



Consolidated Financial Statements

For the quarter ended September 30, 2009

Pareto Corporation

Consolidated Balance Sheets

As at	September 30 2009 (unaudited)	December 31 2008 (audited) – note 3
Assets		
Current assets		
Accounts receivable	\$ 16,029,248	\$ 16,460,617
Inventories (note 4)	2,948,487	1,746,355
Prepaid expenses	607,898	466,040
Current future income tax assets	43,759	38,167
	<u>19,629,392</u>	<u>18,711,179</u>
Loans receivable and other assets (note 5)	1,669,734	1,299,045
Long-term future income tax assets	183,184	258,209
Capital assets (note 6)	4,728,082	3,340,697
Intangible assets (note 7)	1,292,245	1,343,493
Goodwill (note 8)	21,058,577	21,058,577
	<u>\$ 48,561,214</u>	<u>\$ 46,011,200</u>
Liabilities and Shareholders' Equity		
Current liabilities		
Bank indebtedness (note 9)	\$ 1,645,284	\$ 654,573
Accounts payable and accrued liabilities	10,450,224	12,032,039
Dividends payable	488,762	1,717,246
Deferred revenue	2,774,619	2,023,252
Income taxes payable	1,495,295	983,915
Current portion of capital lease obligations (note 10)	-	314,275
Current portion of lease inducements (note 11)	42,482	42,482
Current portion of long-term loan (note 12)	1,200,000	-
	<u>18,096,666</u>	<u>17,767,782</u>
Long-term future income tax liabilities (note 3)	326,890	194,192
Long-term capital lease obligations (note 10)	-	395,004
Deferred lease inducements (note 11)	310,881	342,742
Long-term loan (note 12)	10,623,106	-
Total liabilities	<u>29,357,543</u>	<u>18,699,720</u>
Shareholders' equity		
Share capital (note 13(b))	12,635,777	16,501,855
Contributed surplus (note 13(f))	1,888,789	1,492,547
Retained earnings and accumulated other comprehensive income (note 3)	4,679,105	9,317,078
Total shareholders' equity	<u>19,203,671</u>	<u>27,311,480</u>
	<u>\$ 48,561,214</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

	Three months ended September 30 (unaudited)		Nine months ended September 30 (unaudited)	
	2009	2008 (note 3)	2009	2008 (note 3)
Revenue	\$ 17,591,647	\$ 18,126,430	\$ 50,823,212	\$ 55,433,452
Operating and administrative expenses	14,919,821	16,536,954	44,606,499	50,670,690
	2,671,826	1,589,476	6,216,713	4,762,762
Amortization of capital assets	153,221	177,355	477,226	494,945
Amortization of intangible assets	52,779	52,778	158,336	158,333
Interest expense	51,938	118,691	148,306	404,328
Interest income	(47,410)	(6,375)	(105,992)	(20,559)
Share-based compensation (note 13(f))	208,441	203,214	629,374	604,805
	418,969	545,663	1,307,250	1,641,852
Earnings before income taxes	2,252,858	1,043,813	4,909,464	3,120,910
Income taxes (note 14)	757,735	399,483	1,683,608	1,058,189
Net earnings and comprehensive income for the period	1,495,122	644,330	3,225,855	2,062,721
Retained earnings, beginning of period (note 3)	9,758,685	8,766,100	9,317,077	7,877,806
Dividends declared	(488,762)	-	(1,777,887)	-
Excess price paid over carrying value on repurchase of common shares	(6,085,940)	-	(6,085,940)	(530,097)
Retained earnings, end of period	\$ 4,679,105	\$ 9,410,430	\$ 4,679,105	\$ 9,410,430
Basic earnings per share	\$ 0.036	\$ 0.015	\$ 0.076	\$ 0.048
Diluted earnings per share (note 15)	\$ 0.034	\$ 0.014	\$ 0.073	\$ 0.046
Weighted average number of common shares outstanding:				
Basic (note 15)	41,545,569	42,773,370	42,244,025	43,066,546
Diluted (note 15)	43,857,647	44,664,783	44,410,848	44,841,339

