



Consolidated Financial Statements of

Route1 Inc.

June 30, 2010 and 2009

The Company has prepared the unaudited interim consolidated balance sheets, statements of operations, comprehensive loss and deficit, statements of cash flow, and notes thereto as at and for the three and six months ended June 30, 2010. The auditors of the Company, Deloitte & Touche LLP, have not audited or reviewed these unaudited interim consolidated financial statements. The accompanying notes are an integral part of these unaudited interim consolidated financial statements and should be read in conjunction with the Company's December 31, 2009 audited consolidated financial statements.

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CONSOLIDATED BALANCE SHEETS

Route1 Inc.

As at June 30, 2010 (unaudited) and December 31, 2009 (audited)

	June 30, 2010	December 31 2009
Assets		
Current		
Cash	\$ 936,640	\$ 640,045
Accounts receivable	391,232	88,583
Other receivables	17,405	34,954
Notes receivable (note 5)	-	173,000
Inventory (note 15)	916,346	900,775
Prepaid expenses	328,513	128,630
Total current assets	2,590,136	1,965,987
Capital assets (note 6)	144,916	74,571
Total assets	\$ 2,753,052	\$ 2,040,558
Liabilities		
Current		
Bank indebtedness (note 4)	\$ -	\$ 854,717
Accounts payable and accrued liabilities	734,173	1,197,258
Current portion of deferred revenue	2,167,702	1,535,823
Total current liabilities	2,981,875	3,587,798
Deferred revenue	33,556	32,861
Total liabilities	2,935,431	3,620,659
Shareholders' equity (deficiency)		
Common shares (note 7)	24,095,591	23,977,296
Warrants (note 7)	1,763,200	2,949,072
Contributed surplus (note 7)	8,940,307	5,702,410
Deficit	(34,999,477)	(34,208,879)
Total shareholders' equity (deficiency)	(200,379)	(1,580,101)
	\$ 2,753,052	\$ 2,040,558

Approved by the Board of Directors:

Director:

● "signed" _____

Michael F. Doolan

Director:

● "signed" _____

Tony Busseri

The accompanying notes are an integral part of these consolidated statements

CONSOLIDATED STATEMENTS OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT

Route1 Inc.

For the three and six months ended June 30, 2010 and 2009
(unaudited)

	For the three months ended June 30		For the six months ended June 30	
	2010	2009	2010	2009
Revenue				
Devices and Appliances	\$211,931	\$1,017,240	\$258,446	\$1,118,361
Services	995,065	566,079	1,954,005	903,477
	1,206,996	1,583,319	2,212,451	2,021,838
Cost of revenue (note 15)	137,644	896,545	245,258	1,004,876
Gross margin	1,069,352	686,774	1,967,193	1,016,962
Expenses				
General administration	640,794	339,815	1,053,732	826,374
Research and development	460,797	451,554	891,372	925,877
Selling and marketing	165,882	327,246	357,665	608,391
Stock-based compensation	223,380	67,779	288,825	118,569
Amortization	19,186	36,185	48,899	79,267
	1,510,039	1,222,579	2,640,493	2,558,478
Loss before the following items	(440,687)	(535,805)	(673,300)	(1,541,516)
Interest (expense) income	(17,958)	2,945	(15,505)	6,180
Foreign exchange (loss) gain	(51,326)	(86,790)	(101,793)	(28,372)
Net loss and comprehensive loss for the period	(509,971)	(619,650)	(790,598)	(1,563,708)
Deficit, beginning of year	(34,489,506)	(31,744,035)	(34,208,879)	(30,799,977)
Deficit, end of year	\$(34,999,477)	\$(32,363,685)	\$(34,999,477)	\$(32,363,685)
Basic and diluted loss per share (note 9)	\$(0.00)	\$(0.00)	\$(0.00)	\$(0.00)
Weighted average number of common shares outstanding	388,388,115	350,388,115	388,388,115	350,388,

The accompanying notes are an integral part of these consolidated statements

CONSOLIDATED STATEMENTS OF CASH FLOW

Route1 Inc.

For the three and six months ended June 30, 2010 and 2009
(unaudited)

