ 282,929
2010	377,239
2011	45,197
	705,365
Less: imputed interest	71,456
	633,909
Less: current portion of capital lease obligation	327,231
	<b>\$ 306,678</b>

The leases bear interest at rates between 10% and 12% and expire between 2009 and 2011.

**Pareto Corporation**  
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**11. Deferred Lease Inducements**

During the year ended December 31, 2008 the Company received various lease inducements under two of its 10 year lease agreements. In accordance with CICA EIC-21 "Accounting for Lease Inducements by the Lessee", the Company adopted the recommended balance sheet presentation as well as the amortization of the lease inducements over the term of the lease as a reduction to rental expense.

	Leasehold improvement allowance paid by landlord		Rent holiday	Total
Cost	\$ 227,285	\$ 197,130	\$ 424,415	
Amortization	(13,259)	(25,932)	(39,191)	
Balance at December 31, 2008	214,026	171,198	385,224	
Amortization	(5,682)	(4,939)	(10,621)	
Balance at March 31, 2009	\$ 208,344	\$ 166,259	\$ 374,603	
Less: Current portion	22,729	19,753	42,482	
	\$ 185,615	\$ 146,506	\$ 332,121	

**12. Share Capital**

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

b) Issued common shares:

	Number of Shares	Amount
Balance, December 31, 2007	43,994,648	\$ 16,872,129
Shares issued on exercise of stock options	250,000	128,109
Shares repurchased for cancellation	(1,313,500)	(496,332)
Shares issue costs	-	(2,051)
<b>Balance, December 31, 2008 and March 31, 2009</b>	<b>42,931,148</b>	<b>\$ 16,501,855</b>

c) Stock options

The Company has a stock option plan (the "Plan") for employees, consultants and officers of the Company and was amended in May 2007. Pursuant to the amended Plan, the lesser of 10 per cent of the outstanding and 3,500,000 common shares of the Company have been reserved for issue.

In addition, subject to regulatory approval, the Company grants options which are not included under the Plan to new employees as an incentive of employment. Currently, there are no options awaiting regulatory approval. One-third of granted options vest on each of the anniversary dates of the grant and expire after five years.

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**12. Share Capital (continued)**

Stock option transactions under the Plan, including options issued as incentives, during the period are as follows:

	Number of Options Outstanding	Weighted Average Exercise Price
Options outstanding, December 31, 2007	1,904,168	\$ 1.02
Granted in 2008	424,521	0.68
Exercised in 2008	(250,000)	0.39
Forfeited in 2008	(5,000)	1.05
Options outstanding, December 31, 2008	2,073,689	\$ 1.03
<b>Granted in 2009</b>	<b>797,630</b>	<b>1.03</b>
<b>Exercised in 2009</b>	<b>-</b>	<b>-</b>
<b>Forfeited in 2009</b>	<b>(152,110)</b>	<b>0.99</b>
<b>Options outstanding, March 31, 2009</b>	<b>2,719,209</b>	<b>\$ 0.87</b>

	Number of Options Exercisable	Weighted Average Exercise Price
Options exercisable, December 31, 2008	751,938	\$ 1.11
<b>Vested in 2009</b>	<b>127,778</b>	<b>1.11</b>
<b>Forfeited in 2009</b>	<b>(71,665)</b>	<b>1.01</b>
<b>Options exercisable, March 31, 2009</b>	<b>808,051</b>	<b>\$ 1.12</b>

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

Exercise Price	Number Outstanding	Weighted Average Contractual Life	Number Exercisable	Weighted Average Contractual Life
\$0.52 - \$0.75	1,166,708	4.77	0	0
\$0.76 - \$1.00	109,167	0.72	109,167	0.72
\$1.01 - \$1.25	1,303,334	3.15	588,886	3.07
\$1.26 - \$1.53	140,000	2.08	109,998	2.06
	<b>2,719,209</b>	<b>3.69</b>	<b>808,051</b>	<b>2.61</b>

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**12. Share Capital (continued)**

d) Restricted stock units:

The Company has a long-term incentive plan (LTIP) for employees, consultants, directors and officers of the Company which was amended in May 2007. Pursuant to the amended LTIP, a total of 2,000,000 of the Company's common shares have been reserved for issue through the redemption of restricted stock units. RSUs are convertible into common shares on a one-to-one basis at a price equal to the common share value when granted. 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. During the three months ending March 31, 2009 300,000 units were granted and 23,000 were cancelled. At March 31, 2009, 1,270,285 restricted stock units were outstanding pursuant to the LTIP (993,285 at December 31, 2008) and 833,333 restricted stock units were outstanding outside of the LTIP as issued as incentives (833,333 at December 31, 2008). The fair value of a restricted stock unit granted in 2008 and 2007 was estimated to equal the market price of a Pareto common share on the date of grant.

e) Share-based compensation:

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

	<b>2009</b>	<b>2008</b>
Dividend yield	0%	0%
Expected volatility	60.17% to 64.18%	52.30% to 60.73%
Risk-free interest rate	1.38% to 1.60%	2.22% to 2.94%
Expected option life	2 to 4 years	2 to 4 years

f) Contributed surplus

In the three months ending March 31, 2009, \$189,659 of share based compensation was added to contributed surplus.

