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**ROUTE1 INC.****MANAGEMENT DISCUSSION AND ANALYSIS****FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2009****AS AT NOVEMBER 23, 2009**

The following discussion and analysis of the financial condition and results of operations (“**MD&A**”) of Route1 Inc. (also referred to as “**we**”, “**us**”, “**our**”, “**Route1**”, or the “**Company**”), has been prepared in accordance with National Instrument 51-102F1, been reviewed and approved by the Company’s Board of Directors prior to filing and should be read in conjunction with the Company’s unaudited interim consolidated financial statements and related notes as at and for the three and nine months ended September 30, 2009, and with the Company’s audited consolidated financial statements and related notes as at and for the years ended December 31, 2008 and 2007, which have been prepared in accordance with Canadian Generally Accepted Accounting Principles (“**GAAP**”), and with the Company’s annual management discussion and analysis dated April 15, 2009.

**FORWARD-LOOKING STATEMENTS**

The following discussion may contain forward looking statements about matters that involve risk and uncertainties, such as statements of Route1’s plans, objectives, expectations and intentions, as well as financial trends. The discussion also includes cautionary statements about these matters. You should read the cautionary statements made below as being applicable to all forward-looking statements wherever they appear in this document. In drawing a conclusion or making a forecast or projection set out in the forward-looking information, the Company takes into account the following material factors and assumptions in addition to the above factors: the Company’s ability to execute on its business plan; the acceptance of the Company’s devices and services by its customers; the timing of execution of outstanding or potential customer orders by the Company; the sales opportunities available to the Company; the Company’s subjective assessment of the likelihood of success of a sales lead or opportunity; the Company’s historic ability to generate sales leads or opportunities; and that sales will be completed at or above the Company’s estimated margins. This list is not exhaustive of the factors that may affect our forward-looking information. These and other factors should be considered carefully and readers should not place undue reliance on such forward-looking information.

Factors that could cause Route1’s actual results to differ materially from the forward-looking statements are contained herein and include, but are not limited to, overall economic conditions, competitive pressures and unexpected technology changes. Additional information concerning risks and uncertainties affecting Route1’s business and other factors that could cause financial results to fluctuate is set forth later in this document, as well as elsewhere herein, and is contained in Route1’s filing with Canadian securities regulatory authorities, available on the SEDAR website ([www.sedar.com](http://www.sedar.com)) under Route1 Inc. and on the Company’s website ([www.route1.com](http://www.route1.com)).

This MD&A includes additional disclosures on the critical accounting policies and estimates, additional disclosure on the annual selected financial information, additional discussion and analysis on the factors affecting the Company’s financial performance, additional disclosure on future liquidity and capital needs including the addition of a tabular presentation of contractual obligation, additional disclosure on the last eight quarters, and details of related party transactions. The Company does not believe that any of the additional information provided that has not otherwise been disclosed in other filings is material in nature.

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## OVERVIEW

Route1 delivers award-winning security and identity management solutions to customers world-wide. 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.

## HIGHLIGHTS

- In January 2009, the Company announced that it signed an agreement granting reseller Qwest Government Services Inc. ("Qwest") the exclusive rights to resell Route1 security and identity management solutions to the U.S. Federal Government in 2009. As part of the agreement, Qwest committed to purchase a minimum of 30,000 Route1 MobiKEY devices and 30,000 TruOFFICE one-year subscription-based services, which is valued at approximately US\$8.0 million in 2009 to the Company. The potential recurring annual revenue stream to Route1 from these 30,000 TruOFFICE subscription-based services is estimated at US\$5.5 million. In addition to the purchase commitment, Qwest provides advertising and marketing support to promote Route1's solutions to various U.S. Federal departments and agencies. Qwest also provides network-hosting services to Route1 from their facilities. The Company started delivering on this agreement in the second quarter of 2009 with the shipment of approximately 2,000 MobiKEYs and 2,000 TruOFFICE subscriptions having an approximate value of US\$500,000.
- In April 2009, the Company announced the successful installation of its DEFIMNET™ (DEFense Identity Management NETwork), its military version of its service delivery platform for identity and entitlement management, at a United States Government's Department of Homeland Security ("DHS") site. DEFIMNET was developed and designed to reside within all levels of classified and unclassified networks, to interact with other defense network systems. DEFIMNET is sanctioned for use by military units to command and control confidentiality, integrity and availability of secure and real-time data. This initial three (3) year agreement announced by the Company in October 2008 for the installation and maintenance of DEFIMNET is valued in excess of US\$2 million and is being delivered through Qwest under the Washington Interagency Telecommunications System (WITS) 2001 Crossover contract. Based on preliminary discussions and the leverage strength of DEFIMNET, management expects with the completion of the installation, will see DHS's subscriber base to significantly grow for the Company's MobiKEY devices and TruOFFICE™ subscription-based services over the next 12 to 18 months.
- On July 20, 2009, the Company announced that Mr. Dean Peloso, a member of Route1's then Board of Directors, would step in immediately on an interim basis to serve as President and Chief Executive Officer of the Company. The move followed the removal of Mr. K. Andrew White who previously served in this role.
- On July 27, 2009, the Company announced that it had been awarded a National Master Standing Offer (NMSO) contract by Public Works and Government Services Canada (PWGSC). Under the NMSO, Canadian Government departments and agencies have been pre-approved to purchase up to \$20 million of Route1 products and services over a three-year period. Route1 is now a pre-approved to supply the Government of Canada to allow its employees to perform their job functions outside of the office without any risk of data leakage.
- On August 10, 2009, the Company announced the introduction of its beta version of the MobiKEY® Fusion, an identity validation device that supports government-issued identity and access cards,

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powered by MobiNET®. Route1 demonstrated the MobiKEY Fusion at the U.S. General Services Administration's 2009 Network Services Conference in Chicago, Illinois from August 10 to 13, 2009.