	For the three months ended June 30		For the six months ended June 30	
	2010	2009	2010	2009
Net cash inflow (outflow) related to the following activities				
Operating activities				
Loss from operations	\$ (509,971)	\$ (619,650)	\$ (790,598)	\$ (1,563,708)
Items not affecting cash				
Amortization	19,186	36,185	48,899	79,267
Stock based compensation (note 7)	223,380	67,779	288,825	118,569
	(267,405)	(515,686)	(452,874)	(1,365,872)
Net changes in working capital balances				
Accounts receivable	481,074	(281,199)	(302,649)	(409,129)
Other receivables	(5,473)	24,849	17,549	14,249
Inventory	(44,120)	800,522	(15,571)	847,877
Prepaid expenses	(168,037)	9,785	(199,883)	52,038
Accounts payable and accrued liabilities	(187,352)	35,012	(463,085)	(466,985)
Deferred revenue	564,045	418,755	632,574	460,168
	372,732	492,038	(783,939)	(867,654)
Investing activities				
Acquisition of capital assets	(110,004)	-	(119,244)	-
Notes receivable	173,000	(2,805)	173,000	(5,610)
Bank indebtedness (repayment)	(834,717)	-	(854,717)	-
	(771,721)	(2,805)	(800,961)	(5,610)
Financing activities				
Repayment of obligations under capital lease	-	-	-	(2,700)
Issuance of share capital – net	-	-	1,881,495	-
	-	-	1,881,495	(2,700)
Net cash inflow (outflow) for the period	(398,989)	489,233	296,595	(875,964)
Cash, beginning of year	1,335,629	755,136	640,045	2,120,333
Cash, end of period	\$ 936,640	\$ 1,244,369	\$ 936,640	\$ 1,244,369
Supplementary information				
Interest paid	\$ 8,529	\$ 24	\$ 19,073	\$ 667

The accompanying notes are an integral part of these consolidated statements

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

June 30, 2010 (unaudited)

1. BASIS OF PRESENTATION

Route1 Inc. (“Route1” or “the Company”) is a publicly traded company on the TSX Venture Exchange. The Company is incorporated under the laws of the Province of Ontario by articles of amendment dated October 14, 2004 followed by articles of continuance dated November 10, 2004.

Going concern assumption

While the accompanying audited consolidated financial statements have been prepared on a going concern basis which assumes that the Company will realize its assets and discharge its liabilities and commitments in the normal course of business, conditions such as raising sufficient capital or generating enough cash flow from operations will need to be met to support the validity of this assumption.

For the three months ended June 30, 2010 and 2009, the Company incurred losses of \$509,971 and \$619,650 respectively. For the six months ended June 30, 2010 and 2009, the Company incurred losses of \$790,598 and \$1,563,708 respectively and has an accumulated deficit of \$34,999,477 as at June 30, 2010.

If the going concern assumption were not appropriate to these financial statements, then adjustments would be necessary in the carrying values of assets and liabilities, the reported net loss and the balance sheet classifications used.

2. SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”) applied on a basis consistent with the prior year.

The significant accounting policies of the Company are as follows:

Principles of consolidation

These audited consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary companies, Route1 Technologies Inc., Route1 Security Corporation, Prospectus Group Inc. and The Clones Society Inc.

Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the exchange rate in effect at the balance sheet date; non-monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at historical exchange rates; revenues and expenses denominated in foreign currencies are translated into Canadian dollars at the average exchange rate for the period. Foreign exchange gains and losses on translation are included in the consolidated statement of operations in the period in which they occur.

For the three months ended June 30, 2010, the Company incurred foreign currency losses of \$51,326 compared to a loss of \$86,790 for the three months ended June 30, 2009. For the six months ended June 30, 2010, the Company incurred foreign currency losses of \$101,793 compared to a loss of \$28,372 for the six months ended June 30, 2009.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

June 30, 2010 (unaudited)

Cash

Cash consists of cash balances with chartered banks both in Canada and the United States of America.

Financial instruments

Financial assets and financial liabilities are initially recognized at fair value and their subsequent measurement is dependent on their classification as described below. Their classification depends on the purpose, for which the financial instruments were acquired or issued, their characteristics and the Company's designation of such instruments. Settlement date accounting is used.

Classification

Cash	Held for trading
Accounts receivable	Loans and receivables
Other receivables	Loans and receivables
Notes receivable	Loans and receivables
Bank Indebtedness	Other liabilities
Accounts payable and accrued liabilities	Other liabilities

Held for trading

Held for trading financial assets are financial assets typically acquired for resale prior to maturity or that are designated as held for trading. They are measured at fair value at the balance sheet date.

Fair value fluctuations including interest earned, interest accrued, gains and losses realized on disposal and unrealized gains and losses are included in other income.

Financial liabilities designated as held for trading are those non-derivative financial liabilities that the Company elects to designate on initial recognition as instruments that it will measure at fair value through other interest expense. These are accounted for in the same manner as held for trading assets. The Company has not designated any non-derivative financial liabilities as held for trading.

Loans and receivables

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

Other liabilities

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

Effective interest method

The Company uses the effective interest method to recognize interest income or expense which includes transaction costs or fees, premiums or discounts earned or incurred for financial instruments.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

June 30, 2010 (unaudited)

Allowance for doubtful accounts

The allowance for doubtful accounts receivable is determined based on management's assessment of the collectability of specific customer balances, considering general and industry economic and market conditions as well as other credit information available for the customer. Recoveries of the allowances are recorded when payment is received.

Inventory

Inventory is valued at the lower of cost and net realizable value with cost being calculated on a weighted average basis.

