
ROUTE1 INC.

MANAGEMENT DISCUSSION AND ANALYSIS

FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2010

As at August 24, 2010

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, reviewed and approved by the Company’s Board of Directors prior to filing and should be read in conjunction with the Company’s unaudited consolidated financial statements and related notes as at and for the three and six months ended June 30, 2010, and the audited financial statements as at and for the year ended December 31, 2009, which have been prepared in accordance with Canadian Generally Accepted Accounting Principles (“**GAAP**”).

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) under Route1 Inc. and on the Company’s website (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, and that has not been otherwise disclosed in other filings, is material in nature.

OVERVIEW

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 patented solution is based on FIPS-140-2 cryptographic modules, and simplifies the process of meeting increasingly stringent regulatory requirements around privacy and security.

HIGHLIGHTS

- On January 11, 2010, the Company announced that a U.S. based provider of telecommunications and data communications products, services, systems and solutions for the U.S. Federal government (the "Reseller") informed Route1 that it would not be respecting its contractual obligations under its agreement (see January 2009 above). The Reseller also informed the Company that it wished to continue to market and sell Route1 security and identity management solutions to the U.S. Federal Government in 2010, but on a non-exclusive basis. Route1 has communicated to the Reseller that it will continue to fulfill its obligations under the agreement and work with the Reseller to continue to service the U.S. Federal Government through the end of the agreement's term. The Company also informed the Reseller that in no way should the Company's actions be construed as a waiver of any of its rights under the agreement based on the Reseller's action to not respect certain material contractual obligations.
- On February 26, 2010, the Company announced the appointment of Tony P. Busseri as President and Chief Executive Officer of Route1. The Company also announced that Mr. White has stepped down as President and CEO of Route1 and will become Vice Chairman where he will continue to play an active role in business development.
- On February 26, 2010, the Company announced the closing of a non-brokered private placement of 38,000,000 units (Units) at \$0.05 per Unit (the Unit Price) for aggregate proceeds of CDN\$1,900,000 (the Offering) to Route1. Each Unit is comprised of one common share and one common share purchase warrant of Route1 (a Warrant). Each Warrant entitles the holder to purchase one additional common share of the Company at a price of \$0.15 per common share for a period of 60 months (the Expiry Date) following the closing date. Proceeds of the Offering will be used for general working capital and corporate purposes. No fees or commissions were paid as part of the Offering.
- On March 1, 2010, the Company announced that, as part of its management changes and compensation review, a total of 9,500,000 stock options were granted to an officer and a consultant of Route1. 5,250,000 of the stock options are exercisable at \$0.10 per share and the remaining 4,250,000 stock options are exercisable at \$0.15 per share.
- On March 2, 2010, the Company announced the commercial availability of its MobiKEY® Fusion identity validation device. MobiKEY Fusion extends portable and high assurance identity-based access to information and systems needed from anywhere, at any time, to identity and access cards based on the ID-1 standard. ID-1 is an international standard

(ISO/IEC 7810-2003) commonly used for government-issued cards such as drivers' licenses and passports, bank cards, credit cards and other personal identity cards. The Route1 solution provides government and military users with a combination of ease-of-use and strong cryptography for in-theater operations. Coupled with strong multifactor identification and sophisticated entitlement controls, MobiKEY Fusion ensures that field personnel and warfighters have secure access to C4ISR (Command, Control, Communications, Computers, Intelligence, Surveillance and Reconnaissance) systems and information they need, when and where they need it.

- On March 2, 2010, the Company announced that it has been selected to participate in a six-month pilot project to deploy the Route1 DEFIMNET[®] (Defense Identity Management Network) and MobiKEY[®] Fusion devices to the U.S. Navy Reserve. Route1 is working with HP Enterprise Services to roll out the DEFIMNET to a limited group of users in Navy Reserve Forces Command over the next six-months, which includes deploying and testing the DEFIMNET. The objective of the pilot is to demonstrate increased flexibility for Navy personnel who require secure access to internal systems and digital resources when physical access to their normal working facilities and equipment is not practical. More than 300,000 potential DEFIMNET users have been identified within the U.S. Navy. Personnel can connect to the DEFIMNET using their MobiKEY Fusion identity validation devices that support Department of Defence issued common access cards (CAC).
- On March 24, 2010, the Company granted a total of 12,525,000 stock options to purchase common shares of Route1 to employees, officers and a director of at an exercise price of \$0.13 per share, expiring on March 24, 2015.
- On April 7, 2010 the Company announced that a total of 1,000,000 stock options were granted to a consultant of Route1. 500,000 of the stock options are exercisable at \$0.13 per share and 500,000 stock options are exercisable at \$0.15 per share. The grant is subject to regulatory approval. Under the Company's stock option plan, 10% of the issued capital or 38,838,811 common shares are reserved for issuance. Including the above grant, a total of 31,025,000 options are currently outstanding under the stock option plan.
- On April 13, 2010, the Company announced the release of TruOFFICE 2.8 with strengthened security and Windows 7 support. This enables TruOFFICE users the ability to connect to Microsoft[®] Windows 7 desktops from anywhere, at any time. This version also supports 64-bit Windows operating systems including 64-bit versions of Vista and Windows 7. In addition, TruOFFICE 2.8 now supports AES 256 (Advanced Encryption Standard) for encrypted data communications.
- On April 28, 2010, the Company announced that the United States Patent and Trademark Office allowed Route1's patent application titled, "Portable Device for Accessing Host Computer Via Remote Computer." Route1 expects its U.S. patent to be issued later this year. The Route1 patent application claims a portable device for enabling access to a host computer via a guest computer using an intermediary controller to set up the connection between the guest computer and the host computer. The guest computer interface may include a USB connector and a USB controller. The patent application expands on how the device may use a cryptographic processor to establish secure communication with the host computer. The portable device may be able to receive a biometric sample from a user, and allow the cryptographic processor to operate only when the biometric sample is for an authorized user.

