



*Consolidated Financial Statements of*

**Route1 Inc.**

*March 31, 2009*

The Company has prepared the unaudited interim consolidated balance sheets, statements of operations, comprehensive loss and deficit, and statements cash flow and notes thereto as at and for the three months ended March 31, 2009. 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, 2008 audited consolidated financial statements.

## TABLE OF CONTENTS

Route1 Inc.

March 31, 2009 (unaudited)

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	<u>Page</u>
Consolidated Balance Sheets	1
Consolidated Statements of Operations, Comprehensive Loss and Deficit	2
Consolidated Statements of Cash Flow	3
Notes to the Consolidated Financial Statements	4 – 19

## CONSOLIDATED BALANCE SHEETS

### Route1 Inc.

As at March 31, 2009 (unaudited) and December 31, 2008

	March 31, 2009	December 31, 2008
<b>ASSETS</b>		
Current		
Cash	\$ 755,136	\$ 2,120,333
Accounts receivable	243,550	115,620
Other receivables	29,473	18,873
Notes receivable (note 5)	201,025	198,220
Inventory	1,286,072	1,333,427
Prepaid expenses	186,216	228,469
	<b>2,701,472</b>	<b>4,014,942</b>
Investments (note 6)	4	4
Capital assets (note 7)	163,382	206,464
	<b>\$ 2,864,858</b>	<b>\$ 4,221,410</b>
<b>LIABILITIES</b>		
Current		
Accounts payable and accrued liabilities	\$ 418,544	\$ 920,541
Deferred revenue	1,674,108	1,658,691
Current portion of obligations under capital lease (note 8)	-	2,700
	<b>2,092,652</b>	<b>2,581,932</b>
Non current		
Deferred revenue	74,298	48,302
	<b>2,166,950</b>	<b>2,630,234</b>
Commitments and contingencies (note 13)		
<b>SHAREHOLDERS' EQUITY</b>		
Common shares (note 9)	24,038,562	24,038,562
Warrants (note 9)	3,203,207	3,203,207
Contributed surplus (note 9)	5,200,174	5,149,384
Deficit	(31,744,035)	(30,799,977)
	<b>697,908</b>	<b>1,591,176</b>
	<b>\$ 2,864,858</b>	<b>\$ 4,221,410</b>

Approved by the Board of Directors:

Director:

Director:

<<Signed>>

<<Signed>>

Michael F. Doolan

K. Andrew White

**CONSOLIDATED STATEMENTS OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT**

**Route1 Inc.**

**For the three months ended March 31, 2009 (unaudited) and 2008 (unaudited)**

	2009	2008
<b>Revenues</b>		
Devices	\$ 101,121	\$ 78,024
Services	337,398	116,273
	438,519	194,297
<b>Cost of revenues</b>	120,537	176,595
<b>Gross margin</b>	317,982	17,702
<b>Expenses</b>		
General administration	461,406	717,280
Research and development	486,767	582,015
Selling and marketing	285,140	327,285
Amortization	31,963	65,847
	1,265,276	1,692,427
<b>Loss before the following items</b>	(947,294)	(1,674,725)
<b>Interest income</b>	3,236	42,175
<b>Net loss and comprehensive loss for the period</b>	(944,058)	(1,632,550)
<b>Deficit, beginning of period</b>	(30,799,977)	(25,353,296)
<b>Deficit, end of period</b>	\$ (31,744,035)	\$ (26,985,846)
<b>Loss per share (note 12)</b>	\$ (0.00)	\$ (0.00)
<b>Weighted average number of common shares outstanding</b>	350,388,115	349,388,115

## CONSOLIDATED STATEMENTS OF CASH FLOW

### Route1 Inc.

For the three months ended March 31, 2009 (unaudited) and 2008 (unaudited)