- On August 31, 2009, the Company announced that the Government of the Netherlands Ministry Foreign Affairs increased its deployment of Route1's TruOFFICE™ subscription-based service and MobiKEY<sup>R</sup> devices to enable secure interactions with their digital resources from anywhere, at any time. The Route1 solution will be deployed to both personnel at headquarters in The Hague, Netherlands, as well as personnel located at Dutch Embassies abroad. The Ministry has piloted the use of the Route1 MobiKEY devices within the organization over the last year. The spread of the H1N1 Swine Flu pandemic was a catalyst for the Ministry to accelerate their MobiKEY deployments in order to prepare for the pandemic by enabling employees to continue their work from locations outside of the office. The importance of ensuring the continuity of critical processes triggered the Ministry to augment the application of Route1's solution, since it had been tested and proven to meet the requirements of the Ministry.
- On September 24, 2009, the Company announced that the Concerned Shareholder's Nominees to the Board of Directors received shareholder support at the Company's Annual and Special Meeting of Shareholders. Approximately 66% (138 million) of the shares voted at the meeting supported the Concerned Shareholder's Nominees to the Board, while the nominees proposed by the Company received approximately 31% (65 million) of the votes, and approximately 3% (6 million) of the shares were withheld from voting. As a result of the shareholder vote, the Company's Board of Directors now consists of Messers Tony Busseri, Peter Chodos, Michael Doolan, Michael Harris, and Andrew White, with Mr. Harris appointed as Chair of the Board. Shareholders also established the number of directors at five. The Company also terminated the contract of interim President and CEO, Mr. Peloso, and Mr. White will serve as the Company's Interim President and CEO while a Special Committee consisting of the independent directors of the Board review the claims and allegations made by the prior Board.
- On September 25, 2009, the Company announced that a total of 6,500,000 options to purchase common shares of the Company were granted to newly appointed Directors on September 24, 2009 at an exercise price of \$0.10 per share, expiring on September 24, 2014. Including the above grant, a total of 21,572,876 options are currently outstanding under the stock option plan. Ninety (90) days following the election of a new board of directors at the Company's Annual and Special Meeting of Shareholders held on September 24, 2009, 3,550,730 options to purchase common shares of the Company held by the outgoing board of directors will expire unless exercised.
- On October 15, 2009, the Company announced that the TSX Venture Exchange had approved an extension to the expiry date of 32,360,333 common share purchase warrants, priced at \$0.155, from November 7, 2009 to May 7, 2010.
- On October 16, 2009, the Company closed a \$2.5 million senior debt financing with a major Canadian financial institution. The financing bears interest at the bank's prime rate plus two and a half percent (2.5%) for a rate of four and three quarter percent (4.75%) on the closing date, and is scheduled to be repaid by February 28, 2010. The funds from the financing will be used to purchase additional inventory to fulfill committed orders, including the balance of the Qwest Government Services Inc. commitment for approximately 25,300 MobiKEY devices by the end of 2009.
- On October 28, 2009, the Company announced that the Special Committee consisting of the independent directors of the Board, after reviewing the report of independent third party (Stanley M. Beck, Q.C), announce that Mr. Andrew White has been cleared with respect to the claims and allegations made by the prior Board. Mr. Andrew White was appointed board of director as well as CEO and President of Route1 Inc. As well, the Company announced that, effective immediately, it has terminated its relationships with Mr. Anthony Rzepka, Executive Vice-President, Chief Financial Officer and Treasurer and Mr. Timothy Hyland, Executive Vice-President and Chief Operating Officer.

## SELECTED FINANCIAL INFORMATION

The following table sets out selected unaudited interim financial information of the Company on a consolidated basis for the three and nine months ended September 30, 2009, and 2008.

(in thousands of Canadian dollars, except per share amounts)

	As at and for the three months ended				As at and for the nine months ended			
	Sept 30, 2009	Sept 30, 2008	Change		Sept 30, 2009	Sept 30, 2008	Change	
			\$	%			\$	%
<b>STATEMENT OF OPERATIONS</b>								
Revenues								
Devices	\$ 703	\$ 287	\$ 416	145%	\$ 1,821	\$ 419	\$ 1,402	335%
Services	790	171	619	362	1,693	418	1,275	305
Total revenues	1,493	458	1,035	226	3,514	837	2,677	320
Cost of revenues	481	286	195	73	1,504	637	867	136
Gross margin	1,011	172	839	491	2,010	200	1,810	905
Operating expenses								
General administration	506	658	152	23	1,429	2,037	(608)	(2)
Research and development	444	397	47	12	1,374	1,426	(52)	(4)
Selling and marketing	404	339	65	19	1,014	1,035	(21)	(18)
Stock-based compensation	70	56	14	25	183	273	(90)	(33)
Amortization	31	50	(19)	(39)	92	178	(86)	(48)
Total operating expenses	1,455	1,500	(45)	(3)	4,092	4,949	(857)	(17)
Loss before undernoted	(444)	(1,328)	884	67	(2,082)	(4,749)	2,837	60
Interest income	3	11	(8)	(73)	9	75	(66)	(88)
Foreign exchange translation	(137)	13			(69)	57	(126)	(210)
Proxy contest	(515)	-	(515)	(100)	(515)	-	(515)	(100)
Net loss for the period	\$ (1,093)	\$ (1,304)	\$ 211	16%	\$ (2,657)	\$ (4,617)	\$ 1,960	42%
Loss per share	\$ (0.00)	\$ (0.00)	\$ -	-	\$ (0.00)	\$ (0.01)	\$ 0.01	-
<b>CASH FLOW INFORMATION</b>								
Operating activities	\$ (935)	\$ (1,328)	\$ 393		\$ (1,803)	\$ (4,637)	\$ 2,834	
Investing activities	(5)	(3)	(2)		(10)	(96)	86	
Financing activities	-	99	(99)		(3)	15	(18)	
Net cash inflow (outflow)	(940)	(1,232)	292		(1,816)	(4,718)	2,902	
Cash, beginning of period	1,244	2,817	(1,573)		2,120	6,303	(4,183)	
Cash, end of period	\$ 304	\$ 1,585	\$ (1,281)		\$ 304	\$ 1,585	\$ (1,281)	
<b>BALANCE SHEET INFORMATION AS AT SEPTEMBER 30</b>								
Working capital (deficiency)	\$ (624)	\$ 2,162	\$ (2,716)		\$ (624)	\$ 2,162	\$ (2,716)	
Total assets	\$ 3,526	\$ 4,382	\$ (856)		\$ 3,526	\$ 4,382	\$ (856)	
Obligation under capital lease	\$ -	\$ 8	\$ (8)		\$ -	\$ 8	\$ (8)	
Shareholders' equity (deficiency)	\$ (877)	\$ 2,403	\$ (3,280)		\$ (877)	\$ 2,403	\$ (3,280)	

## GOING CONCERN ASSUMPTION

Our consolidated financial statements have been prepared on a going concern basis which assumes that the Company will be able to meet its commitments, realize its assets and discharge its liabilities in the normal course of business. For the nine months ended September 30, 2009, the Company incurred a net loss of \$2,656,625, and has an accumulated deficit of \$33,456,602 and shareholders' equity deficiency of \$876,555 as at September 30, 2009. Continuation of the Company as a going concern is dependent upon achieving profitable operations, and the ability of the Company to obtain financing when necessary. If the going concern assumption were not appropriate for our consolidated financial statements, adjustments would be necessary in the carrying values of assets and liabilities, the reported net loss and the balance sheet classification used. Operating results for the current period are not necessarily indicative of the results to be expected for any future periods. On January 7, 2009, the Company announced an exclusivity agreement with Qwest Government Services Inc., in which Qwest committed to purchase a minimum of 30,000 MobiKEY devices along with 30,000 TruOFFICE subscription-based services in 2009, which is valued at

approximately US\$8.0 million. The Company started delivering on this agreement in the second quarter of 2009 and has delivered approximately 4,700 of the 30,000 commitment as at September 30, 2009.