Capital assets

Capital assets are recorded at cost. Amortization is provided over the estimated useful life of the assets as follows:

Furniture and equipment	-	straight-line over 36 months
Computer equipment	-	straight-line over 36 months
Computer software	-	straight-line over 12 months
Leasehold improvements	-	straight-line over 60 months or the term of the lease (whichever is shorter)

Revenue recognition

The Company recognizes revenue when it is realized and earned. The Company considers revenue realized or realizable and earned when the product has been delivered or the services have been provided to the customer, the sales price is fixed or determinable and collectability is reasonably assured. The following paragraphs describe the specific revenue recognition policies for each major category of revenue.

Devices

Revenues from the sale of MobiKEY devices are recognized when title is transferred to the customer and all significant contractual obligations that affect the customer's final acceptance have been fulfilled.

Appliances

Revenues from the sale of DEFIMNET and EnterpriseLIVE appliances are recognized when title is transferred to the customer and all significant contractual obligations that affect the customer's final acceptance have been fulfilled.

Service

Revenue from TruOFFICE subscription-based services, and DEFIMNET and other appliance maintenance are recognized rateably over the term of the contract on a monthly basis when the service is provided. In instances where the Company bills the customer prior to performing the service, the prepayment amount is recorded as deferred revenue.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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Multiple-element arrangements

The Company enters into transactions that represent multiple-element arrangements which may include any combination of device and service. These multiple-element arrangements are assessed to determine whether they can be separated into more than one unit of accounting or element for the purpose of revenue recognition. When the appropriate criteria for separating revenue into more than one unit of accounting is met and there is vendor specific objective evidence of fair value for all units of accounting or elements in an arrangement, the arrangement consideration is allocated to the separate units of accounting or elements based on the residual method which allocates each undelivered component its fair value and the remaining amount is allocated to the undelivered element. This vendor specific objective evidence of fair value is established through prices charged for each revenue element when that element is sold separately. The revenue recognition policies described above are then applied to each unit of accounting.

Research and development

Currently, research and development expenditures are charged as an operating expense of the Company as incurred. Expenditures for research and development equipment are capitalized and amortized when the criteria for capitalization and amortization are met; otherwise they are expensed as incurred. To date, no development expenditures have been capitalized.

Earnings (loss) per share

Basic earnings (loss) per share are computed by dividing the net income (loss) by the weighted average shares outstanding during the reported period.

The Company uses the treasury stock method of calculating the dilutive effect of options and warrants on earnings (loss) per share. Diluted earnings (loss) per share is computed similarly to basic earnings (loss) per share, except the weighted average shares outstanding are increased to include additional shares from the assumed exercise of stock options and warrants, if dilutive. The number of additional shares is calculated by assuming that outstanding stock options and warrants were exercised and that the proceeds from such exercises were used to acquire shares of common stock at the average market price during the reporting period.

Income taxes

The Company follows the liability method of accounting for income taxes. Under this method future income tax assets and liabilities are determined based on differences between the financial reporting and tax basis of assets and liabilities, and measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. Valuation allowances are established when necessary to reduce future income tax assets to the amount expected to be realized.

Use of estimates

In preparation of the Company's consolidated financial statements in accordance with Canadian generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amount of assets, liabilities, and the disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates used in the Company's

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

June 30, 2010 (unaudited)

consolidated financial statements and such differences could be material. Examples of significant estimates include:

- the allowance for doubtful accounts;
- the allowance for inventory obsolescence;
- the estimated useful lives of capital assets;
- the recoverability of investments;
- the impairment of assets
- the valuation of future tax assets; and
- the calculation of stock option compensation expense.

Stock-based compensation

The Company has a stock-based compensation plan, which is described in note 7. The Company adopted the recommendation of the Canadian Institute of Chartered Accountants (“CICA”) with respect to stock-based compensation issued to employees. The fair value of stock options granted under the stock option plan is determined using the Black-Scholes Option Pricing Model and is amortized to income on a straight-line basis over the vesting period and a corresponding increase to contributed surplus. Any consideration paid by the employees or non-employees on exercise of the options is credited to share capital, and the contributed surplus balance is reduced as stock options are exercised and credit to share capital.

3. RECENT ACCOUNTING PRONOUNCEMENTS ISSUED NOT YET ADOPTED

International Financial Reporting Standards

On February 13, 2008, the Canadian Accounting Standards Board (“AcSB”) confirmed the mandatory International Financial Reporting Standards (“IFRS”) changeover date for Canadian profit-oriented publicly accountable entities (“PAEs”). This means that PAEs will be required to prepare financial statements in accordance with IFRS for interim and annual financial statements for fiscal years beginning on or after January 1, 2011. The transition date of January 1, 2011 will require restatement for comparative purposes of amounts reported by the Company for annual and interim periods for the year ended December 31, 2010.