	2009	2008
<b>Net cash inflow (outflow) related to the following activities</b>		
<b>Operating activities</b>		
Loss from operations	\$ (944,058)	\$(1,632,550)
Items not affecting cash		
Amortization	43,082	117,651
Stock based compensation	50,790	148,543
	<b>(850,186)</b>	<b>(1,366,356)</b>
Net changes in working capital balances		
Accounts receivable	(127,930)	(15)
Other receivables	(10,600)	622
Inventory	47,355	(8,354)
Prepaid expenses	42,253	(143,129)
Accounts payable and accrued liabilities	(501,997)	(14,690)
Deferred revenue	41,413	6,131
	<b>(1,359,692)</b>	<b>(1,525,791)</b>
<b>Investing activities</b>		
Acquisition of capital assets	-	(20,164)
Notes receivable	(2,805)	(25,972)
	<b>(2,805)</b>	<b>(46,136)</b>
<b>Financing activities</b>		
Repayment of obligations under capital lease	(2,700)	(52,680)
Issuance of share capital – net of issuance costs	-	(1,644)
	<b>(2,700)</b>	<b>(54,324)</b>
<b>Net cash outflow</b>	<b>(1,365,197)</b>	<b>(1,626,251)</b>
<b>Cash, beginning of period</b>	<b>2,120,333</b>	<b>6,303,351</b>
<b>Cash, end of period</b>	<b>\$ 755,136</b>	<b>\$ 4,677,100</b>
<b>Supplementary information</b>		
Interest paid	\$ 643	\$ 2,373

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### Route1 Inc.

**March 31, 2009 (unaudited)**

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#### **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.

Route1 delivers award-winning security and identity management solutions to customers worldwide. These solutions provide universal, secure access to all digital resources and sensitive data. At the heart of Route1’s solutions is MobiNET, a communications and service delivery platform focused on identity management and entitlement-based access to resources. Route1’s patent-pending solutions are based on FIPS-140-2 cryptographic modules, and simplify the process of meeting increasingly stringent regulatory requirements around privacy and security.

The Company participates in the high-technology industry and management believes that changes in any of the following areas could have a material adverse effect on the Company's future financial position, results of operations or cash flows: advances and trends in new technologies and industry standards, competitive pressures in the form of new products and services or price reductions on current products and services, changes in the overall demand for products and services offered by the Company, market acceptance of the Company's products and services, development of sales channels, changes in certain strategic relationships or customer relationships, litigation or claims against the Company based on intellectual property, patent, product, regulatory or other factors, and the Company's ability to attract and retain necessary employees to support its growth.

#### *Going concern assumption*

While the accompanying unaudited interim 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, several 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 March 31, 2009 and 2008, the Company incurred losses of \$944,058 and \$1,632,550 respectively, and has an accumulated deficit of \$31,744,035 as at March 31, 2009. The Company’s continued existence is dependent upon its ability to obtain additional financing and ultimately achieve profitable operations. However there can be no assurance that the Company will be able to achieve profitable operations, nor that financing efforts will continue to be successful.

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.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### Route1 Inc.

March 31, 2009 (unaudited)

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#### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These unaudited interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”) for going concern entities and reflect the following significant accounting policies:

##### *Principles of consolidation*

These unaudited interim 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.

##### *Cash*

Cash consist of cash balances with banks.

##### *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 as per guidelines of the Canadian Institute of Chartered Accountants (“CICA”) Handbook Section 3031 “Inventories”.

##### *Investments*

Investments are classified as “Available-for-sale”. They are carried at fair value with changes to fair value recorded in other comprehensive income (loss). If a decline in fair value is determined to be other-than temporary, the cumulative loss included in accumulated other comprehensive income (loss) is removed and recognized as net income (loss). Gains and losses realized on disposal of available-for-sale securities are recognized in other income.

#### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### Route1 Inc.

**March 31, 2009 (unaudited)**

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#### *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. In addition to this general policy, 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.

##### *Service*

Revenue from service is recognized rateably 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.

##### *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 each unit's relative fair value. 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.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### Route1 Inc.

March 31, 2009 (unaudited)

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#### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

##### *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 deferred and amortized when the criteria for deferral are met, or otherwise, are expensed as incurred. To date, no development expenditures have been deferred.

##### *Earnings (loss) per share*

Basic earnings (loss) per share is 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/measurement uncertainty*

In preparing the Company's unaudited interim 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 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 valuation of future tax assets; and
- the calculation of stock option compensation expense.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### Route1 Inc.

March 31, 2009 (unaudited)

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#### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

##### *Stock compensation*

The Company has a stock-based compensation plan, which is described in note 9. 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. ADOPTION OF NEW ACCOUNTING STANDARDS

On January 1, 2009, the Company adopted the following new accounting standards; CICA Handbook Section 3064 “Goodwill and Intangible Assets”, Section 1000 “Financial Statements Concepts”. These standards have been adopted prospectively and comparative amounts for the prior year have not been restated.