-
- On May 10, 2010, the Company announced that a total of 32,360,333 warrants (the “Warrants”), issued as part of a private placement announced on October 15, 2007 (the “Offering”), expired on May 7, 2010, following an extension of the expiry date of the Warrants by six (6) months from November 7, 2009. The Warrants were issued with an exercise price of \$0.155 per share and had an original term of twenty-four (24) months.
 - On May 12, 2010, the Company announced that The Fleet and Industrial Supply Center (FISC) Norfolk, Contracting Department, Philadelphia Office has procured directly from Route1, 400 MobiKEY Fusion devices and TruOFFICE subscriptions on behalf of the Commander Navy Reserve Forces (RESFOR) in Norfolk, Virginia. The procurement was made in advance of completing the six-month pilot project to deploy the Route1 DEFIMNET® (Defense Identity Management Network) and MobiKEY® Fusion devices to the U.S. Navy Reserve, which was announced on March 2, 2010.
 - On May 19, 2010 and June 7, 2010, the Company granted a total of 325,000 and 4,000,000 stock options respectively to employees of Route1. 325,000 of the stock options are exercisable at \$0.13 per share, 2,000,000 of the stock options are exercisable at \$0.15 per share and 2,000,000 stock options are exercisable at \$0.20 per share. The grant is subject to regulatory approval. Under the Company’s stock option plan, 10% of the issued capital or 38,838,811 common shares are reserved for issuance. Including the above grant, a total of 35,350,000 options are currently outstanding under the stock option plan.
 - On June 15, 2010, the Company announced that the United States Patent and Trademark Office has issued Route1’s first patent titled, “Portable Device for Accessing Host Computer via Remote Computer.” The abstract for U.S. Patent 7,739,726 B2, dated today, states:

A portable device enables access to a host computer via a guest computer. The portable device is connected to the guest computer, and a program stored in a memory on the portable device is activated, the program including instructions for establishing communication with the host computer such that input to the guest computer serves as input to the host computer, and output displays from the host computer are displayed on the guest computer. The portable device includes a cryptographic processor for performing cryptographic processing. The protected memory can be internal or external to the cryptographic processor. The Route1 MobiKEY is the portable device that is used to access a host computer from a remote computer. Route1 filed the patent on November 14, 2005.
 - On June 23, 2010, the Company announced that it has fully repaid its non-revolving senior credit facility to its lender. The Company’s operating cash flow was used to make the payment.

NON-GAAP FINANCIAL MEASURE: EBITDA

Within this MD&A we use the term EBITDA (earnings before interest, income taxes, depreciation and amortization, and restructuring and other costs). EBITDA does not have any standardized meaning prescribed under GAAP and is therefore unlikely to be comparable to similar measures presented by other companies.

We use EBITDA, among other measures, to assess the operating performance of our ongoing businesses without the effects of stock-based compensation and foreign exchange translation. We exclude stock-based compensation expense because it is largely dependent on the accounting methods and assumptions we use, along with non-operating factors, such as the value of our common shares. We exclude gains or losses on foreign exchange because they are generally not part of our ongoing operations.

EBITDA allows us to compare our operating performance over time on a consistent basis. We believe that certain investors and analysts use EBITDA to measure a company's ability to service debt and to meet other payment obligations, or as a common valuation measurement in the technology industry.

Readers are cautioned that EBITDA should not be confused with cash flow from operating activities. The most comparable GAAP financial measure is *loss before undernoted*, which is discussed below. The table below reconciles EBITDA to *loss before undernoted* for the quarters presented.

<i>In thousands of Canadian dollars</i>	June 30 2010	Mar 31 2010	Dec 31 2009	Sept 30 2009	June 30 2009
EBITDA	(199)	(137)	(513)	(339)	(432)
Stock-based Compensation	223	65	27	70	68
Amortization	19	30	34	35	36
Loss before undernoted	(441)	(232)	(574)	(444)	(536)

SELECTED FINANCIAL INFORMATION

The following table outlines selected unaudited financial information of the Company on a consolidated basis for the three and six month periods ended June 30, 2010, 2009 and 2008.