Canadian generally accepted accounting principles will be converged with IFRS through a combination of two methods: as current joint-convergence projects of the United States Financial Accounting Standards Board and the International Accounting Standards Board are agreed upon, they will be adopted by the AcSB and may be introduced in Canada before the completed changeover to IFRS; and standards not subject to a joint-convergence project will be exposed in an omnibus manner for introduction at the time of the complete changeover to IFRS.

As the International Accounting Standards Board currently, and expectedly, has projects underway that should result in new pronouncements that continue to evolve IFRS, this Canadian convergence initiative is evolving as it approaches implementation. The Company will not adopt IFRS for annual and interim reporting periods before the fiscal year beginning January 1, 2011.

Business combinations, consolidated financial statements and non-controlling interests

In January 2009, the CICA issued the following new Handbook sections: Section 1582, Business Combinations, Section 1601, Consolidated Financial Statements and Section 1602, Non-Controlling

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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Interests which replace Section 1581, Business Combinations and Section 1600, Consolidated Financial Statements. These new Sections will be applicable to financial statements relating to fiscal years beginning on or after January 1, 2011. Early adoption is permitted to the extent the three new Sections are adopted simultaneously. Together, the new Sections establish standards for the accounting for a business combination, the preparation of consolidated financial statements and the accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. The Company is currently evaluating the impact of the adoption of these new Sections on its consolidated financial statements. The Company does not expect that the adoption of these new Sections will have a material impact on its consolidated financial statements.

Multiple deliverable revenue arrangements

In December 2009, the CICA issued EIC 175, Multiple Deliverable Revenue Arrangements, replacing EIC 142, Revenue Arrangements with Multiple Deliverables. This abstract provides updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated and the consideration allocated; require, in situations where a vendor does not have vendor-specific objective evidence (VSOE) or third party evidence of selling price, that the entity allocate revenue in an arrangement using estimated selling prices of deliverables; eliminate the use of residual method and require an entity to allocate revenue using the relative selling price method; and require expanded qualitative and quantitative disclosures regarding significant judgments made in applying this guidance. This EIC is effective for future years beginning on or after January 1, 2011. The Company is currently evaluating the impact of the adoption of these new standards on its consolidated financial statements.

4. BANK INDEBTEDNESS

The Company had a \$1,000,000 (Dec. 31, 2009 - \$2,500,000) non-revolving senior credit facility with interest at bank prime plus 2.5% per annum. On June 23, 2010, the Company repaid the credit facility in full (December 31, 2009 - \$854,717). The credit facility terminated on the repayment.

As at June 30, 2010 the Company had recorded interest expense related to this credit facility for the six months ended June 30, 2010 of \$18,591 (2009 - \$nil).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

June 30, 2010 (unaudited)

5. NOTES RECEIVABLE

Notes receivable consist of the following:

	June 30, 2010	December 31, 2009
Due from the Vice-Chairman of the Company, secured and on demand with interest at 6%	\$ -	\$ 95,200
Due from the former Executive Vice President and COO of the Company, secured and due on demand with interest at 6%	-	-
Due from the Executive Vice-President and CTO of the Company, secured and due on demand with interest at 6%	-	50,000
Due from the Executive Vice-President and CTO of the Company, non-secured and due on demand with interest at 6%	-	27,800
	<u>\$ -</u>	<u>\$ 173,000</u>

6. CAPITAL ASSETS

	June 30, 2010		
	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net Book Value</u>
Furniture and equipment	\$ 235,950	\$ 235,600	\$ 350
Computer equipment	1,454,410	1,326,768	127,642
Computer software	607,691	607,691	-
Leasehold improvements	86,179	69,255	16,924
	<u>\$ 2,384,230</u>	<u>\$ 2,239,314</u>	<u>\$ 144,916</u>
	December 31, 2009		
	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net Book Value</u>
Furniture and equipment	\$ 235,950	\$ 234,178	\$ 1,772
Computer equipment	1,351,576	1,283,982	67,594
Computer software	607,691	607,691	-
Leasehold improvements	69,769	64,564	5,205
	<u>\$ 2,264,986</u>	<u>\$ 2,190,415</u>	<u>\$ 74,571</u>

Included in computer equipment are assets held under capital leases with a cost of \$657,847 (December 31, 2009 - \$657,847), accumulated amortization of \$657,847 (December 31, 2009 - \$657,847) and net book value of \$nil (December 31, 2009 - \$nil).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

June 30, 2010 (unaudited)

7. SHARE CAPITAL, WARRANTS AND CONTRIBUTED SURPLUS

The Company's authorized share capital consists of the following:

- Unlimited number of common shares with voting rights.
- Unlimited number of non-cumulative, non-voting first preferred shares with no fixed dividend rate, issuable in series.
- Unlimited number of non-cumulative, non-voting second preferred shares with no fixed dividend rate, issuable in series.
- Unlimited number of non-cumulative, non-voting Series A first preferred shares with no fixed dividend rate, issuable in series and convertible into common shares at the option of the holder on a one-for-one basis at any time after October 31, 2000.