## **COMPARISON FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2009 TO 2008**

### **Revenue**

Revenues for the three months ended September 30, 2009 were \$1,492,757, representing an increase of \$1,034,682 or 226%, from \$458,075 for the same period in 2008, with the comparison discussed by segment below.

Revenues from our device (i.e. MobiKEY, DEFIMNET equipment, and EnterpriseLIVE AG) segment for the three months ended September 30, 2009 were \$703,068, representing an increase of \$415,893 or 145%, from \$287,175 for the same period in the 2008, with device revenue as a percentage of total revenue decreasing by 16% pts to 47% for the current period as compared to 63% for the prior period. This is due to the increased delivery of MobiKEY devices in the current quarter as compared to the same period in 2008, being approximately 2,800 MobiKEY devices related to the 30,000 MobiKEY device commitment by Qwest Government Services Inc. in connection the exclusivity agreement as announced on January 7, 2009 and approximately 2,300 MobiKEY devices to other customers in the current quarter.

Revenues from our services (i.e. TruOFFICE subscription-based services, DEFIMNET software licenses and maintenance, and MAP – MobiNET Administration and Provisioning Portal) segment for the three months ended September 30, 2009 were \$789,689, representing an increase of \$618,789 or 362%, from \$170,900 for the same period in 2008, with service revenue as a percentage of total revenue increasing by 16% pts to 53% for the current period as compared to 37% for the prior period. This increase in revenues represents the continued growth in our subscriber base for MobiNET subscription-based services with new subscribers added during the quarter, including the continuing delivery of approximately 2,800 TruOFFICE subscriptions related to the commitment by Qwest in connection with the exclusivity agreement, plus 2,300 new TruOFFICE subscription delivered to other customers, and the recording of the DEFIMNET 3 year software license that started in the second quarter of 2009 which was not present in the same period in 2008.

Deferred revenue for the three months ended September 30, 2009 increased by \$1,004,507 to \$3,171,668 from \$2,167,161 as at June 30, 2009, this revenue will be recognized into income when such services are delivered and/or performed in future periods.

In January 2009, the Company signed an agreement granting Qwest the exclusive rights to resell Route1 devices and services to the U.S. Federal Government for 2009. Qwest has committed to purchasing a minimum of 30,000 Route1 MobiKEY devices along with TruOFFICE subscription-based services in 2009 which is valued at approximately US\$8.0 million, with a potential reoccurring annual revenue stream from such subscriptions valued at approximately US\$5.5 million. The Company started delivering on this agreement in the second quarter of 2009 and has delivered approximately 4,700 of the 30,000 commitment as at September 30, 2009.

### **Gross Margin**

Gross margin is equivalent to revenues minus the cost of revenues. The cost of revenues primarily includes the cost of the devices sold, as well as that of their shipping and packing, plus the cost to operate and maintain the MobiNET (the Company's infrastructure for its software based subscriptions services).

The cost of revenues for the three months ended September 30, 2009 were \$481,160, representing an increase of \$195,158 from \$286,002 for the same period in 2008. This is primarily related to the increased product costs associated with the increase in sales of MobiKEY devices for the quarter.

Gross margin for the three months ended September 30, 2009 was \$1,011,597, representing an increase of \$839,524 from a gross margin of \$170,885 for the same period in 2008. This increase in gross margin can be largely attributed to a higher percentage of revenues being derived from the service segment which results in higher margins than device segment, and also associated with the subscriber base continuing to grow in the period with addition of new customers.

## **Operating Expenses**

Operating expenses consist of general administration, research and development, selling and marketing, and amortization. Operating expenses for the three months ended September 30, 2009 were \$1,455,211, representing a slight decrease of \$45,111 or 3%, from \$1,500,322 for the same period in 2008; the increase is discussed in detail below.

### *General administration*

General administration expenses consist primarily of salaries and benefits for administration staff, professional fees, rent, telephone, computer related, directors' fees, insurance, bad debts, public company regulatory costs, and other overhead expenditures.

General administration expenses for the three months ended September 30, 2009 were \$506,432, representing a decrease of \$151,769 or 23%, from \$658,201 for the same period in 2008 and can be summarized as follows:

- Legal and accounting fees decreased by approximately \$131,000 for the three months ended September 30, 2009 as compared to the same period in 2008, due to fewer regulatory and legal matters during the current quarter;
- Professional fees, such as director fees, recruitment and consulting, decreased by approximately \$47,000 for the three months ended September 30, 2009 as compared to the same period in 2008 due to fewer board meetings in held the current quarter and a reduction in use of recruitment services;
- Salaries and benefits expenses decreased by approximately \$37,000 for the three months ended September 30, 2009 as compared to the same period in 2008, this is due to a reduction in head count compared to 2008;
- Other overhead type expenses such as telephone, courier charges, equipment leasing and computer related expenses decreased by approximately \$18,000 for the three months ended September 30, 2009 as compared to the same period in 2008; and

### *Research and development*

Research and development expenses consist of salaries and benefits for the research and development department, and other professional fees associated with development work.

Research and development expenses for the three months ended September 30, 2009 were \$444,284, representing an increase of \$46,768 or 12%, from \$397,516 for the same period in 2008 and can all be attributed to:

- Salaries and benefits expenses decreased by approximately \$48,000 for the three months ended September 30, 2009 as compared to the same period in 2008, as a result of an increase in head count in this department.

#### *Selling and marketing*

Selling and marketing expenses consist primarily of salaries and commissions, agent fees, marketing and trade shows, and travel and entertainment.

Selling and marketing expenses for the three months ended September 30, 2009 were \$403,523, representing an increase of \$64,816 or 19%, from \$338,707 for the same period in 2008 and can be summarized as follows:

- Salaries and benefits and commissions expenses increased by approximately \$104,000 for the three months ended September 30, 2009 as compared to the same period in 2008; this is attributed to an increased commission expense related to higher sales for the current quarter; and
- Marketing costs, including travel expenses and tradeshow fees, increased by approximately \$14,000 for the three months ended September 30, 2009 as compared to the same period in 2008. This is mainly attributed to an increase in advertising, including but not limited to the Company's in-video advertising on Air Canada flights: offset by a decrease in trade show costs as a result of the Company not attending as many events in 2009 as compared to 2008.

#### *Stock-based compensation*

Stock-base compensation was \$70,325 for the three months ended September 30, 2009, an increase of \$14,580 or 26% from \$55,745 for the same period in 2008. This can be attributed to the additional issuance of stock options granted in the period.