<i>(in thousands of Canadian dollars, except per share amounts)</i>	As at and for the three months ended			As at and for the six months ended		
	June 30, 2010	June 30, 2009	June 30, 2008	June 30, 2010	June 30, 2009	June 30, 2008
STATEMENT OF OPERATIONS						
Revenue						
Devices and appliances	\$212	\$1,017	\$55	\$258	\$1,118	\$132
Services	995	566	130	1,954	904	247
Total Revenue	1,207	1,583	185	2,212	2,022	379
Cost of revenue	138	896	183	245	1,005	359
Gross margin	1,069	687	2	1,967	1,017	20
Operating expenses						
General administration	641	340	714	1,054	826	1,431
Research and development	461	452	543	891	926	1,125
Selling and marketing	166	327	386	357	608	713
Stock-based compensation	223	68	-	289	119	-
Amortization	19	36	62	49	79	128
Total operating expenses	1,510	1,223	1,705	2,640	2,558	3,397
Loss before undernoted	(441)	(536)	(1,703)	(673)	(1,542)	(3,377)
Interest (expense) income	(18)	3	23	(16)	6	64
Foreign exchange translation	(51)	(87)	-	(102)	(28)	-
Net loss for the period	\$(510)	\$(620)	\$(1,680)	\$(791)	\$(1,564)	\$(3,313)
Loss per share	\$(0.00)	\$(0.00)	\$(0.00)	\$(0.00)	\$(0.00)	\$(0.01)
CASH FLOW INFORMATION						
Operating activities	\$373	\$492	\$(1,784)	\$(784)	\$(867)	\$(3,310)
Investing activities	(772)	(3)	(47)	(801)	(6)	(93)
Financing activities	-	-	(30)	1,882	(3)	(84)
Net cash inflow (outflow)	(399)	489	(1,861)	297	(876)	(3,487)
Cash, beginning of period	1,336	755	4,677	640	2,120	6,303
Cash, end of period	\$937	\$1,244	\$2,816	\$937	\$1,244	\$2,816
Working capital (deficiency)	\$(392)	\$514	\$3,262	\$(392)	\$514	\$3,262
Total assets	\$2,753	\$2,767	\$5,028	\$2,753	\$2,767	\$5,028
Obligation under capital lease	\$-	\$-	\$9	\$-	\$-	\$9
Shareholders' equity (deficiency)	\$(200)	\$146	\$3,552	\$(200)	\$146	\$3,552

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 three months ended June 30, 2010, the Company incurred a net loss of \$509,971. For the six months ended June 30, 2010, the Company incurred a net loss of \$780,598, and had an accumulated deficit of \$34,999,477 and shareholders'

deficiency of \$200,379 as at June 30, 2010. 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.

COMPARISON FOR THE THREE MONTHS ENDED JUNE 30, 2010 AND 2009

Revenue

Revenue for the three months ended June 30, 2010 was \$1,206,996, representing a decrease of \$376,323 or 24%, from \$1,583,319 for the same period in 2009. The comparison, discussed by segment, is as follows:

Devices and Appliances

Revenue from our device and appliance segment (i.e. MobiKEY®, DEFIMNET™ equipment, and EnterpriseLIVE AG) for the three months ended June 30, 2010 was \$211,931, representing a decrease of \$805,309 or 79%, from \$1,017,240 for the same period in the 2009. Device and appliance revenue as a percentage of total revenue represents 18% of total revenue for the three months ended June 30, 2010 as compared to 64% for the prior period. The reduction in device and appliance revenue for the three months ended June 30, 2010 is a result of (1) the second quarter of 2009 included the sale of a DEFIMNET™, and (2) there were fewer MobiKEY device sales in the second quarter of 2010 versus the prior year.

The table provided below details the number and sales value of MobiKEY devices sold during each of the last five quarters.

MobiKEY Devices Sold <i>(in thousands of Canadian dollars for Sales Value)</i>	June 30 2010	Mar 31 2010	Dec 31 2009	Sept 30 2009	June 30 2009
Number	177	304	285	4,962	3,145
Sales Value per Device	\$141	\$115	\$151	\$123	\$124
Sales Value	\$25	\$35	\$43	\$610	\$391

Services

Revenue from our services segment (i.e. TruOFFICE™ subscription-based services, DEFIMNET™ and other appliance maintenance) for the three months ended June 30, 2010 was \$995,065, representing an increase of \$428,986 or 76%, from \$566,079 for the same period in 2009. Service revenue, as a percentage of total revenue, represents 82% for the three months ended June 30, 2010 as compared to 36% for the prior period. The increase in service revenue represents the continued growth in our TruOFFICE™ subscriber base.

The table below provides information on the number of and revenue amount for the TruOFFICE subscribers during each of the last five quarters.

TruOFFICE Subscribers <i>(in thousands of Canadian dollars for Revenue)</i>	June 30 2010	Mar 31 2010	Dec 31 2009	Sept 30 2009	June 30 2009
Number	13,451	16,719	16,363	15,968	10,782
Revenue per Subscriber	\$271	\$208	\$194	\$163	\$166
Revenue	\$912	\$869	\$794	\$650	\$446

During the second quarter ended June 30, 2010, current management evaluated the various pricing models which were used by the previous management team to arrive at a subscriber total. Current management, after reviewing the sustainable and upward trend seen on a revenue per subscriber basis, elected to terminate any heavily discounted and/or free arrangements subscriptions. All of these discounted and/or free service arrangements were with channel partners and had been put in place by past management.