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

Pareto Corporation

Consolidated Statements of Cash Flows

	Three months ended		Nine months ended	
	September 30 (unaudited)		September 30 (unaudited)	
	2009	2008 (note 3)	2009	2008 (note 3)
Operating activities				
Net earnings for the period	\$ 1,495,122	\$ 644,330	\$ 3,225,855	\$ 2,062,721
Items not involving cash:				
Amortization of capital assets	153,221	177,354	477,226	494,945
Amortization of intangible assets	52,779	52,778	158,336	158,333
Amortization of lease inducement (note 11)	(10,621)	(28,571)	(31,862)	(28,571)
Non-cash interest	(41,805)	-	(90,189)	-
Non-cash lease expense	-	-	-	197,130
Share-based compensation (note 13 (f))	208,441	203,214	629,374	604,805
Future income tax provision (notes 3 and 14)	69,491	236,099	202,131	847,976
	1,926,628	1,285,204	4,570,871	4,337,339
Changes in non cash operating accounts (note 16)	(37,428)	424,557	(1,246,689)	(1,579,800)
	1,889,200	1,709,761	3,324,182	2,757,539
Investing activities				
Capital asset additions	(1,596,770)	(144,903)	(1,864,611)	(629,174)
Intangible asset additions	(107,088)	-	(107,088)	-
Proceeds from lease inducement (note 11)	-	227,285	-	227,285
Loans receivable and other assets	(190,250)	(188,500)	(380,500)	(738,500)
Acquisitions, net of cash (note 8 (a))	-	-	-	(3,066,668)
	(1,894,108)	(106,118)	(2,352,199)	(4,207,057)
Financing activities				
Dividends paid	(645,147)	-	(3,006,371)	-
Repayment of capital lease obligations	(582,503)	(71,353)	(709,279)	(208,331)
Repayment of Loans Receivable	75,000	-	100,000	-
Proceeds from term loan (note 12)	11,823,106	-	11,823,106	-
Issuance of shares	-	86,000	-	98,500
Share issue costs	-	-	-	(2,051)
Repurchase of common shares	(10,170,150)	-	(10,170,150)	(1,026,430)
	500,306	14,647	(1,962,694)	1,138,312
Increase (Decrease) in cash for the period	495,398	1,618,290	(990,711)	(2,587,830)
(Bank Indebtedness)/Cash, beginning of period	(2,140,682)	(4,574,411)	(654,573)	(368,291)
(Bank Indebtedness)/Cash, end of period	\$ (1,645,284)	\$ (2,956,121)	\$ (1,645,284)	\$ (2,956,121)

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 Secom Plus 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
Long-term loans	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
Machinery and equipment	Straight-line over useful life
Leasehold improvements	Straight-line over lease term

2. Summary of Significant Accounting Policies (continued)

Intangible Assets

Intangible assets consist of the value of the Company's acquired customer relationships and internally developed software. In the marketing services industry, customer relationship assets are typically long-term in nature, and therefore are amortized on a straight-line basis over an estimated useful life of 10 years. Internally developed software are costs to design, develop and implement proprietary software including fees paid to independent contractors, salaries and related expenses of personnel engaged in these activities, and are amortized on a straight-line basis over an estimated useful life of 5 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 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.

2. Summary of Significant Accounting Policies (continued)

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.

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 period, plus the effects of potential dilutive common shares outstanding during the period. 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 period.

2. Summary of Significant Accounting Policies (continued)

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.

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 beginning of the Company's 2008 fiscal year was reflected as a charge to opening retained earnings.

Net Earnings Impact – For the nine months ending September 30, 2009, the implementation of the new standard resulted in an increase to the Company's pre-tax net earnings of \$118,851, a decrease to future income taxes of \$33,090, and an increase to net earnings of \$85,761.

3. Changes in Accounting Policies (continued)

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 and a \$41,348 reduction in long-term future income tax liabilities

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.

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 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.

Pareto Corporation
Notes to Consolidated Financial Statements
September 30, 2009

4. Inventories

	September 30 2009	December 31 2008
Work in progress	\$ 2,783,654	\$ 623,226
Finished goods	151,025	73,129
Loyalty reward units	13,808	1,050,000
	\$ 2,948,487	\$ 1,746,355

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

	September 30 2009	December 31 2008
Employee loans receivable (a)	\$ 150,000	\$ 250,000
Employee loan receivable (b)	236,250	236,250
Employee loan receivable(c)	188,500	188,500
Convertible debenture (d)	698,409	624,295
Convertible debenture (e)	396,575	-
	\$ 1,669,734	\$ 1,299,045

- (a) In May 2006, the Company issued loans totalling \$250,000 to executives of the Company for the purchase of 192,308 common shares of the Company. During 2009, \$100,000 was repaid to the Company. The loan is carried at the carrying amount of \$150,000 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.

5. Loans Receivable and Other Assets (continued)

- (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.

At September 30, 2009, the carrying amount of the loan includes \$148,409 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.