#### *Amortization*

Amortization expense for the three months ended September 30, 2009 was \$30,647, representing a decrease of \$19,506 or 39% from \$50,153 for the same period in 2008. The decrease can be attributed to computer hardware assets fully amortized in 2008 and therefore no expense incurred in the current quarter, and an overall reduction in the asset base used in the calculation of amortization expense using the declining-balance method combined with no new capital expenditures in the quarter.

#### *Interest income*

Interest income for the three months ended September 30, 2009 was \$2,837, representing a decrease of \$7,959 or 74% from \$10,796 for the same period in 2008. This decrease was primarily due to lower average cash balance in the quarter as compared to the same period in 2008.

#### *Foreign Exchange Translation*

Loss due to foreign exchange translation on balance sheet on items such as Accounts Receivable, Accounts Payable and foreign bank accounts was \$137,446 for the three months ended September 30, 2009, an decrease of \$150,447 from a translation gain of \$13,001 for the same period in 2008. The Canadian dollar appreciated by 4% and 8% respectively against the Euro and the American dollar in the third quarter of 2009 from the second quarter of 2009 resulting in foreign exchange translation loss on balance sheet accounts like cash and Accounts Receivables.

### *Proxy Contest Charges*

Proxy contest charges for the three months ended September 30, 2009 was \$514,694 and represents legal fees, proxy solicitation fees and expenses, and other professional consulting fees related to the Annual and Special Shareholders Meeting held on September 24, 2009 which was a contested meeting. These charges are expected to be one time in nature and not to recur in the future.

### **Net loss**

Net loss for the three months ended September 30, 2009 was \$1,092,917 or \$nil per share, representing a significant improvement of \$211,535 or 16%, from a net loss of \$1,304,452 or \$ nil per share for the same period in 2008.

Net loss before interest income, foreign exchange translation and proxy contest charges for the three months ended September 30, 2009 was \$443,614 representing a significant improvement of \$884,635 or 67% from \$1,328,149 for the same period in 2008.

## **COMPARISON FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2009 TO 2008**

### **Revenue**

Revenues for the nine months ended September 30, 2009 were \$3,514,595, representing an increase of \$2,677,286 or 320%, from \$837,309 for the same period in 2008, with the comparison discussed by segment below.

Revenues from our device (i.e. MobiKEY, DEFIMNET equipment, and EnterpriseLIVE AG) segment for the nine months ended September 30, 2009 were \$1,821,429, representing an increase of \$1,402,440 or 335%, from \$418,989 for the same period in the 2008, with device revenue as a percentage of total revenue increasing by 2% pts to 52% for the current period as compared to 50% for the prior period. This is due to the increased delivery of MobiKEY devices in the current period as compared to the same period in 2008, being approximately 4,700 MobiKEY devices related to the 30,000 MobiKEY device commitment by Qwest Government Services Inc. in connection the exclusivity agreement as announced on January 7, 2009 and approximately 3,900 MobiKEY devices to other customers in the current period.

Revenues from our services (i.e. TruOFFICE subscription-based services, DEFIMNET software licenses and maintenance, and MAP – MobiNET Administration and Provisioning Portal) segment for the nine months ended September 30, 2009 were \$1,693,166, representing an increase of \$1,274,846 or 305%, from \$418,320 for the same period in 2008, with service revenue as a percentage of total revenue decreasing by 2% pts to 48% for the current period as compared to 50% for the prior period. This increase in revenues represents the continued growth in our subscriber base for MobiNET subscription-based services with new subscribers added during the period, including the continuing delivery of approximately 4,700 TruOFFICE subscriptions related to the commitment by Qwest in connection with the exclusivity agreement, plus 3,900 new TruOFFICE subscription delivered to other customers, and the recording of the DEFIMNET 3 year software license that started in the second quarter of 2009 which was not present in the same period in 2008.

Deferred revenue for the nine months ended September 30, 2009 increased by \$1,464,675 to \$3,171,668 from \$1,706,993 as at December 31, 2008, this revenue will be recognized into income when such services are delivered and/or performed in future periods.

## Gross Margin

Gross margin is equivalent to revenues minus the cost of revenues. The cost of revenues primarily includes the cost of the devices sold, as well as that of their shipping and packing, plus the cost to operate and maintain the MobiNET (the Company's infrastructure for its software based subscriptions services).

The cost of revenues for the nine months ended September 30, 2009 were \$1,504,704, representing an increase of \$867,172 from \$637,532 for the same period in 2008. This is primarily due to the increase in sales of MobiKEY devices for the period, and the sale of DEFIMNET equipment, as discussed above.

Gross margin for the nine months ended September 30, 2009 was \$2,009,891, representing a significant improvement of \$1,810,114 from a gross margin of \$199,777 for the same period in 2008. This increase in gross margin can be largely attributed to a increase in revenues being derived from the service segment which results in higher margins than device segment, and also associated with the subscriber base continuing to grow in the period with addition of new customers, and with the delivery of the DEFIMNET software license in the second quarter of 2009 which will be recorded over a three (3) year period and was not present in same period in 2008.

## Operating Expenses

Operating expenses consist of general administration, research and development, selling and marketing, and amortization. Operating expenses for the nine months ended September 30, 2009 were \$4,092,136, representing a decrease of \$856,685 or 17%, from \$4,948,821 for the same period in 2008; the decrease is discussed in detail below.

### *General administration*

General administration expenses consist primarily of salaries and benefits for administration staff, professional fees, rent, telephone, computer related, directors' fees, insurance, bad debts, public company regulatory costs, and other overhead expenditures.

General administration expenses for the nine months ended September 30, 2009 were \$1,428,914, representing a decrease of \$607,967 or 30%, from \$2,036,881 for the same period in 2008 and can be summarized as follows:

- Legal and accounting fees decreased by approximately \$373,000 for the nine months ended September 30, 2009 as compared to the same period in 2008, due to fewer regulatory and legal matters during the nine month period, and primarily associated with the statement of claims filed against resellers as announced by the Company in January 2008 and the legal costs incurred in the 2008;
- Salaries and benefits expense decreased by approximately \$148,000 for the nine months ended September 30, 2009 as compared to the same period in 2008, this is due to a reduction in head count in this department compared to 2008;
- Professional fees, such as director fees, recruitment and consulting, decreased by approximately \$136,000 for the nine months ended September 30, 2009 as compared to the same period in 2008, due to fewer employees being hired and hence the reduction in recruitment fees and few directors' meetings held during the first nine months of 2009 as compared to 2008;
- Other overhead type expenses such as telephone, equipment leasing, postage & courier, and computer related expenses decreased by approximately \$64,000 for the nine months ended September 30, 2009 as

compared to the same period in 2008; due to the overall reduction in head count of employees as compared to the same period 2008; and

#### *Research and development*

Research and development expenses consist of salaries and benefits for the research and development department, and other professional fees associated with development work.