The active subscriber number has now been adjusted to reflect paid subscribers only and stands at 13,451 as at June 30, 2010 and 14,129 as at August 20, 2010. The earlier announced sale of 400 MobiKEY Fusion devices and TruOFFICE subscriptions to US Navy Reserve Forces is reflected in the paying, active subscriber count as of late July 2010, when the devices were received by the client.

Revenue reported to date and expected revenue to be generated from paid subscribers has not changed.

Deferred revenue as at June 30, 2010 increased by \$632,574 to \$2,201,258 from \$1,568,684 as at December 31, 2009. 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 revenue minus the cost of revenue. The cost of revenue primarily includes the cost of the devices and appliances sold, as well as the cost of their shipping and packaging, plus the cost to operate and maintain the MobiNET® (the Company's infrastructure for its software-based subscriptions services).

The cost of revenue for the three months ended June 30, 2010 was \$137,644, representing a decrease of \$758,901 from \$896,545 for the same period in 2009. This decrease is primarily related to (1) the cost of equipment sold as part of the DEFIMNET™ transaction in the second quarter of the prior year, and (2) the increased product costs associated with the increase in sales of MobiKEY devices incurred during the three months ended June 30, 2009.

Gross margin for the three months ended June 30, 2010 was \$1,069,352, representing an increase of \$382,578 from a gross margin of \$686,774 for the same period in 2009. This increase in gross margin can be largely attributed to a higher percentage of revenue derived from the service segment as our subscriber base is continuing to grow with the addition of new customers and users. Additionally, the prior year had the costs associated with the DEFIMNET™ for the three months ended June 30, 2009.

Expenses

Operating expenses consist of general administration, research and development, selling and marketing, stock-based compensation and amortization. Operating expenses for the three months ended June 30, 2010 were \$1,510,039, representing an increase of \$287,460 or approximately 23%, from \$1,222,579 for the same period in 2009.

General administration

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

General administration expenses for the three months ended June 30, 2010 were \$640,794, representing an increase of \$300,979 or 88%, from \$339,815 for the same period in 2009 and the change can be summarized as follows:

- Legal and accounting fees increased by approximately \$43,000 for the three months ended June 30, 2010 as compared to the same period in 2009, as a result of additional regulatory and legal matters during the current period;
- Professional fees increased by approximately \$185,000 from the same period in the prior year. Increases from the prior year of note are:
 - \$13,000 in director fees,
 - \$60,000 in management fees which includes consulting fees from the Company's President and CEO,
 - \$55,000 in performance incentive payouts to two Officers of the Company, and
 - \$15,000 in recruitment fees as a result of new hires made by the Company.
- Other overhead type expenses such as telephone, courier charges, equipment leasing, insurance and computer related expenses increased by approximately \$58,000 for the three months ended June 30, 2010 as compared to the same period in 2009. During the second quarter in 2009 there was a \$26,000 credit that was recorded from Bell Canada for errors in prior years. Computer related expenses increased by approximately \$18,000 during the three months ended June 30, 2010 compared to the same period in the prior year as a result of additional maintenance and service contracts for software support; and
- Salaries and benefits expenses decreased by approximately \$22,000 for the three months ended June 30, 2010 as compared to the same period in 2009, primarily as a result of a reduction in head count compared to 2009.

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 June 30, 2010 were \$460,797, representing an increase of \$9,243 or 2%, from \$451,554 for the same period in 2009 and the change can be summarized as follows:

-
- Salaries and benefits expenses increased by approximately \$110,000 for the three months ended June 30, 2010 as compared to the same period in 2009, as a result of an increase in head count in this department; and
 - For the three months ended June 30, 2010, the company recorded a net tax credit of \$103,841 for scientific research tax credits (“SRED”). This credit represents the portion of SRED for which the company was entitled to in the 2009 tax year.

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 June 30, 2010, were \$165,882, representing a decrease of \$161,364 or 49%, from \$327,246 for the same period in 2009 and can be summarized as follows:

- Salaries, benefits and commissions expenses decreased by approximately \$154,000 for the three months ended June 30, 2010 as compared to the same period in 2009, primarily as a result of a reduction in head count compared to 2009; and
- Marketing costs, including travel expenses and tradeshow fees, increased by approximately \$8,000 for the three months ended June 30, 2010 as compared to the same period in 2009. This is mainly attributed to an increase in travel costs associated with various meetings the Company attended in the United States during the second quarter of this year compared to same period last year.

Stock-based compensation

Stock-based compensation was \$223,380 for the three months ended June 30, 2010, an increase of \$155,601 from \$67,779 for the same period in 2009. This increase is a result of the stock price in Q2 2010 being higher than in the same period a year earlier along with an increase in stock options granted during the current period.

Amortization

Amortization expense for the three months ended June 30, 2010 was \$19,186, representing a decrease of \$16,999 or 47% from \$36,185 for the same period in 2009. The decrease can be attributed to a net book value reduction in the asset base used in the calculation of amortization expense using the declining-balance method combined with minimal new capital expenditures in the quarter.