##### *Goodwill and Intangible Assets*

In February 2008, the CICA issued Handbook Section 3064, Goodwill and Intangible Assets which supersedes Sections 3062 *Goodwill and Other Intangible Assets*. Section 3064 provides additional guidance on when expenditures qualify for recognition as intangible assets and requires that costs be deferred only when relating to an item meeting the asset definition. CICA Handbook Section 1000, Financial Statement Concepts, was also amended to provide consistency with this new standard. The Company adopted this standard for the fiscal year commencing January 1, 2009. The adoption of this standard has had no material impact on the Company’s financial statements or disclosures.

#### 4. FUTURE ACCOUNTING PRONOUNCEMENTS

##### *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.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### Route1 Inc.

March 31, 2009 (unaudited)

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#### 4. FUTURE ACCOUNTING PRONOUNCEMENTS (continued)

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 in its infancy. The Company anticipates that it will not adopt IFRS for annual and interim reporting periods before our fiscal year beginning January 1, 2011. By the end of fiscal 2009, we will have completed an analysis of accounting policies and standards under IFRS. The analysis will include those policies we are required to us, as well as those we expect to apply where choices are permitted in preparing IFRS financial statements.

The Company is currently assessing the impact of this standard on its consolidated financial statements.

#### 5. NOTES RECEIVABLE

Notes receivable consist of the following:

	<u>March 31, 2009</u>	<u>December 31, 2008</u>
Due from an officer of the Company, secured and repayable no later than December 15, 2009 with interest at 6%	\$ 91,375	\$ 90,100
Due from an officer of the Company, secured and due on demand with interest at 6%	55,900	55,120
Due from an employee of the Company, secured and due on demand with interest at 6%	53,750	53,000
	<u>\$ 201,025</u>	<u>\$ 198,220</u>

#### 6. INVESTMENTS

Investments in companies not subject to significant influence are as follows:

	<u>March 31, 2009</u>	<u>December 31, 2008</u>
Hypernet Inc.	\$ 1	\$ 1
Other	3	3
	<u>\$ 4</u>	<u>\$ 4</u>

The Company holds first preferred shares in Hypernet Inc. (“Hypernet”), which Hypernet shall redeem all or a portion of the first preferred shares based on a percentage Hypernet revenues exceeding a certain level.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### Route1 Inc.

March 31, 2009 (unaudited)

#### 7. CAPITAL ASSETS

	March 31, 2009		
	Cost	Accumulated Amortization	Net Book Value
Furniture and equipment	\$ 235,950	\$ 231,562	\$ 4,388
Computer equipment	1,335,154	1,191,830	143,324
Computer software	607,691	607,691	-
Leasehold improvements	69,769	54,099	15,670
	<u>\$ 2,248,564</u>	<u>\$ 2,085,182</u>	<u>\$ 163,382</u>

	December 31, 2008		
	Cost	Accumulated Amortization	Net Book Value
Furniture and equipment	\$ 235,950	\$ 230,551	\$ 5,399
Computer equipment	1,335,154	1,159,013	176,141
Computer software	607,691	601,926	5,765
Leasehold improvements	69,769	50,610	19,159
	<u>\$ 2,248,564</u>	<u>\$ 2,042,100</u>	<u>\$ 206,464</u>

Included in computer equipment are assets held under finance leases with a cost of \$657,847 (December 31, 2008 - \$657,847), accumulated amortization of \$655,421 (December 31, 2008 - \$652,995) and net book value of \$2,426 (December 31, 2008 - \$4,852).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### Route1 Inc.

#### March 31, 2009 (unaudited)

#### 8. OBLIGATIONS UNDER CAPITAL LEASE

The Company has obligations under capital lease as follows:

	<u>March 31, 2009</u>	<u>December 31, 2008</u>
Computer equipment lease agreement in the amount of \$32,400, repayable in quarterly instalments of \$2,700 including interest calculated at 8.3%, with a bargain purchase option at maturity on March 1, 2009	\$ -	\$ 2,700
Total amount of future minimum lease payments	-	2,700
Executory costs and interest included in instalments	-	-
	-	2,700
Current portion	-	2,700
	<u>\$ -</u>	<u>\$ -</u>

#### 9. 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, 2008	349,388,115	\$23,905,243
Shares issued on exercise of warrants (a)	1,000,000	139,035
Other	-	(5,716)
Balance, December 31, 2008 and March 31, 2009	<u>350,388,115</u>	<u>\$24,038,562</u>

During the year ended December 31, 2008, the following share transactions took place:

- a. 1,000,000 warrants were exercised at \$0.10 per share for total proceeds of \$100,000. Included in the stated share capital amount is \$39,035 reallocated from contributed surplus as related to the valuation of the warrants exercised under the Black-Scholes option pricing model.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### Route1 Inc.