Research and development expenses for the nine months ended September 30, 2009 were \$1,374,380, representing a decrease of \$51,691 or 3.6% from \$1,426,071 for the same period in 2008 and can all be attributed to:

- Salaries and benefits expenses increased by approximately \$5,000 for the nine months ended September 30, 2009 as compared to the same period in 2008; and
- Consulting fees decreased by approximately \$57,000 for the nine months ended September 30, 2009 as compared to the same period in 2008, as a direct result of the Company's cost rationalize and reduction program and lesser reliance on outside contractors in 2009.

#### *Selling and marketing*

Selling and marketing expenses consist primarily of salaries and commissions, agent fees, marketing and trade shows, and travel and entertainment.

Selling and marketing expenses for the nine months ended September 30, 2009 were \$1,014,302, representing a decrease of \$20,304 or 2%, from \$1,034,606 for the same period in 2008 and can be summarized as follows:

- Salaries and benefits expenses and commissions increased by approximately \$130,000 for the nine months ended September 30, 2009 as compared to the same period in 2008, this is attributed to the increased commission expense related to higher revenues for the current period; and
- Marketing costs, including travel and tradeshow fees decreased by approximately \$151,000 for the nine months ended September 30, 2009 as compared to the same period in 2008; this is mainly attributed to the Company not attending as many events in 2009 as compared to 2008 which has been offset by an increase in advertising, including but not limited to the Company's in-video advertising on Air Canada flights.

#### *Amortization*

Amortization expense for the nine months ended September 30, 2009 was \$91,883, representing a decrease of \$85,975 or 48% from \$177,858 for the same period in 2008. The decrease can be attributed to computer hardware assets fully amortized in 2008 and therefore no expense incurred in the period, and an overall reduction in the asset base used in the calculation of amortization expense using the declining-balance method combined with no new capital expenditures in the period.

#### *Interest income*

Interest income for the nine months ended September 30, 2009 was \$9,019, representing a decrease of \$66,398, from \$75,417 for the same period in 2008. This decrease was primarily due to lower average cash balance in the period as compared to the same period in 2008.

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### *Foreign Exchange Translation*

Loss due to foreign exchange translation on balance sheet on items such as Accounts Receivable, Accounts Payable and foreign bank accounts was \$68,705 for the nine months ended September 30, 2009, an increase of \$125,186 from a translation gain of \$56,481 for the same period in 2008.

### *Proxy Contest Charges*

Proxy contest charges for the three months ended September 30, 2009 was \$514,694 and represents legal fees, proxy solicitation fees and expenses, and other professional consulting fees related to the Annual and Special Shareholders Meeting held on September 24, 2009 which was a contested meeting. These charges are expected to be one time in nature and not to recur in the future.

### **Net loss**

Net loss for the nine months ended September 30, 2009 was \$2,656,625 or negative \$0.01 per share, representing a significant improvement of \$1,960,625, or 42%, from a net loss of \$4,617,146 or \$0.01 per share for the same period in 2008.

Net loss before interest income, foreign exchange translation and proxy contest charges for the nine months ended September 30, 2009 was \$2,082,245 representing a significant improvement of \$2,666,799 or 56% from \$4,749,044 for the same period in 2008.

## **SUMMARY OF QUARTERLY RESULTS**

The following table sets out selected unaudited financial information of the Company on a consolidated basis for the last eight quarters. The information has been derived from the Company's quarterly unaudited consolidated financial statements that, in management's opinion, have been prepared on a basis consistent with the consolidated financial statements and are reviewed and approved by the Company's Board of Directors. The Company's quarterly operating results have varied substantially in the past and may vary substantially in the future. Accordingly, the information below is not necessarily indicative of results for any future quarter.

As at and for the three months ended  
(in thousand of Canadian dollars, except per share data)

	Sept 30 2009	June 30 2009	Mar 31 2009	Dec 31 2008	Sept 30 2008	June 30 2008	Mar 31 2008	Dec 31 2007
<b>STATEMENT OF OPERATIONS</b>								
Revenues								
Devices	\$ 703	\$ 1,017	\$ 101	\$ 25	\$ 287	\$ 55	\$ 78	\$ 46
Services	790	566	338	307	171	130	116	98
Total revenues	1,493	1,583	439	332	458	185	194	144
Cost of revenues	482	903	120	164	286	180	171	265
Gross margin (loss)	1,011	680	319	168	172	5	23	(121)
Operating expenses								
General administration	506	438	484	407	656	677	701	567
Research and development	444	456	475	396	398	519	509	499
Selling and marketing	404	329	281	277	339	380	317	422
Stock-based compensation	70	62	51	52	56	66	152	114
Amortization	31	29	32	36	50	62	66	72
Total operating expenses	1,455	1,314	1,323	1,168	1,499	1,704	1,745	1,674
Loss before under noted	(444)	(634)	(1,004)	(1,000)	(1,327)	(1,699)	(1,722)	(1,795)
Interest income	3	3	3	6	10	23	42	18
Foreign exchange translation	(137)	12	57	164	13	(4)	47	(4)
Proxy contest	(515)	-	-	-	-	-	-	-
Write-off of investment	-	-	-	-	-	-	-	(75)
Net loss for the period	\$ (1,093)	\$ (619)	\$ (944)	\$ (830)	\$ (1,304)	\$ (1,680)	\$ (1,633)	\$ (1,856)
Loss per share	\$ (0.00)	\$ (0.00)	\$ (0.00)	\$ (0.00)	\$ (0.00)	\$ (0.00)	\$ (0.00)	\$ (0.00)
<b>CASH FLOW INFORMATION</b>								
Operating activities	\$ (935)	\$ 492	\$ (1,359)	\$ 548	\$ (1,328)	\$ (1,784)	\$ (1,526)	\$ (1,381)
Investing activities	(5)	(3)	(3)	(4)	(3)	(47)	(46)	(75)
Financing activities	-	-	(3)	(9)	99	(30)	(54)	6,984
Net cash inflow (outflow)	(940)	489	(1,365)	535	(1,232)	(1,861)	(1,626)	5,528
Cash, beginning of period	1,244	755	2,120	1,585	2,817	4,677	6,303	775
Cash, end of period	\$ 304	\$ 1,244	\$ 755	\$ 2,120	\$ 1,585	\$ 2,816	\$ 4,677	\$ 6,303
<b>BALANCE SHEET INFORMATION</b>								
Working capital (deficiency)	\$ (624)	\$ 558	\$ 608	\$ 1,433	\$ 2,162	\$ 3,262	\$ 4,807	\$ 6,196
Total assets	\$ 3,526	\$ 2,784	\$ 2,865	\$ 4,221	\$ 4,382	\$ 5,028	\$ 6,778	\$ 8,325
Shareholders' equity (deficiency)	\$ (877)	\$ 163	\$ 698	\$ 1,591	\$ 2,403	\$ 3,552	\$ 5,167	\$ 6,652

The Company's revenues and financial results are difficult to forecast and have historically fluctuated on a quarterly basis, and it is expected that quarterly revenues and financial results will continue to fluctuate in the future as the Company continues growing into the marketing and commercialization stage. Fluctuations in results related to the growth of the Company's revenues, the timing of revenues being recognized and sales to customers, which may place large single orders in any one quarter, and to the timing of staffing and infrastructure additions to support growth.