Other Items

Interest (expense) income

Interest expense for the three months ended June 30, 2010 was \$17,958, representing an increase of \$20,903 from income of \$2,945 for the same period in 2009. This increase of interest expense was primarily due to interest paid to a financial institution with respect to the credit facility that was in place in current period that was not present as compared to the same period in 2009.

Foreign Exchange Translation

Loss due to foreign exchange translation on balance sheet items such as Accounts Receivable, Accounts Payable and foreign bank accounts was a loss of \$51,326 for the three months ended June 30, 2010, an improvement of \$35,464 from a translation loss of \$86,790 for the same period in 2009.

Net loss

Net loss for the three months ended June 30, 2010 was \$509,971 or \$0.00 per share, representing an improvement of \$109,679 from a net loss of \$619,650 or \$0.00 per share for the same period in 2009.

COMPARISON FOR THE SIX MONTHS ENDED JUNE 30, 2010 AND 2009

Revenue

Revenue for the six months ended June 30, 2010 was \$2,212,451, representing an increase of \$190,693 or 9%, from \$2,021,838 for the same period in 2009. The comparison discussed by segment is as follows:

Devices and Appliances

Revenue from our device and appliance segment (i.e. MobiKEY®, DEFIMNET™ equipment, and EnterpriseLIVE AG) for the six months ended June 30, 2010 were \$258,446, representing a decrease of \$859,915 or 77%, from \$1,118,361 for the same period in the 2009. Device and appliance revenue as a percentage of total revenue represents 12% of total revenue for the current period as compared to 55% for the prior period. The reduction in device and appliance revenue for the six months ended June 30, 2010 is due to the sale of a DEFIMNET™ in the second quarter of 2009 plus a greater number of new devices sold during the second quarter of 2009 versus the second quarter of 2010.

Services

Revenue from our services segment (i.e. TruOFFICE™ subscription-based services, DEFIMNET™ and other appliance maintenance) for the six months ended June 30, 2010 was \$1,954,005, representing an increase of \$1,050,528 or 116%, from \$903,477 for the same period in 2009. Service revenue, as a percentage of total revenue, represents 88% for the current period as compared to 45% for the prior period. The increase in service revenue represents the continued growth in our TruOFFICE™ subscriber base.

Deferred revenue as at June 30, 2010 increased by \$632,574 to \$2,201,258 from \$1,568,684 as at December 31, 2009. 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 revenue minus the cost of revenue. The cost of revenue primarily includes the cost of the devices and appliances sold, as well as the cost of their shipping and packaging, plus the cost to operate and maintain the MobiNET® (the Company's infrastructure for its software-based subscriptions services).

The cost of revenue for the six months ended June 30, 2010 was \$245,258, representing a decrease of \$759,618 from \$1,004,876 for the same period in 2009. This decrease is related to the cost of equipment sold as part of the DEFIMNET™ transaction in the second quarter of the prior year and the increased product costs associated with the increase in sales of MobiKEY devices incurred during the three months ended June 30, 2009.

Gross margin for the six months ended June 30, 2010 was \$1,967,193, representing an increase of \$950,231 from \$1,016,962 for the same period in 2009. This increase in gross margin can be largely attributed to a higher percentage of revenue derived from the service segment as our subscriber base continuing to grow with the addition of new customers and users. Additionally, the prior year had the costs associated with the DEFIMNET™ for the three months ended June 30, 2009.

Expenses

Operating expenses consist of general administration, research and development, selling and marketing, stock-based compensation and amortization. Operating expenses for the six months ended June 30, 2010 were \$2,640,493, representing an increase of \$82,015 or approximately 3%, from \$2,558,478 for the same period in 2009.

General administration

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

General administration expenses for the six months ended June 30, 2010 were \$1,053,732, representing an increase of \$227,358 or 28%, from \$826,374 for the same period in 2009 and the change can be summarized as follows:

- Legal and accounting fees decreased by approximately \$30,000 for the six months ended June 30, 2010 as compared to the same period in 2009, as a result of fewer regulatory and legal matters during the current six-month period, as well as one time credits being booked during the year for reduction in legal invoices previously billed and the reversal of accounting accruals due to final costs being lower than anticipated;
- Professional fees increased by approximately \$271,000 from the same period in the prior year. The increase is primarily attributable to the following items:
 - Professional fees related to director fees for \$29,000.
 - Amounts relating to contract fees of a sales person and a US based technical person for \$48,000.

-
- Management fees, which includes consulting fees from the Company’s President and CEO, for \$110,000.
 - \$55,000 in performance incentive payouts to two Officers of the Company.
 - Salaries and benefits expenses decreased by approximately \$70,000 for the six months ended June 30, 2010 as compared to the same period in 2009, primarily as a result of a reduction in head count compared to 2009; and
 - Other overhead type expenses such as telephone, courier charges, equipment leasing, insurance and computer related expenses increased by approximately \$74,000 for the six months ended June 30, 2010 as compared to the same period in 2009. During the second quarter in 2009 there was a \$26,000 credit that was recorded from Bell Canada for errors in prior years. Computer related expenses increased by approximately \$20,000 during the three months ended June 30, 2010 compared to the same period in the prior year as a result of additional maintenance and service contracts for software support.