March 31, 2009 (unaudited)

#### 9. SHARE CAPITAL, WARRANTS AND CONTRIBUTED SURPLUS (continued)

##### *Escrow requirements*

As at March 31, 2009, approximately 22,570,000 (December 31, 2008 – 22,570,000) 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.

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

	March 31, 2009		December 31, 2008	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Options Outstanding				
Balance, beginning of the period	5,949,660	\$ 0.18	10,598,660	\$ 0.26
Options granted during the period	-	-	1,125,000	0.08
Options expired during the period	-	-	(2,837,000)	0.44
Options forfeited during the period	(12,500)	0.30	(2,937,000)	0.18
Balance, end of the period	5,937,160	\$ 0.18	5,949,660	\$ 0.18

Exercise Price	Options Outstanding March 31, 2009		Options Exercisable March 31, 2009	
	Number of Options	Weighted Average Life (Years)	Number of Options	Weighted Average Life (Years)
\$ 0.08	1,125,000	3.9	375,000	3.9
\$ 0.125	950,000	2.0	-	-
\$ 0.20	1,185,000	0.8	-	-
\$ 0.205	1,790,160	3.3	596,720	3.3
\$ 0.30	887,000	2.1	591,333	2.1
	5,937,160	2.5	1,563,053	3.0

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### Route1 Inc.

March 31, 2009 (unaudited)

#### 9. SHARE CAPITAL, WARRANTS AND CONTRIBUTED SURPLUS (continued)

Exercise Price	Options Outstanding December 31, 2008		Options Exercisable December 31, 2008	
	Number of Options	Weighted Average Life (Years)	Number of Options	Weighted Average Life (Years)
\$ 0.08	1,125,000	4.2	-	-
\$ 0.125	950,000	2.3	-	-
\$ 0.20	1,185,000	1.0	-	-
\$ 0.205	1,790,160	3.5	596,720	3.5
\$ 0.30	899,500	2.3	599,666	2.3
	<u>5,949,660</u>	<u>2.8</u>	<u>1,196,386</u>	<u>2.9</u>

During the three months ended March 31, 2009, the Company recorded stock-based compensation expense of \$50,790 (March 31, 2008 - \$148,543), 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:

	2009	2008
Risk free interest rate	4.25%	4.25%
Expected life (years)	5	5
Expected volatility	100%	100%
Dividend yield	Nil	Nil
Weighted average fair value of options granted	<u>\$ 0.09</u>	<u>\$ 0.09</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. On March 9, 2008, 29,369,174 warrants issued as part of a private placement on March 9, 2006 expired with a value of \$1,679,917 which was reallocated to contributed surplus from warrants. On September 20, 2008, 41,135,618 warrants issued as part of a private placement on September 20, 2006 expired with a value of \$1,605,729 which was reallocated to contributed surplus from warrants.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### Route1 Inc.

March 31, 2009 (unaudited)

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#### 9. SHARE CAPITAL, WARRANTS AND CONTRIBUTED SURPLUS (continued)

##### *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, 2008	107,748,365	\$0.134
Warrants exercised	(1,000,000)	0.100
Warrants expired	(70,504,792)	0.120
Balance, December 31, 2008 and March 31, 2009	<u>36,243,573</u>	<u>\$0.155</u>

- (a) 36,243,573 warrants expiring November 6, 2009 with an exercise price of \$0.155 per share and value of \$3,203,207.

#### 10. CAPITAL MANAGEMENT

The Company's capital currently consists of shareholders' equity. The Company's capital management objectives are to safeguard its ability to continue as a going concern, in order to provide future returns for shareholders. Management intends to accomplish this objective with the least dilution to our shareholders. The Company manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. There were no changes in the Company's approach to capital management during the three months ended March 31, 2009. The Company is not subject to externally imposed capital requirements.

#### 11. RELATED PARTY TRANSACTIONS

On March 31, 2009, the Company had notes receivable from officers in the amount of \$201,025 (December 31, 2008 - \$198,220) inclusive of accrued interest. These notes are secured and bear interest at six percent (6%) (See note 5).

#### 12. 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. For the three months ended March 31, 2009 and 2008, the loss per share was \$0.00 and \$0.00 respectively.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### Route1 Inc.