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## LIQUIDITY AND CAPITAL RESOURCES

Management continually assesses liquidity in terms of the ability to generate sufficient cash flow to fund the business. Net cash flow is affected by the following items: i) operating activities, including the level of accounts receivable, inventory, prepaids, accounts payable and deferred revenues; ii) investing activities, including the purchase of capital assets; and iii) financing activities, including the issuance of capital stock.

### *Cash flow used in operating activities*

Cash flow used by operating activities for the three months ended September 30, 2009 was \$935,773 (which includes proxy contest charges of \$514,694), compared to \$1,328,087 in the same period in 2008, representing an improvement of \$392,314. Cash used in the day to day operations for the three months ended September 30, 2009 was \$987,458 (which includes non-recurring charges of \$514,694) compared to \$1,184,947 in the same period in 2008, representing a decrease and improvement of \$197,489, which was combined with an increase in cash provided by non-cash working capital activities of \$194,825 such as: an increase in cash provided by accounts payable and accrued liabilities of \$1,127,787, deferred revenues of \$151,034, and inventory of \$40,182, offset by cash used by accounts receivable of \$1,051,133, other receivables of \$46,076, and prepaid expenses of \$26,969.

Cash flow used by operating activities for the nine months ended September 30, 2009 was \$1,803,427 (which includes non-recurring proxy contest charges of \$514,694), compared to \$4,637,918 in the same period in 2008, representing an improvement of \$2,834,491. Cash used in the day to day operations for the nine months ended September 30, 2009 was \$2,353,330 (which includes non-recurring charges of \$514,694) compared to \$4,060,550 in the same period in 2008, representing a decrease and improvement of \$1,707,220, which was combined with an increase in cash provided by non-cash working capital activities of \$729,885 such as: an increase in cash provided by inventory of \$1,286,280, accounts payable and accrued liabilities of \$877,019, deferred revenues of \$510,053 and prepaid expenses of \$134,666, offset by cash used by accounts receivable of \$1,650,114 and other receivables of \$30,633.

### *Cash flow used in investing activities*

Cash flow used in investing activities for the three months ended September 30, 2009 was \$4,529, compared to \$2,805 in the same period in 2008, representing an increase in the use of cash of \$1,724. The increase can be attributed to the acquisition of capital assets of \$10,142 in the quarter offset by cash received on notes receivable of \$8,418.

Cash flow used in investing activities for the nine months ended September 30, 2009 was \$10,139 compared to \$95,978 in the same period in 2008, representing a decrease in the use of cash of \$85,839. The decrease can be attributed a decrease in the acquisition of capital assets of \$54,254 combined with an decrease in cash used for notes receivable of \$31,585.

### *Cash flow provided by financing activities*

Cash flow used by financing activities for the three months ended September 30, 2009 was \$nil compared to cash provided of \$99,253 for the same period in 2008, representing a decrease in cash provided of \$99,253. In the prior period, there was an exercise of warrants which provided cash of \$100,000, which was offset with repayment of obligations under capital leases of \$747, which was retired in the first quarter of 2009.

Cash flow used by financing activities for the nine months ended September 30, 2009 was \$2,700 compared to cash provided of \$15,429 for the same period in 2008, representing a decrease in cash provided of

\$18,129. In the prior period, there was an exercise of warrants which provided cash of \$100,000, which was offset with expenses of \$1,644 and the repayment of obligations under capital leases of \$747, which was retired in the first quarter of 2009.

The cash balance of the Company at September 30, 2009 was \$304,067, a decrease of \$940,302 from \$1,244,369 at June 30, 2009. Subsequent to September 30, 2009, the Company has collected approximately \$702,500 of its outstanding accounts receivable. Current assets at September 30, 2009 were \$3,423,907 compared to \$2,639,553 at June 30, 2009. Working capital decreased by \$1,137,492 to a deficiency of \$623,764 as of September 30, 2009 from \$513,728 in working capital as of June 30, 2009.

The Company's current business plan and sales forecast projects revenue growth for the remainder of 2009, including but not limited to the contractual order placed by Qwest Government Services, Inc. in January 2009 for 30,000 MobiKEY devices and TruOFFICE subscriptions to be delivered in 2009 with an approximately value of US\$8 million, in exchange for the Company granting Qwest the exclusive rights to sell its products to the United States Government. The Company started delivering on this agreement in the second quarter of 2009 and has delivered approximately 4,700 of the 30,000 commitment as at September 30, 2009. The Company also believes that its announcement of its DEFIMENT™ transaction with the United States Department of Homeland Security in October 2008 will lead to future opportunities within other departments in the United States Government and also abroad with other governments.

The Company's need for capital expenditures is limited to such items as computer hardware and software, expenditures to support sales, marketing and general administration activities, and working capital. Since inception, the Company has financed its cash and/or capital requirements through the issuance of equity from private placements and through the issuance of obligations under capital leases. Until the Company starts generating and receiving significant revenues and the resulting cash flow from the sales of its devices and services, historically, the primary source of funding for the Company has been from private placements, which given the current economic times could prove to be difficult.

On an ongoing basis, the Company investigates various financing options, including a credit facility and/or additional equity financings as well as other strategic funding sources to fund the continuing efforts to commercialize its devices and services. These events may or may not happen depending on the availability of funds under acceptable terms and conditions, and the availability of equity capital, and the price at which additional equity could be issued, is dependent upon the success of the Company and upon the state of the capital markets in general.

On October 19, 2009, the Company announced that it had closed a \$2.5 million senior debt financing with a major Canadian financial institution. The financing bears interest at the bank's prime rate plus two and a half percent (2.5%), and is scheduled to be repaid by February 28, 2010. The funds from the financing will be used to purchase additional inventory to fulfill committed orders, including Qwest Government Services Inc. commitment for 30,000 MobiKEY devices by the end of 2009.

The following table discloses future payments as at September 30, 2009 committed by the Company over the next five (5) years. It includes both principal and interest obligation required under capital lease agreements and all other current contractual commitments.

Contractual Obligations	Payment Due by Period				
	Total	Less than 1 year	1 – 3 years	4 – 5 years	After 5 years
Operating leases	\$ 168,000	\$ 120,000	\$ 48,000	\$ -	\$ -

## OFF-BALANCE SHEET ARRANGEMENTS

The Company has not entered into any off balance sheet arrangements.