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 six months ended June 30, 2010 were \$891,372, representing a decrease of \$34,505 or 4%, from \$925,877 for the same period in 2009 and the change can be summarized as follows:

- Salaries and benefits expenses increased by approximately \$232,000 for the six months ended June 30, 2010 as compared to the same period in 2009, as a result of an increase in head count in this department; and
- For the six months ended June 30, 2010, the company recorded a net tax credit of \$265,610 for scientific research tax credits (“SRED”). This credit represents the portion of SRED for which the company was entitled to in the 2008 and 2009 taxation years.

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 six months ended June 30, 2010, were \$357,665, representing a decrease of \$250,726 or 41%, from \$608,391 for the same period in 2009 and can be summarized as follows:

- Salaries, benefits and commissions expenses decreased by approximately \$197,000 for the six months ended June 30, 2010 as compared to the same period in 2009, primarily as a result of a reduction in head count compared to 2009; and
- Marketing costs, including travel expenses and tradeshow fees, decreased by approximately \$54,000 for the six months ended June 30, 2010 as compared to the same period in 2009. This is mainly attributed to a decrease in trade show costs, which includes travel associated costs, as a result of the Company not attending as many events as compared to 2009.

Stock-based compensation

Stock-based compensation was \$288,825 for the six months ended June 30, 2010, an increase of \$170,256 from \$118,569 for the same period in 2009. This increase is a result of the stock price in Q2 2010 being higher than in the same period a year earlier along with additional stock options being granted during the current period.

Amortization

Amortization expense for the six months ended June 30, 2010 was \$48,899, representing a decrease of \$30,368 or 38% from \$79,267 for the same period in 2009. The decrease can be attributed to a net book value reduction in the asset base used in the calculation of amortization expense using the declining-balance method combined with minimal new capital expenditures in the year.

Other Items

Interest (expense) income

Interest expense for the six months ended June 30, 2010 was \$15,505, representing an increase of \$21,685 from interest income of \$6,180 for the same period in 2009. This decrease was primarily due to lower cash balances during the year as compared to the same period in 2009. This increase of interest expense was primarily due to interest paid to a financial institution with respect to the credit facility that was in place in current period that was not present as compared to the same period in 2009.

Foreign Exchange Translation

Loss due to foreign exchange translation on balance sheet items such as Accounts Receivable, Accounts Payable and foreign bank accounts was a loss of \$101,793 for the six months ended June 30, 2010, an increase of \$73,421 from a translation loss of \$28,372 for the same period in 2009. The Canadian dollar appreciated against both the Euro and the American dollar during the six months ended June 30, 2010 compared to the same period in 2009.

Net loss

Net loss for the six months ended June 30, 2010 was \$790,598 or \$0.00 per share, representing an improvement of \$773,110 from a net loss of \$1,563,708 or \$0.00 per share for the same period in 2009.

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 annual 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 thousands of Canadian dollars, except per share data)

	June 30 2010	Mar 31 2010	Dec 31 2009	Sept 30 2009	June 30 2009	Mar 31 2009	Dec 31 2008	Sept 30 2008
STATEMENT OF OPERATIONS								
Revenue								
Devices and appliances	\$ 212	\$ 46	\$ 751	\$ 703	\$ 1,017	\$ 101	\$ 25	\$ 287
Services	995	959	944	790	566	338	307	171
Total revenue	1,207	1,005	1,695	1,493	1,583	439	332	458
Cost of revenue	138	107	288	482	903	120	164	286
Gross margin (loss)	1,069	898	1,407	1,011	680	319	168	172
Operating expenses								
General administration	641	413	989	506	438	484	483	656
Research and development	461	430	457	444	456	475	410	398
Selling and marketing	166	192	479	404	329	281	277	339
Stock-based compensation	223	65	27	70	62	51	18	56
Amortization	19	30	29	31	29	32	36	50
Total operating expenses	1,510	1,130	1,981	1,455	1,314	1,323	1,224	1,499
Loss before under noted	(441)	(232)	(574)	(444)	(634)	(1,004)	(1,056)	(1,327)
Interest (expense) income	(18)	2	3	3	3	3	6	10
Foreign exchange translation	(51)	(50)	(181)	(137)	12	57	220	13
Proxy contest	-	-	-	(515)	-	-	-	-
Net loss for the period	\$ (510)	\$ (280)	\$ (752)	\$ (1,093)	\$ (619)	\$ (944)	\$ (830)	\$ (1,304)
Loss per share	\$ (0.00)	\$ (0.00)	\$ (0.00)	\$ (0.00)	\$ (0.00)	\$ (0.00)	\$ (0.00)	\$ (0.00)
CASH FLOW INFORMATION								
Operating activities	\$ 373	\$ (1,155)	\$ (557)	\$ (935)	\$ 492	\$ (1,359)	\$ 548	\$ (1,328)
Investing activities	(772)	(30)	895	(5)	(3)	(3)	(4)	(3)
Financing activities	-	1,881	(2)	-	-	(3)	(9)	99
Net cash inflow (outflow)	(399)	696	336	(940)	489	(1,365)	535	(1,232)
Cash, beginning of period	1,336	640	304	1,244	755	2,120	1,585	2,817
Cash, end of period	\$ 937	\$ 1,336	\$ 640	\$ 304	\$ 1,244	\$ 755	\$ 2,120	\$ 1,585
BALANCE SHEET INFORMATION								
Working capital (deficiency)	\$ (392)	\$ 92	\$ (1,622)	\$ (624)	\$ 558	\$ 608	\$ 1,433	\$ 2,162
Total assets	\$ 2,753	\$ 3,481	\$ 2,041	\$ 3,526	\$ 2,784	\$ 2,865	\$ 4,221	\$ 4,382
Shareholders' equity (deficiency)	\$ (200)	\$ 86	\$ (1,580)	\$ (877)	\$ 163	\$ 698	\$ 1,591	\$ 2,403