March 31, 2009 (unaudited)

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#### 13. 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:

2009	\$ 108,000
2010	120,000
2011	12,000
	<u>\$ 240,000</u>

(ii) *Legal matters*

In the normal course of operations, the Company maybe 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.

#### 14. 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 obligations.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### Route1 Inc.

March 31, 2009 (unaudited)

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#### 15. FINANCIAL INSTRUMENTS

The carrying amount of financial instruments including cash, accounts receivable, other receivables, notes receivable 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 March 31, 2009 and December 31, 2008:

	March 31, 2009		December 31, 2008	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
FINANCIAL ASSET				
Held for trading				
Cash (i)	\$755,136	\$755,136	\$2,120,333	\$2,120,333
Loans and receivables				
Accounts receivable (i)	\$243,550	\$243,550	\$115,620	\$115,620
Other receivables (i)	\$29,473	\$29,473	\$18,873	\$18,873
Notes receivable (i)	\$201,025	\$201,025	\$198,220	\$198,220
FINANCIAL LIABILITIES				
Other liabilities				
Accounts payable and accrued liabilities (i)	\$418,544	\$418,544	\$920,541	\$920,541

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

#### 16. FINANCIAL 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.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### Route1 Inc.

March 31, 2009 (unaudited)

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#### 16. FINANCIAL RISK MANAGEMENT (continued)

The Company's financial instruments and the nature of the risks which they may be subject to 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	

##### (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 March 31, 2009, the largest single customer represented approximately 28% of recorded revenues.

##### *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 March 31, 2009, the Company had cash consisting of cash on hand and deposits with banks of \$755,136 (December 31, 2008 - \$2,120,333). During the three months ended March 31, 2009, 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 are 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. At March 31, 2009, the largest single customer represented approximately 37% of accounts receivable.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### Route1 Inc.

March 31, 2009 (unaudited)

#### 16. FINANCIAL RISK MANAGEMENT (continued)

The following table outlines the details of the aging of the Company's receivables as at March 31, 2009 and December 31, 2008:

	<u>2009</u>	<u>2008</u>
Current	<b>\$150,581</b>	\$19,882
Past due		
1 – 60 days	<b>5,811</b>	15,244
Greater than 60 days	<b>185,002</b>	180,554
Less: Allowance for doubtful accounts	<b>(97,844)</b>	(100,060)
Total accounts receivable, net	<b><u>\$243,550</u></b>	<u>\$115,620</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 March 31, 2009:

	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>Total</u>
Accounts payable and accrued liabilities	\$418,543	\$ -	\$ -	\$418,543
Operating lease commitments	108,000	120,000	12,000	\$240,000
	<u>\$526,543</u>	<u>\$120,000</u>	<u>\$12,000</u>	<u>\$658,543</u>

#### (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 March 31, 2009, the Company's had no non Canadian dollar net monetary liabilities (December 31, 2008 - approximately US\$26,300 and €34,000), any changes in the respective exchange rates as at March 31, 2009 would have resulted in an exchange gain or loss which would have been included in the determination of net income.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### Route1 Inc.

**March 31, 2009 (unaudited)**

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#### 16. FINANCIAL RISK MANAGEMENT (continued)

##### *Interest rate*

The Company has cash balances which are exposed to interest rate fluctuations. At March 31, 2009, cash totalled \$755,136 (December 31, 2008 - \$2,120,333). An increase of 100 basis points in the market interest rate would have decreased net loss by approximately \$3,600 (a 100 basis point decrease would have had the equal but opposite effect) for the three months ended March 31, 2009.

#### 17. SEGMENTED INFORMATION

The Company is organized and managed as a single reportable business entity with two distinct revenue segments, being devices and services. The Company considers revenue realizable and earned when the product has been delivered or the services have been provided to the customer and collectability is reasonably assured. For sale of devices, revenue is recognized at the time of shipment of the device which constitutes transfer of ownership of the device. Revenue for the services component is reported as deferred revenue on the balance sheet and is recognized as earned revenue in the period which the service is provided. At March 31, 2009, the Company had \$1,748,406 (December 31, 2008 - \$1,706,993) of deferred revenues.

	<b>March 31, 2009</b>	December 31, 2008
<b>Revenues</b>		
Devices	\$ 101,121	\$ 78,024
Services	337,398	116,273
	<b>\$ 438,519</b>	<b>\$ 194,297</b>