- (e) On April 7, 2009, the Company provided an additional loan in the amount of \$190,250 ("First Tranche Debenture") to Peerset in return for a two year convertible debenture. In accordance with the terms of the Subscription Agreement, a second amount of \$190,250 was provided to Peerset on July 13, 2009 ("Second Tranche Debenture") in return for a two year convertible debenture, and has terms and conditions substantially similar to the First Tranche Debentures, including the maturity date thereof. The debenture bears an annualized interest rate of 12% 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.

At September 30, 2009, the carrying amount of the loan includes \$16,075 of accrued interest from the first issue date of April 7, 2009 and approximates fair value calculated based on the present value of estimated cash flows at current interest rates.

The Peerset debentures have been classified as held-to-maturity. Management deemed the value of the conversion right to be insignificant at the date of issue and at September 30, 2009 based on an assessment of the conversion rights and term to expiry.

Pareto Corporation
Notes to Consolidated Financial Statements
September 30, 2009

6. Capital Assets

September 30, 2009	Cost	Accumulated Amortization	Net book Value
Computer software	\$ 1,769,091	1,108,308	660,783
Computer hardware	1,118,375	720,433	397,942
Furniture and fixtures	1,264,478	743,527	520,951
Machinery and equipment	2,253,583	190,469	2,063,114
Leasehold improvements	1,680,981	595,689	1,085,292
	\$ 8,086,508	3,422,956	4,728,082

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	1,237,567	655,880	581,687
Machinery and equipment	697,230	185,742	511,488
Leasehold improvements	1,621,015	478,516	1,142,499
	\$ 6,246,263	\$ 2,905,566	\$ 3,340,697

7. Intangible Assets

	Cost	Accumulated Amortization	Net book Value
Customer relationships	\$ 2,111,106	\$ 925,949	\$ 1,185,157
Internally developed software	107,088	-	107,088
Balance at September 30, 2009	\$ 2,218,194	\$ 925,949	\$ 1,292,245

8. Goodwill

Balance at December 31, 2007	\$ 19,058,577
Additional consideration from acquisition of Secom Plus Inc.	2,000,000
Balance at December 31, 2008 and September 30, 2009	\$ 21,058,577

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 and additional transaction costs of \$12,429 were 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.

Pareto Corporation
Notes to Consolidated Financial Statements
September 30, 2009

9. Bank Indebtedness

On September 9, 2009, the Company entered into a new credit facility with a major Canadian chartered bank. The credit facility is comprised of a three year term loan in the amount of \$15 million and a revolving line of credit in the amount of \$10 million. The revolving line of credit bears interest at an annual rate equal to prime rate plus 1% and is repayable in monthly interest-only payments. The line of credit will be used initially to repay funds borrowed on the company's existing line of credit and subsequently for operating purposes. As at September 30, 2009, the prime rate was 2.25% (3.5% as of December 31, 2008).

10. Capital Lease Obligations

At September 30, 2009, the Company has no outstanding capital lease commitments. The Company paid the outstanding amount of the leases funded by a term loan drawn from the Company's new credit facility discussed in note 12.

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	(17,045)	(14,816)	(21,241)	
Balance at September 30, 2009	\$ 196,981	\$ 156,382	\$ 353,363	
Less: Current portion	22,729	19,754	42,483	
	\$ 174,252	\$ 136,628	\$ 310,880	

Pareto Corporation
Notes to Consolidated Financial Statements
September 30, 2009

12. Long term loan

On September 21, 2009, the Company drew upon its new credit facility in note 9 to fund the Company's substantial issuer bid described in note 22 for \$10 million and to fund the purchase of capital assets and repayment of capital leases of \$2 million. The term loan bears interest at an annual rate starting at banker's acceptance rate plus 3.25% and is repayable in quarterly installments starting at an annual rate of 10% of the amount drawn. The term loan was initially recognized at its fair value including all directly attributable transaction costs. After initial recognition, the balance is measured at amortized cost using the effective interest method. The loan has a term of three years and is payable on September 8, 2012. The Company used an effective interest rate of 0.6038%. The Company is in compliance with the covenants of the long-term loan as at September 30, 2009 and currently expects to be in compliance with the covenants for the remainder of the year.