## **FUTURE 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. As at December 31, 2008, we continue to carry a full valuation allowance against our income tax asset due to the uncertainty surrounding their full usage. There will be no income tax expenses against earnings in Canada until either all unrecognized operating loss carry-forwards of approximately \$32,439,000 are used or expire. The carry-forwards expire between 2009 and 2028.

## **TRANSACTIONS WITH RELATED PARTIES**

The Company had the following transactions and/or outstanding amounts with related parties as at or for the three and nine months ended September 30, 2009:

- Recorded interest income of \$1,275 and \$3,825 for the three and nine months ended September 30, 2009 respectively, related to \$85,000 advanced in terms of a promissory note dated January 8, 2008 to the President and CEO of the Company, secured and repayable no later than December 28, 2009 with interest at 6%. As at September 30, 2009 the total outstanding amount including interest amounted to \$93,925.
- Recorded interest income of \$780 and \$2,340 for the three and nine months ended September 30, 2009 respectively, related to \$52,000 advance in terms of a promissory note dated December 27, 2007 to a former officer, the Executive Vice President and COO, of the Company, secured and due on demand with interest at 6%. As at September 30, 2009 the total outstanding amount including interest amounted to \$52,000.
- Recorded interest income of \$750 and \$2,250 for the three and nine months ended September 30, 2009 respectively, 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 with interest at 6%. As at September 30, 2009 the total outstanding amount including interest amounted to \$52,292.
- Recorded proxy contest charges related to the Annual and Special Shareholders Meeting held on September 24, 2009 for payments made to Growth Equity Partners and Boyle & Co. LLP of \$100,000 and \$50,454 respectively in the three months ended September 30, 2009. These charges are one-time charges in nature and not expected to recur.
- Recorded proxy contest charges related to the Annual and Special Shareholders Meeting held on September 24, 2009 for a payment made to Andrew White for reimbursement of costs incurred for third party service providers, including but not limited to printing, mailing, and transfer agent services, in the amount of \$45,809 in the three months ended September 30, 2009. These charges are one-time charges in nature not expected to recur.

## **PROPOSED TRANSACTIONS**

The Company has not entered into any asset or business acquisition or disposition transactions.

## CRITICAL ACCOUNTING ESTIMATES

The Company's unaudited interim consolidated financial statements as at and for the three and nine months ended September 30, 2009 have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). Management makes certain estimates and relies on certain assumptions relating to reporting the Company's assets and liabilities as well as operating results in order to prepare the unaudited interim consolidated financial statements in conformity with Canadian GAAP. On an on-going basis, the Company evaluates its estimates and assumptions including those related to revenue, the valuation of accounts receivable, the estimation of useful lives of the various classes of capital assets, investments, stock-based compensation expense, and the measurement of income tax valuation allowances. Actual results could differ from those estimates, which are as follows:

- The Company's revenue is derived from hardware (i.e. MobiKEY) sales and subscription services (i.e. TruOFFICE). The Company recognizes revenue in accordance with EIC 141, "Revenue Recognition", and EIC 142, "Revenue Arrangements with Multiple Deliverables".
- In the determination of the valuation of accounts receivable, including the allowance for doubtful accounts, the Company relies on current customer information, payment history and trends as well as future business and economic conditions.
- The determination of inventory obsolescence allowance.
- The determination of fair value of investments is based on a discounted cash flow model.
- The estimation of useful lives of the various classes of capital assets is based upon history and experience of similar assets within each class.
- The fair value of stock options is based on certain estimates applied to the Black-Scholes option-pricing model as disclosed in the Company's financial statements.
- The measurement of the income tax valuation allowance is based upon estimates of future taxable income and the expected timing of reversals of temporary differences.

## CHANGES IN ACCOUNTING POLICIES INCLUDING INITIAL ADOPTION

### *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.

### *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 anticipates that it will not adopt IFRS for annual and interim reporting periods before the fiscal year beginning January 1, 2011. By the end of first quarter 2010, the Company will have completed an analysis of the impact of IFRS on accounting policies, information systems and internal controls over financial reporting. The analysis will include those policies the Company will be required to use, as well as those the Company would expect to apply where choices are permitted in preparing IFRS financial statements. To facilitate this transition in January 1, 2011, the Company will internally apply IFRS to the 2010 quarterly results ensuring that comparative results for fiscal year 2010 will be available when preparing the 2011 financial reports. Changes implemented when converting to IFRS will be reported in next year's MD&A.

## FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

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 of these instruments. The carrying amount of obligations under capital lease approximates fair value due to the market rate of interest associated with the instrument.

The following table sets out the classification, carrying amount, and fair value of the Company's financial assets and liabilities as at September 30, 2009 and December 31, 2008:

	September 30, 2009		December 31, 2008	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
FINANCIAL ASSET				
Held for trading				
Cash (i)	\$304,067	\$304,067	\$2,120,333	\$2,120,333
Loans and receivables				
Accounts receivable (i)	\$2,490,571	\$2,490,571	\$115,620	\$115,620
Other receivables (i)	\$37,404	\$37,404	\$18,873	\$18,873
Notes receivable (i)	\$198,217	\$198,217	\$198,220	\$198,220
FINANCIAL LIABILITIES				
Other liabilities				
Accounts payable and accrued liabilities (i)	\$1,231,004	\$1,231,004	\$920,541	\$920,541

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

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 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 nine months ended September 30, 2009, the largest single customer represented approximately 66% 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. As at September 30, 2009, the Company had cash consisting of cash on hand and deposits with banks of \$304,067 (December 31, 2008 - \$2,120,333). During the nine months ended September 30, 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 September 30, 2009, the largest single customer represented approximately 52% of accounts receivable.

The following table outlines the details of the aging of the Company's receivables as at September 30, 2009 and December 31, 2008:

	<b>September 30, 2009</b>	December 31, 2008
Current	<b>\$ 2,078,050</b>	\$19,882
Past due		
1 – 60 days	<b>377,574</b>	15,244
Greater than 60 days	<b>159,808</b>	180,554
Less: Allowance for doubtful accounts	<b>(124,861)</b>	(100,060)
Total accounts receivable, net	<b>\$ 2,490,571</b>	\$115,620

(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 receivables.

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 September 30, 2009:

	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>Total</b>
Accounts payable and accrued liabilities	\$ 1,231,004	\$ -	\$ -	\$ 1,231,004
Operating lease commitments	36,000	120,000	12,000	\$168,000
	<u>\$ 1,276,004</u>	<u>\$ 120,000</u>	<u>\$ 12,000</u>	<u>\$1,399,004</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 September 30, 2009, the Company had non Canadian dollar net monetary liabilities of approximately US\$76,700 and €108,300 (December 31, 2008 - approximately US\$26,300 and €34,000), any changes in the respective exchange rates as at September 30, 2009 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. As at September 30, 2009, cash totalled \$304,067 (December 31, 2008 - \$2,120,333). An increase of 100 basis points in the market interest rate would have decreased net loss by approximately \$9,100 (a 100 basis point decrease would have had the equal but opposite effect) for the nine months ended September 30, 2009.