The following is a summary of the issued and outstanding common shares of the Company:

	<u>Number of Shares</u>	<u>Share Capital</u>
Balance, January 1, 2010	350,388,115	\$ 23,977,296
Shares issued – February 26, 2010	38,000,000	118,295
Balance, June 30, 2010 and December 31, 2009	<u>388,388,115</u>	<u>\$ 24,095,591</u>

Escrow requirements

As at June 30, 2010, approximately 5,642,546 (December 31, 2009 – 11,285,000) common shares of the Company were held in an Exchange escrow agreement dated October 14, 2004. These shares are to be released over a period of seventy two (72) months at six (6) month intervals in accordance with the requirements of the TSX Venture Exchange.

Stock options

The Company has a Stock Option Plan (the "Plan") that was created in 1997 to attract, retain and motivate officers, salaried employees and directors who are in a position to make important contributions toward the success of the Company. Under the Plan, options may be granted to directors, officers, employees, and consultants of the Company at an exercise price determined by the Board of Directors provided that such exercise price should not be less than permitted under the rules of any stock exchange where the shares are listed. The period during which an option may be exercised (the "Option Period") is determined by the Board at the time the option is granted, subject to any vesting limitations which may be imposed by the Board in its sole unfettered discretion at the time such option is granted. Options are exercisable as determined by the Board at the date of the grant. Shares covered by options granted with respect to any year may not exceed 10% of the issued and outstanding shares of the Company, calculated on a non-diluted basis.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

June 30, 2010 (unaudited)

The following tables reflect the movement and status of the stock options:

	June 30, 2010		December 31, 2009	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Options Outstanding				
Balance, beginning of the year	12,020,360	\$ 0.11	5,949,660	\$ 0.18
Options granted during the period	27,350,000	0.14	17,135,716	0.08
Options expired during the period	(1,200,000)	0.21	-	-
Options cancelled during the period	(2,820,360)	0.06	(7,501,786)	0.06
Options forfeited during the period	-	-	(3,563,230)	0.11
Balance, end of the period	<u>35,350,000</u>	<u>\$ 0.12</u>	<u>12,020,360</u>	<u>\$ 0.11</u>

The cancelled stock options represent those options that were granted below the allowable TSX Venture Exchange exercise price of \$0.10 as well as options that were not properly filed with TSX Venture Exchange.

Exercise Price	Options Outstanding June 30, 2010		Options Exercisable June 30, 2010	
	Number of Options	Weighted Average Life (Years)	Number of Options	Weighted Average Life (Years)
\$ 0.10	13,250,000	4.7	-	-
\$ 0.13	13,350,000	4.8	-	-
\$ 0.15	6,750,000	4.9	-	-
\$ 0.20	2,000,000	5.0	-	-
	<u>35,350,000</u>	<u>4.9</u>	<u>-</u>	<u>-</u>

Exercise Price	Options Outstanding December 31, 2009		Options Exercisable December 31, 2009	
	Number of Options	Weighted Average Life (Years)	Number of Options	Weighted Average Life (Years)
\$ 0.10	8,000,000	4.8	-	-
\$ 0.125	950,000	1.0	633,333	1.0
\$ 0.20	1,185,000	0.1	1,185,000	0.1
\$ 0.205	1,298,360	0.1	1,298,360	0.1
\$ 0.30	587,000	1.3	587,000	1.3
	<u>12,020,360</u>	<u>3.7</u>	<u>3,703,693</u>	<u>0.5</u>

The Company cancelled 2,820,360 stock options which included all options granted in the prior year. The aforementioned stock options were cancelled as the grants were not in compliance with the policies of the Exchange.

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Ninety days following the termination of his relationship with the Company on October 27, 2009, the 1,200,000 vested stock options held by the former Executive Vice President, Chief Financial Officer and Treasurer expired. Those options expired on January 27, 2010.

During the six months ended June 30, 2010, the Company recorded stock-based compensation expense of \$288,825 (June 30, 2009 - \$217,660), as derived using the Black-Scholes option valuation model.

The table below shows the assumptions used in determining stock based compensation expense, as derived under the Black-Scholes option pricing model as at June 30, 2010 and December 31, 2009:

	<u>2010</u>	<u>2009</u>
Risk free interest rate	2.62%	2.62%
Expected life (years)	5	5
Expected volatility	128%	129%
Dividend yield	Nil	Nil
Weighted average fair value of options granted	<u>\$ 0.14</u>	<u>\$ 0.06</u>

The Black-Scholes option valuation model used by the Company to determine fair values was developed for use in estimating the fair value of freely traded options, which are fully transferable and have no vesting restrictions. The Company's stock options are not transferable and cannot be traded and are subject to vesting restrictions and exercise restrictions under the Company's black-out policy which would tend to reduce the fair value of the Company's stock options. Changes to subjective input assumptions used in the model can cause a significant variation in the estimate of the fair value of the options.