	Amount
Principal amount	12,000,000
Less: Transaction costs	(178,654)
Initial proceeds	11,821,346
Amortized to interest expense	1,760
	11,823,106
Less: Current portion	1,200,000
Balance at September 30, 2009	10,623,106

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, 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)
Balance, December 31, 2008	42,931,148	\$ 16,501,855
Shares issued on redemption of restricted stock units	179,333	218,132
Shares repurchased for cancellation	(10,526,315)	(4,084,210)
Balance, September 30, 2009	32,584,166	12,635,777

13. Share Capital (continued)

On September 17, the Company announced the results of its "modified Dutch Auction" offer previously announced August 7, 2009 to purchase for cancellation up to \$10,000,000 of its common shares. The auction process was over-subscribed with 12,099,345 Shares validly tendered to the Offer. Pursuant to the terms of the Offer, the Company determined the Purchase Price to be \$0.95 per Share and purchased for cancellation 10,526,315 Shares for a total cost of \$10,000,000. These 10,526,315 Shares represented approximately 24.4% of the total Shares outstanding as of September 16, 2009. Shares deposited to the Offer at or below \$0.95 per Share were purchased for cancellation at the Purchase Price of \$0.95 per Share subject to a proration factor of 95.3%. The payment was funded by the Company's new credit facility (note 12)

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.

Pareto Corporation
Notes to Consolidated Financial Statements
September 30, 2009

13. 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
Granted in 2009	797,630	0.50
Exercised in 2009	-	-
Expired in 2009	(35,000)	0.86
Forfeited in 2009	(152,110)	0.99
Options outstanding, September 30, 2009	2,684,209	\$ 0.87

	Number of Options Exercisable	Weighted Average Exercise Price
Options exercisable, December 31, 2008	751,938	\$ 1.11
Vested in 2009	470,810	1.07
Expired in 2009	(35,000)	0.86
Forfeited in 2009	(71,665)	1.01
Options exercisable, September 30, 2009	1,116,083	\$ 1.11

The range of exercise prices for options outstanding and exercisable options at September 30, 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	4.27	89,695	3.85
\$0.76 - \$1.00	74,167	0.41	74,167	0.41
\$1.01 - \$1.25	1,303,334	2.65	812,221	2.55
\$1.26 - \$1.53	140,000	1.58	140,000	1.58
	2,684,209	3.24	1,116,083	2.39

Pareto Corporation
Notes to Consolidated Financial Statements
September 30, 2009

13. 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. Restricted stock units are redeemable upon the third anniversary of the date of grant.

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.

At September 30, 2009, 1,090,952 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.

Restricted stock unit transactions including RSU's issued under the Plan and RSU's issued as incentives, during the period are as follows:

	Number of RSU's Outstanding
RSU's outstanding, December 31, 2007	1,515,952
Granted in 2008	333,333
Forfeited in 2008	(22,667)
RSU's outstanding, December 31, 2008	1,826,618
Granted in 2009	300,000
Redeemed in 2009	(179,333)
Forfeited in 2009	(23,000)
RSU's outstanding, September 30, 2009	1,924,285

e) Share-based compensation:

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

	2009	2008
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	3 to 4 years	2 to 4 years

Pareto Corporation
Notes to Consolidated Financial Statements
September 30, 2009

13. Share Capital (continued)

f) Contributed surplus

In the nine months ending September 30, 2009, \$629,375 (2008 - \$401,591) of share based compensation was added to contributed surplus with \$218,133 (2008 - \$128,109) of contributed surplus reallocated to share capital as a result of restricted stock units redeemed in the period.

14. Income Taxes

	Three months ended September 30		Nine months ended September 30	
	2009	2008	2009	2008
Provision for income taxes consists of:				
Current	\$ 688,244	164,384	\$ 1,481,477	\$ 210,213
Future (note 3)	69,491	235,099	202,131	847,976
	\$ 757,735	399,483	\$ 1,683,608	\$ 1,058,189

15. Earnings Per Share

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

	Three months ended September 30		Nine months ended September 30	
	2009	2008	2009	2008
Net earnings (note 3)	\$ 1,495,122	644,330	\$ 3,225,855	\$ 2,062,721
Weighted average number of common shares outstanding	41,545,569	42,773,370	42,244,025	43,066,546
Stock options	346,489	64,795	189,070	105,109
Restricted stock units	1,965,589	1,826,618	1,977,752	1,669,684
Weighted average number of diluted common shares outstanding	43,857,647	44,664,783	44,410,848	44,841,339
	\$ 0.034	0.014	\$ 0.073	\$ 0.046

The calculation of the dilutive impact of the exercise of options excludes those securities considered anti-dilutive because their exercise price exceeded the average market price of Pareto's common shares during the period (2009 - \$0.68), meaning their inclusion would increase diluted earnings per share. In 2009, 2,822,620 stock options were excluded because their effect would be anti-dilutive.