The Company's revenue and financial results are difficult to forecast and have historically fluctuated on a quarterly basis, and it is expected that quarterly revenue and financial results will continue to fluctuate in the future as the Company continues growing. Fluctuations in results are related to the growth of the Company's revenue, the timing of revenue being recognized and sales

to customers, which may place large single orders in any one quarter, and the timing of staffing and infrastructure additions to support growth.

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, prepaid expenses, accounts payable and deferred revenue; 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 (“OCF”) for the three months ended June 30, 2010 was \$267,405, compared to \$515,686 in the same period in 2009, representing an improvement of \$248,281. Non-cash working capital activities provided \$640,137 for the three months ended June 30, 2010 versus \$1,007,724 in the same period a year earlier. Therefore net cash provided by the day-to-day operations for the three months ended June 30, 2010 was \$372,732 compared to \$492,038 in the same period in 2009, representing a decrease of \$119,306.

Cash flow used by operating activities (“OCF”) for the six months ended June 30, 2010 was \$452,874, compared to \$1,365,872 in the same period in 2009, representing an improvement of \$912,998. Non-cash working capital activities used \$331,065 for the six months ended June 30, 2010 versus providing non-cash working capital \$498,218 in the same period a year earlier. Therefore net cash used in the day-to-day operations for the six months ended June 30, 2010, 2010 was \$783,939 compared to \$867,654 in the same period in 2009, representing a decrease and improvement of \$83,715.

Cash flow used in investing activities

Cash flow used in investing activities for the three months ended June 30, 2010 was \$771,721 compared to \$2,805 in the same period in 2009, representing an increase in the outflow of cash of \$768,916. The increase can be attributed to a repayment of the credit facility the Company had in place with a financial institution.

Cash flow used in investing activities for the six months ended June 30, 2010 was \$800,961 compared to \$5,610 in the same period in 2009, representing an increase in the outflow of cash of \$795,351. The increase can be attributed to a repayment of the credit facility the Company had in place with a financial institution.

Cash flow provided by financing activities

Cash inflow by financing activities for the three months ended June 30, 2010 was \$nil the same as for the same period in 2009. Cash inflow by financing activities for the six months ended June 30, 2010 was \$1,881,495 compared to cash outflow of \$2,700 for the same period in 2009, representing an increase in cash provided of \$1,878,795. This increase in cash is a direct result of the February 26, 2010 private placement, which provided gross proceeds of \$1,900,000 to the Company.

The cash balance of the Company at June 30, 2010 was \$936,640, an increase of \$296,595 from December 31, 2009. Current assets at June 30, 2010 were \$2,590,136 compared to \$1,965,987 at December 31, 2009. Working capital increased by \$1,230,072 to a deficiency of \$391,739 as of June 30, 2010 from a deficiency of \$1,621,811 in working capital as of December 31, 2009.

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

Interest expense related to this credit facility for the three months ended June 30, 2010 was \$8,369 (2009-\$nil). Interest expense related to this credit facility for the six months ended June 30, 2010 was \$18,591 (2009-\$nil).

The following table discloses future payments as at June 30, 2010 committed by the Company over the next five (5) years. It includes both principal and interest obligation's 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	\$ 72,000	\$ 60,000	\$ 12,000	\$ -	\$ -

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 June 30, 2010, 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 \$36,302,000 are used or expire. The carry-forwards expire between 2010 and 2029.

TRANSACTIONS WITH RELATED PARTIES

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

- Recorded interest income of \$213 for the three months ended June 30, 2010 and \$1,488 for the six months ended June 30, 2010, related to \$85,000 advanced in terms of a promissory note dated January 8, 2008 to the former President and CEO of the Company bearing interest at 6% per annum. As at June 30, 2010, the total outstanding amount including interest was fully repaid to the company.

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

PROPOSED TRANSACTIONS

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

CRITICAL ACCOUNTING ESTIMATES

The Company's consolidated unaudited interim financial statements as at June 30, 2010 have been prepared in accordance with 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

There are no current period accounting policy changes.

RECENT ACCOUNTING PRONOUNCEMENTS ISSUED NOT YET ADOPTED

International Financial Reporting Standards

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

Canadian GAAP will be converged with IFRS through a combination of two methods: (1) 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 (2) 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.

The Company has completed an analysis of the impact of IFRS on accounting policies, information systems and internal controls over financial reporting. The analysis includes 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, retroactively on September 30, 2010, 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 2010’s third quarter MD&A.