Contributed surplus

Contributed surplus represents the fair value of stock options granted under the stock option plan, determined using the Black-Scholes Option Pricing Model and is amortized to income on a straight-line basis over the vesting period and also a corresponding increase to contributed surplus. Any consideration paid by the employees or non-employees on the exercise of stock options is reflected as an increase to share capital, with a reduction in contributed surplus.

	<u>June 30, 2010</u>	<u>December 31, 2009</u>
Balance beginning of year	\$ 5,702,410	\$ 5,149,384
Options expensed in period	288,825	209,825
Warrants exercised in period	-	-
Warrants expired in period	2,949,072	343,201
Balance end of period	<u>\$ 8,940,307</u>	<u>\$ 5,702,410</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

June 30, 2010 (unaudited)

Warrants

The following is a summary of the issued and outstanding warrants of the Company:

	<u>Number of Warrants</u>	<u>Weighted Average Exercise Price</u>
Balance, January 1, 2010	32,360,333	\$ 0.155
Warrants expired (a)	(32,360,333)	(\$ 0.155)
Warrants granted	38,000,000	\$ 0.150
Balance, June 30, 2010 (b)	38,000,000	\$ 0.150

- (a) 38,000,000 warrants were granted on February 26, 2010 with an exercise price of \$0.15 per share and value of \$2,949,072.
- (b) 32,360,333 warrants expired on May 7, 2010 with an exercise price of \$0.155 per share and value of \$1,763,200 expiring February 25, 2015.

8. RELATED PARTY TRANSACTIONS

The Company had the following transactions and/or outstanding amounts with related parties for the six months ended June 30, 2010:

- Recorded interest income of \$213 for the three months ended June 30, 2010 and \$1,488 for the six months ended June 30, 2010, related to \$85,000 advanced in terms of a promissory note dated January 8, 2008 to the former President and CEO of the Company bearing interest at 6% per annum. As at June 30, 2010, the total outstanding amount including interest was fully repaid to the company.
- Recorded interest income of \$250 for the three months ended June 30, 2010 and \$1,000 for the six months ended June 30, 2010, related to \$50,000 advance in terms of a promissory note dated December 28, 2007 to the Executive Vice-President and CTO of the Company, secured and due on demand bearing interest at 6% per annum. As at June 30, 2010 the total outstanding amount including interest was fully repaid to the company.
- Recorded interest income of \$139 for the three months ended June 30, 2010 and \$556 for the six months ended June 30, 2010, related to \$27,800 advance in terms of a promissory note dated June 17, 2005 to the Executive Vice-President and CTO of the Company, secured and due on demand bearing interest at 6% per annum. As at June 30, 2010 the total outstanding amount including interest was fully repaid to the company.
- The Company made payments to 1220764 Ontario Inc. for management services provided by Mr. Tony P. Busseri, a director of the Company in the amount of \$75,000 for the three months ended June 30, 2010 and \$125,000 in the six months ended June 30, 2010.

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9. LOSS PER SHARE

The Company uses the treasury stock method to calculate basic and diluted earnings (loss) per share. Basic earnings (loss) per share have been calculated based on the weighted average number of common shares without the inclusion of dilutive effects. Diluted earnings (loss) per share are calculated based on the weighted average number of common shares plus dilutive common share equivalents outstanding which consist of options and warrants to purchase common shares.

	<u>June 30, 2010</u>	<u>December 31, 2009</u>
Net loss	\$ (790,598)	\$ (3,408,902)
Weighted average number of common shares outstanding	<u>388,388,115</u>	350,388,115
Basic and diluted loss per share	<u>\$ (0.00)</u>	<u>\$ (0.01)</u>

The diluted loss per share is equal to the basic loss per share as the effects of the options and warrants are anti-dilutive.

10. COMMITMENTS AND CONTINGENCIES

(i) *Operating leases*

The Company is committed under operating lease agreements for the rental of real property and certain equipment. Minimum annual future lease payments are approximately as follows:

2010	\$ 60,000
2011	12,000
	<u>\$ 72,000</u>

(ii) *Legal matters*

In the normal course of operations, the Company may be subject to litigation and claims from customers, suppliers and former employees. Management believes that adequate provisions have been recorded in the accounts, where required. Although it is not possible to estimate the extent of potential costs, if any, management believes that the ultimate resolution of such contingencies would not have a material adverse effect on the results of operations, financial position or liquidity of the Company.