Pareto Corporation
Notes to Consolidated Financial Statements
September 30, 2009

16. Supplementary Cash Flow Information

	Three months ended September 30		Nine months ended September 30	
	2009	2008	2009	2008
Changes in non-cash operating accounts:				
Accounts receivable	\$ (2,235,008)	(233,205)	\$ 431,369	\$ 510,534
Inventory and work in progress	(813,108)	(73,666)	(1,202,132)	167,264
Prepaid expenses	81,323	21,985	(141,858)	102,168
Accounts payable and accrued liabilities	1,378,715	(627,876)	(1,596,815)	(3,520,151)
Income taxes payable	718,870	90,945	511,380	70,232
Deferred revenue	831,780	1,246,373	751,367	1,090,153
	\$ (37,428)	424,556	\$ (1,246,689)	\$ (1,579,800)
Supplemental cash flow information:				
Interest paid	\$ 51,938	120,228	\$ 148,306	\$ 410,865
Income taxes paid	-	-	999,619	85,932

17. Commitments

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

2009	\$	215,044
2010		858,191
2011		814,027
2012		647,020
2013		661,722
2014 and thereafter		2,569,632

18. Related Party Transactions

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

19. Segmented Information

The Company provides shopper 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.

During the nine month period ending September 30, 2009, one customer represented greater than 10% of the Company's revenue being 24% (2008 – 26%). Amounts due from this customer accounted for 14% of accounts receivable as at September 30, 2009 (December 31, 2008 – 24%). All of the Company's operations are located in Canada.

20. 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, long-term loans, capital lease obligation and shareholders' equity.

	September 30, 2009	December 31, 2008
Bank Indebtedness	\$ 1,645,284	\$ 654,573
Long-term loans	11,821,346	--
Capital lease obligation	-	709,279
Total debt	13,466,630	1,363,852
Shareholders' equity	19,203,671	27,311,480
Total capitalization	\$ 32,670,301	\$ 28,675,332
Debt:Shareholders' equity	0.7:1	0.05:1
Debt:Total Capitalization	0.4:1	0.05:1
Debt: EBITDA ⁽¹⁾	1.4:1	0.17:1

⁽¹⁾ 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.

20. Capital Management (continued)

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. On June 11, 2009, the Company declared another cash dividend of \$0.015 per issued and outstanding share, payable on July 15, 2009, to shareholders of record at the close of business on June 30, 2009. On September 15, 2009, the Company declared a quarterly dividend of \$0.015 per issued and outstanding share, payable on October 15, 2009, to shareholders of record at the close of business on September 30, 2009.

On September 9, 2009, the Company entered into a new credit facility with a major Canadian chartered bank. The credit facility is comprised of a three year term loan in the amount of \$15 million and a revolving line of credit in the amount of \$10 million. The term loan bears interest at an annual rate starting at banker's acceptance rate plus 3.25% and is repayable in quarterly installments starting at an annual rate of 10% of the amount drawn. The Company is in compliance with the covenants of the long term credit facility at September 30, 2009. The revolving line of credit bears interest at an annual rate equal to prime rate plus 1% and is repayable in monthly interest-only payments. The line of credit will be used initially to repay funds borrowed on the company's existing line of credit and subsequently for operating purposes.

On September 17, 2009, the Company announced the completion of its offer to purchase from shareholders up to \$10 million of its outstanding common shares for cancellation. Pursuant to the terms of the offer previously announced on August 7, 2009, the company determined the Purchase Price to be \$0.95 per share and purchased for cancellation 10,526,315 Shares for a total cost of \$10,000,000. These 10,526,315 Shares represent approximately 24.4% of the total Shares outstanding as of September 16, 2009.

On September 21, 2009, the Company drew upon its new credit facility to fund the Company's substantial issuer bid described in note 22 for \$10 million and to fund the purchase of capital assets of \$2 million.

The Company may consider acquisition opportunities. Depending on the size of an acquisition, the Company may need to secure external capital in addition to the current credit facilities, in the form of debt or share equity, to finance the acquisition.

While the overall debt position increased significantly during the quarter, the overall approach to capital management did not change during the quarter.

21. Financial Instruments

(a) Fair value of Financial Instruments

At September 30, 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.

ii. 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 September 30, 2009, a reserve in respect of doubtful accounts of \$68,708 was set up to cover accounts where collection is not assured.

Substantially all of the Company's accounts receivables are within Canada.

iii. 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.

iv. 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.

21. Financial Instruments (continued)

v. Interest Rate Risk

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

Based on the Company's average debt level during the year ended September 30, 2009, the sensitivity of a 100 basis point increase in interest rates would result in an approximate decrease of \$23,000 in net after tax annual earnings.

vi. 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 September 30, 2009, there are no such contracts outstanding.

vii. 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.

22. Comparative Figures

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