**13. Income Taxes**

	Three months March 31, 2009	Three months March 31, 2008
Provision for income taxes consists of:		
Current	\$ 378,439	\$ (10,259)
Future	(45,979)	219,192
	<b>\$ 332,460</b>	<b>\$ 208,933</b>

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**14. Earnings Per Share**

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

	Three months ended March 31, 2009	Three months ended March 31, 2008
Net earnings	\$ 669,270	\$ 403,853
Weighted average number of common shares outstanding	42,931,148	43,408,981
Stock options	25,186	111,931
Restricted stock units	1,904,351	1,515,952
Weighted average number of diluted common shares outstanding	44,860,685	45,036,864
	\$ 0.01	\$ 0.01

The calculation of the dilutive impact of the exercise of options excludes 1,861,823 stock options considered anti-dilutive because their exercise price exceeded the average market price of Pareto's common shares during the three-month period ending March 31, 2009 of \$0.55, meaning their inclusion would increase diluted earnings per share.

**15. Supplementary Cash Flow Information**

	Three months ended March 31, 2009	Three months ended March 31, 2008
<b>Changes in non-cash operating accounts:</b>		
Accounts receivable	\$ 2,853,361	\$ 727,834
Inventory and work in progress	(463,189)	(1,726,787)
Prepaid expenses	(241,917)	88,041
Accounts payable and accrued liabilities	(2,630,805)	(1,239,087)
Income taxes payable	307,677	(36,057)
Deferred revenue	(329,567)	1,334,907
	\$ (504,440)	\$ (851,149)
<b>Supplemental cash flow information:</b>		
Interest paid	\$ 45,224	\$ 116,940
Income taxes paid	70,762	25,798

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**16. Commitments**

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

2009	\$	643,555
2010		845,539
2011		801,375
2012		643,857
2013		661,722
2014 and thereafter		2,569,632

**17. Related Party Transactions**

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

**18. 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 the quarter ending March 31, 2009, one customer represented greater than 10% of the Company's revenue being 28% (2008 – 25%). Amounts due from this customer accounted for 17% of accounts receivable as at March 31, 2008 (December 31, 2008 – 24%). All of the Company's operations are located in Canada.

**19. Capital Management**

The Company's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and sustain future development of the business. The Company defines capitalization to include the total of bank indebtedness, acquisition notes payable, capital lease obligation and shareholders' equity.

	March 31, 2009	December 31, 2008
Bank Indebtedness	\$ 2,029,277	\$ 654,573
Capital lease obligation	633,909	709,279
Total debt	2,663,186	1,363,852
Shareholders' equity	27,498,942	27,429,969
Total capitalization	\$ 30,162,128	\$ 28,793,821
Debt:Shareholders' equity	0.10:1	0.05:1
Debt:Total Capitalization	0.09:1	0.05:1
Debt: EBITDA <sup>(1)</sup>	0.32:1	0.17:1

**19. Capital Management (continued)**

<sup>(1)</sup> For purposes of calculating ratios EBITDA is defined as earnings before amortization, net interest and finance charges, share-based compensation, income taxes, gain on acquisition and non-recurring expenses. EBITDA is not a measure defined under Canadian generally accepted accounting principles ("GAAP") and therefore readers are cautioned that measures adjusted to a basis other than GAAP do not have standardized meaning and are unlikely to be comparable to similar measures used by other companies.

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

The Company seeks to maintain a balance between the higher returns that might be possible with the leverage afforded by higher borrowing levels and the security afforded by a sound capital position. The Company's target is to create value for its shareholders over the long-term through increases in share value.

On November 20, 2008, the Company declared a special cash dividend of \$0.04 per issued and outstanding share payable on January 15, 2009, to shareholders of record at the close of business on December 31, 2008.

On March 4, 2009, the Company initiated a quarterly cash dividend of \$0.015 per issued and outstanding share, with the inaugural dividend payable on April 15, 2009, to shareholders of record at the close of business on March 31, 2009.

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.

There were no changes in the Company's approach to capital management during the period. The Company currently has no externally imposed capital restrictions.

**20. Financial Instruments**

**(a) Fair value of Financial Instruments**

At March 31, 2009, the fair value of the Company's financial instruments approximate their carrying values due to their short-term nature or because they bear interest at market rates.

**(b) Financial Risk Management**

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Company's activities.

**i. Credit Risk**

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises primarily from the Company's receivables from customers and notes receivable.

**20. Financial Instruments (continued)**

**Accounts Receivable**

The Company's exposure to credit risk is dependent upon individual characteristics of each customer. Each new customer is assessed for creditworthiness before standard payment and delivery terms and conditions are offered. The Company deals with large, credit worthy clients and bills in advance of the provision of services, whenever possible.

The Company regularly reviews the collectability of its accounts receivable and establishes an allowance for doubtful accounts based on its best estimate of any potentially uncollectible accounts. Historically, the Company has experienced minimal bad debts. As at March 31, 2009, a reserve in respect of doubtful accounts of \$109,053 was set up to cover accounts where collection is not assured.

All of the Company's accounts receivables are within Canada.

**ii. Liquidity Risk**

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company ensures, as far as possible, that it will always have sufficient liquidity to meet obligations when due and monitors cash flow requirements daily and projections weekly.

**iii. Market Risk**

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices will affect the Company's income or the value of its holding of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return on risk.

**iv. Foreign Exchange Risk**

The Company, on occasion, engages in transactions in foreign currencies, most commonly involving the US dollar and the Euro. The Company mitigates its risk by billing whenever possible in the relevant currency and, on occasion, enters into derivative instruments to manage this risk. At March 31, 2009, there are no such contracts outstanding.

**v. Interest Rate Risk**

The Company's principal exposure to interest rate fluctuations is limited to bank indebtedness (as described in note 10) which bears interest at floating interest rates.

Based on the Company's average debt level during the quarter ended March 31, 2009, the sensitivity of a 100 basis point increase in interest rates would result in an approximate decrease of \$4,365 in net after tax annual earnings.

**vi. Other Market Price Risk**

The Company does not enter into commodity contracts other than to meet the Company's expected usage and sale requirements and such contracts are not settled net.

**21. Comparative Figures**

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