11. INDEMNIFICATIONS

Under certain agreements and the bylaws of the Company, the Company is obligated to indemnify persons who serve as directors or officers (or both) of the Company, against certain costs, charges and expenses suffered or incurred by such person as a result of their service. Claims for indemnity pursuant to such agreements or the bylaws of the Company are subject to certain statutory and other legal limitations. Having regard to the nature of the indemnification obligations and the broad range of circumstances under which the Company may become obligated to make indemnification payments, the Company is unable to make a reasonable estimate of the maximum potential amount that it could be required to pay to persons entitled to indemnification from the Company. The Company has purchased insurance coverage to reduce the risks associated with its indemnification obligation.

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12. FINANCIAL INSTRUMENTS

a) Establishing fair value

The carrying amount of financial instruments including cash, accounts receivable, other receivables, notes receivable, bank indebtedness and accounts payable and accrued liabilities approximates fair value because of the short-term nature of these instruments.

The following table sets out the classification, carrying amount, and fair value of the Company's financial assets and liabilities as at June 30, 2010 and December 31, 2009:

	June 30, 2010		December 31, 2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
FINANCIAL ASSET				
Held for trading				
Cash (i)	\$ 936,640	\$ 936,640	\$ 640,045	\$ 640,045
Loans and receivables				
Accounts receivable (i)	\$ 391,232	\$ 391,232	\$ 88,583	\$ 88,583
Other receivables (i)	\$ 17,405	\$ 17,405	\$ 34,954	\$ 34,954
Notes receivable (i)	\$ -	\$ -	\$ 173,000	\$ 173,000
FINANCIAL LIABILITIES				
Other liabilities				
Accounts payable and accrued liabilities (i)	\$ 734,173	\$ 734,173	\$ 1,197,258	\$ 1,197,258
Bank indebtedness(i)	\$ -	\$ -	\$ 854,717	\$ 854,717

(i) The fair value of these instruments approximates their carrying amount due to their short-term nature.

b) Fair value hierarchy

Financial instruments recorded at fair value on the Consolidated Balance Sheet are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

- Level 1 - valuation based on quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 - valuation techniques based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (ie as prices) or indirectly (i.e. derived from prices);
- Level 3 - valuation techniques using inputs for the asset or liability that are not based on observable market data (unobservable inputs).

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The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

Fair value of cash is measured based on Level 1 inputs referred to in the three levels of hierarchy noted above. No other financial assets or financial liabilities are measured at fair value on the balance sheet.

13. CAPITAL MANAGEMENT

The Company's objectives when managing capital is to maintain a flexible capital structure which optimized the cost of capital at acceptable risk.

The Company manages its capital structure and makes adjustments due to changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the Company may issue new shares, issue new debt, and/or issue new debt to replace existing debt with different characteristics.

Capital management objectives, policies and procedures are unchanged since the preceding year.

14. FINANCIAL INSTRUMENTS - RISK MANAGEMENT

The Company has exposure to credit risk, liquidity risk and market risk associated with its financial assets and liabilities. The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board of Directors has established the Audit Committee which is responsible for monitoring the Company's compliance with risk management policies. The Audit Committee regularly reports to the Board of Directors on its activities.

The Company's risk management program seeks to minimize potential adverse effects on the Company's financial performance and ultimately shareholder value. The Company manages its risks and risk exposures through a system of internal controls and sound business practices.

The Company's financial instruments and the nature of the risks to which they may be subject are set out in the following table:

	Risks			
	Credit	Liquidity	Foreign Exchange	Interest Rate
Cash	Yes		Yes	Yes
Accounts receivable	Yes		Yes	
Other receivables	Yes			
Notes receivable	Yes			
Accounts payable and accrued liabilities		Yes	Yes	
Bank indebtedness	Yes	Yes		Yes

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(a) *Credit risk*

Credit risk arises from cash held with banks and credit exposure to customers, including outstanding accounts receivable. The maximum exposure to credit risk is equal to the carrying value (net of allowances) of the financial assets. The objective of managing credit risk is to prevent losses on financial assets. The Company assesses the credit quality of counterparties, taking into account their financial position, past experience and other factors. During the three months ended June 30, 2010, the largest single customer represented approximately 40.7% of recorded revenues. For the six months ended June 30, 2010, the largest single customer represented approximately 43.5 % of recorded revenue.

Cash

Cash consists of bank balances. Credit risk associated with cash is minimized substantially by ensuring that these financial assets are invested in debt instruments of highly rated financial institutions. At June 30, 2010, the Company had cash consisting of cash on hand and deposits with banks of \$936,640 (December 31, 2009 - \$640,045). During the three months ended June 30, 2010, the Company did not hold any investments in asset-backed commercial paper.

Accounts receivable

Accounts receivable consists primarily of accounts receivable from invoicing of devices and services. The Company's credit risk arises from the possibility that a customer which owes the Company money is unable or unwilling to meet its obligations in accordance with the terms and conditions in the contracts with the Company, which would result in a financial loss for the Company. This risk is mitigated through established credit management techniques, including monitoring customer's creditworthiness, setting exposure limits and monitoring exposure against these customer credit limits.