## OTHER MD&A REQUIREMENTS

### *Disclosure of Outstanding Share Data*

As of the date of this document, the following was outstanding:

- 350,388,115 common shares issued and outstanding
- 36,243,573 common share purchase warrants (“Warrants”)
  - 36,243,573 Warrants at \$0.155/share expiring November 7, 2009. On October 8, 2009, the TSX Venture Exchange has approved an extension to the expiry date of 32,360,333 Warrants, from November 7, 2009 to May 7, 2010.
- 21,572,876 common share purchase options (“Options”) issued under the Company’s stock option plan
  - 1,185,000 Options issued on October 12, 2006 at \$0.20/share expiring January 12, 2010
  - 950,000 Options issued on December 19, 2007 at \$0.125/share expiring March 19, 2011
  - 887,000 Options issued on April 27, 2006 at \$0.30/share expiring April 27, 2011
  - 1,790,160 Options issued on July 12, 2007 at \$0.205/share expiring July 16, 2012
  - 1,125,000 Options issued on February 21, 2008 at \$0.08/share expiring February 21, 2013
  - 1,285,716 Options issued on May 19, 2009 at \$0.07/share expiring May 19, 2014
  - 7,100,000 Options issued on June 1, 2009 at \$0.055/share expiring June 1, 2014
  - 750,000 Options issued on July 20, 2009 at \$0.09/share expiring July 20, 2014
  - 6,500,000 Options issued on September 24, 2009 at \$0.10/share expiring September 24, 2014

### *Risk Factors and Uncertainty*

Although management has a positive outlook for the Company and continually improves and adapts the Company’s risk mitigation strategies, operating in the technology industry inherently involves a certain level of risk and uncertainty. In management’s opinion, the following risk factors, among others, should be considered when evaluating the Company’s business and its results of future operations:

- Management’s ability to secure additional financing in the marketplace on reasonable terms for a company of our size and financial status for short term working capital purposes. Access to such financing at acceptable commercial terms for a company of our size and financial status will be dependent on the timing of recognition and receipt of cash on our current backlog, including but not limited to the US\$8.0 million exclusivity agreement with Qwest Government Services, Inc. on which the Company started delivering in the second quarter, on our ability to demonstrate execution of our business strategy and the general condition of the credit and/or equity markets and may be significantly dilutive to existing shareholders.
- The Company’s access to credit or capital could be further restricted by the current global financial crisis which has restricted credit availability worldwide and could also impact its ability to continue operations.
- The Company’s expected revenue in the short-term is largely expected to arise from the US\$8.0 million exclusivity agreement with Qwest Government Services, Inc. as described above and from related business with Qwest Government Services, Inc. If Qwest Government Services, Inc. were to discontinue its relationship with the Company, or if the Company were to otherwise be involved in any disagreement or dispute with Qwest Government Services, Inc. over the Company’s service performance, such event would have a material and adverse impact on the Company’s financial results.
- There is no assurance that any forward-looking statement will materialize.
- The results or events predicted herein may differ from the actual results or events.
- Unless otherwise indicated, forward-looking statements describe expectations as of the date of this document.

- Route1 disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.
- Route1 had a working capital deficiency at September 30, 2009 of \$623,944, which may not be sufficient to support current operating levels and growth objectives for the current fiscal year;
- Third-party claims for infringement of intellectual property rights by Route1, and the outcome of any litigation with respect thereto, that could harm the Company's competitive advantage in the secure remote access industry;
- Route1's ability to successfully obtain patent or other proprietary or statutory protection for its technologies and products, that could also harm the Company's competitive advantage in the secure remote access industry;
- Route1's ability to obtain rights to use software or components supplied by third parties, which may not be sufficient to support future sales volumes;
- Route1's ability to enhance current products and develop and introduce new products; that could hinder the Company's continued growth;
- The efficient and uninterrupted operation of Route1's MobiNET, which could impact on the credibility of the Company's product and services;
- Route1's ability to establish new, and to build on existing its existing customer base, that could also hamper the Company's continued growth;
- The occurrence or perception of a breach of Route1's secure product and service offering, or an inappropriate disclosure of confidential information, which could also impact on the credibility of the Company's product and services;
- Intense competition within the secure remote access industry; that could hamper future sales volumes;
- Route1's reliance on its suppliers and the risk that suppliers will not be able to deliver components on a timely basis, which may not be sufficient to support future sales volumes;
- Effective management of growth and on-going development of the business;
- The market price of the Route1's common shares could be subject to wide fluctuations in response to Route1's financial results, changes in earnings estimates by analysts, changing conditions in the identity access management sector or changes in general market, economic or political conditions;
- Route1's articles permit the issuance of an unlimited number of common shares and if the Company was to issue a significant number of common shares, it would reduce the relative voting power of previously outstanding common shares. Such future issuances could be at prices less than the shareholders paid for their common shares of the Company. Significant issuance of Route1's common shares, or the perception that such issuances may occur, could impact, negatively or otherwise, the trading price of Route1's common shares;
- As of the date hereof, Route1's directors and executive officers and entities affiliated with them owned approximately 15% of the outstanding share of common shares, not including options or warrants to purchase shares of common shares. As a result, these shareholders, acting together, would be able to influence or control matters requiring approval by our shareholders, including the election of directors, the adoption of equity incentive plans and the approval of mergers or other extraordinary transactions. These shareholders may have interests that differ from shareholders with smaller holdings. The concentration of ownership of Route1's common shares could have the effect of delaying, preventing or deferring a change in control of Route1, deprive its shareholder of an opportunity to receive a premium for their common shares as part of a sale of Route1 and affect the market price of its common shares;
- Government regulation of secure remote access industry, including but not limited to restrictions on encryption of MobiKEY and the MobiNET.

#### *Audit Committee*

All members of the Audit Committee are independent and meet the qualifications of a financial expert.

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*Legal proceedings*

The Company filed Statements of Claim against certain reseller customers relating to non-payment of invoices in January 2008. The reseller customers have maintained that based on non-sanctioned verbal representations made to them by certain employees of the Company who are no longer employed with the Company; they were not obligated to make payment in accordance with the terms of the written binding purchase agreements. As reflected in the Statements of Claim, the reseller customers entered into binding written agreements with Route1 to purchase MobiKEYs that were delivered in 2007 for which revenue of approximately \$333,000 was recorded during 2007 on the strength of these agreements. These proceedings are ongoing as of the date of this report.

*Additional Information*

Additional information about Route1 is available from Route1's website at [www.route1.com](http://www.route1.com), the SEDAR website at [www.sedar.com](http://www.sedar.com), or by request from Route1's head office at 155 University Avenue, Suite 1920, Toronto, Ontario, Canada M5H 3B7 (telephone 416-848-8391).