The carrying amount of accounts receivable is reduced through the use of an allowance for doubtful accounts and the amount of the loss is recognized in the statement of operations. When a receivable balance is considered uncollectible, it is written off against the allowance for accounts receivable. Subsequent recoveries of amounts previously written off reduce other expenses in the statement of operations. As at June 30, 2010 the Company fully wrote-off prior year allowances of invoices and does not anticipate that any accounts receivable at June 30, 2010 will be uncollectable. At June 30, 2010, the largest single customer represented approximately 24.8% of accounts receivable. Subsequent to June 30, 2010 the full amount from the largest single customer was paid in full.

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The following table outlines the details of the aging of the Company's receivables as at June 30, 2010 and December 31, 2009:

	June 30, 2010	December 31, 2009
Current	\$ 293,830	\$ 31,427
Past due		
1 – 60 days	97,402	47,873
Greater than 60 days	-	27,743
Less: Allowance for doubtful accounts	-	(18,460)
Total accounts receivable, net	<u>\$ 391,232</u>	<u>\$ 88,583</u>

The following table outlines the details of the Allowance for Doubtful Accounts of the Company's receivables as at June 30, 2010 and December 31, 2009:

	June 30, 2010	December 31, 2009
Opening balance in period	\$ (18,460)	\$ (99,672)
Collected in period	-	1,297
Increase in reserve in period	-	(2,769)
Write-off in period	18,460	82,684
Closing balance in period	<u>\$ -</u>	<u>\$ (18,460)</u>

(b) *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's objective in managing liquidity risk is to maintain sufficient readily available reserves in order to meet its liquidity requirements at any point in time. In order to meet its financial liabilities, the Company has recently relied on collecting its accounts receivable.

The Company's ability to manage its liquidity risk going forward will require some or all of the following: the ability to secure capital and/or credit facilities on reasonable terms in the current market place and its ability to generate positive cash flows from operations.

The following table details the Company's contractual maturities for its financial liabilities, including interest payments and operating lease commitments, as at June 30, 2010:

	2010	2011	Total
Accounts payable and accrued liabilities	\$ 734,173	\$ -	\$ 734,173
Operating lease commitments	60,000	12,000	72,000
	<u>\$ 794,173</u>	<u>\$ 12,000</u>	<u>\$ 806,173</u>

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(c) *Market risk*

Market risk is the risk that changes in market prices, such as foreign exchange rates and interest rates will affect the fair value of recognized assets and liabilities or future cash flows or the Company's results of operation.

Foreign exchange

The functional currency of the parent company is Canadian dollars and the reporting currency is Canadian dollars. As at June 30, 2010, the Company had non Canadian dollar net monetary liabilities of approximately US\$103,976 and €165,120 (December 31, 2009 - approximately US\$271,400 and €36,000). Any changes in the respective exchange rates as at June 30, 2010 would have resulted in an exchange gain or loss which would have been included in the determination of net income.

Interest rate

The Company has cash balances which are exposed to interest rate fluctuations. At June 30, 2010, cash totalled \$936,640 (December 31, 2009 - \$640,045). An increase of 100 basis points in the market interest rate would have increased the net loss by approximately \$9,366 (a 100 basis point decrease would have had the equal but opposite effect) for the six months ended June 30, 2010.

15. INVENTORY

For the six months ended June, 2010, the cost of inventory recognized as an expense was \$43,665 (\$1,271,060 in December 31, 2009 which included a write-off of inventory of \$239,362).

16. SEGMENTED INFORMATION

The Company is organized and managed as a single reportable business entity with two distinct revenue segments, being devices and appliances, and services. At June 30, 2010, the Company had \$2,201,258 (December 31, 2009 - \$1,568,684) in deferred revenue.

	For the three months ended June 30		For the six months ended June 30	
	2010	2009	2010	2009
Revenues				
Devices	\$ 211,931	\$ 1,017,240	\$ 258,446	\$ 1,118,361
Services	995,065	566,079	1,954,005	903,477
	<u>\$ 1,206,996</u>	<u>\$ 1,583,319</u>	<u>\$ 2,212,451</u>	<u>\$ 2,021,838</u>

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17. COMPARITIVE FIGURES

Prior year comparative figures have been reclassified to conform to current year presentation.

18. SUBSEQUENT EVENTS

On July 26, 2010, the Company shipped to the Commander Navy Reserve Forces (RESFOR) in Norfolk, Virginia 400 MobiKEY Fusion devices and TruOFFICE subscriptions. The procurement was made in advance of completing the six-month pilot project to deploy the Route1 DEFIMNET® (Defense Identity Management Network) and MobiKEY® Fusion devices to the U.S. Navy Reserve, which was announced on March 2, 2010.