The Company started its IFRS conversion process in 2009. It consisted of three primary phases as follows:

- 1) ***Scoping and diagnostic phase***
This phase involved the establishment of a team leader on the project from the management team and then involved a high-level assessment to identify key areas that may be affected by the transition to IFRS, and ranking these as high, medium or low priority.
- 2) ***Impact analysis, evaluation and design phase***
In this phase, each area identified from the scoping and diagnostic phase will be addressed by performing an in-depth analysis of Canadian GAAP/IFRS differences, evaluation and selection of available accounting policies, quantification of impacts and

development of draft IFRS financial statement contents. This phase also includes the identification of operational impacts such as information technology, process and internal control changes.

3) ***Implementation and review phase***

This phase involves the implementation of the necessary changes to the Company's information systems and business processes as identified through the assessment and design phases of the changeover plan. Significant implementation phase milestones will include the development of IFRS-compliant financial models, budgeting and reporting processes, the implementation of the Company's 2010 dual reporting systems strategy, the amendment and testing of internal controls over financial reporting and disclosure controls and procedures impacted by accounting policy changes, the implementation of internal and external communication plans, and the preparation of a January 1, 2010 opening balance sheet and 2010 comparative data under IFRS, with reconciliations from Canadian GAAP. The implementation phase will culminate in the preparation of Route1's financial reporting under IFRS beginning in 2011.

The Company completed the planning and scoping and diagnostic phase. The Company has drafted technical papers and is in the process of selecting accounting policies. The Company has identified the areas expected to have impact on its financial statements and categorized them as High, Medium or Low impact. These areas do not represent a complete list of expected changes. As the Company progresses further into the implementation phase, and as changes to Canadian GAAP and IFRS standards may occur prior to its changeover date, the differences and impacts described below may be subject to change. The Company will continue to disclose additional impacts on its financial reporting, including expected quantitative impacts, systems and processes and other areas of business in future MD&As as they are determined. The Company anticipates having completed its IFRS conversion requirements by September 30, 2010.

First time adoption

The Company's adoption of IFRS will require the application of IFRS 1 First-time Adoption of International Financial Reporting Standards ("IFRS 1") which provides guidance for an entity's initial adoption of IFRS. IFRS 1 generally requires that an entity apply all IFRS effective at the end of its first IFRS reporting period retrospectively, with specific mandatory exemptions and a limited number of optional exemptions. Policy decisions with respect to applicable IFRS 1 choices are in the process of being documented for senior management to review and approve those choices. The following paragraphs outline some of the significant optional IFRS 1 exemptions the Company expects to apply in its first IFRS financial statements and the areas likely to have the highest impact on the Company's accounting policies.

The Company has identified that under *First time adoption* that it has options for 16 elective exemptions of which 9 do not apply to the Company and 4 mandatory exemptions of which 3 do not apply to the Company. Some of the available optional exemptions are as follows:

Business Combinations (IFRS 3)

IFRS allows an entity that has conducted prior business combinations to apply IFRS 3 on a prospective basis only from the date of transition or from another date selected by the Company. This avoids the requirement to restate prior business combinations.

The Company will elect from time of transition of January 1, 2011. No impact to financial statements is expected.

Fair value or revaluation as deemed cost (IAS 16, 40 and 38)***Property, Plant and Equipment***

Consistent with Canadian GAAP, under IFRS, separable components of property, plant and equipment are recognized initially at cost. Under IFRS an entity is required to choose to account for each class of property, plant and equipment using either the cost model or the revaluation model. The cost model is generally consistent with Canadian GAAP where an item of property, plant and equipment is carried at its cost less any accumulated depreciation and any accumulated impairment losses. Under the revaluation method an item of property, plant and equipment is carried at its revalued amount, being its fair value at the date of the revaluation less any accumulated depreciation and accumulated impairment losses. Subsequent increases in fair value are recorded to the revaluation surplus account in equity while decreases in fair value serve to reduce the revaluation surplus account related to the asset, with any excess recognized in income. The Company has chosen not to fair value property, plant and equipment on transition.

No material impacts to recorded amounts are expected upon conversion to IFRS. The adjustment to financial statements will be as follows: 1) The zero net book value items will be eliminated from both the asset base and accumulated depreciation schedule; and 2) the Company's own-use of equipment will be categorized separately.

Assets and liabilities of subsidiaries, associates, and joint venture (IAS 27, 28 and 31)

Provides certain allowances and requirements for situations where the parent and its investees (subsidiaries, associates, and joint ventures or equity investments) adopt IFRS at different dates.

No impact to financial statements is expected.

Designation of previously recognized financial instruments (IAS 39)

Allows an entity to make an available-for-sale designation, or designate any financial asset or financial liability as at fair value through profit or loss at the date of transition.

No impact to financial statements is expected.

Share-based payment transactions (IFRS 2)

Full retrospective application may be avoided for certain share-based instruments depending on the grant date, vesting terms and settlement of any related liabilities. The Company is still assessing the impact to financial statements.

Leases (IAS 17 and IFRIC 4)

Instead of full retrospective application of IFRIC 4, an entity may elect to apply the less onerous transitional provisions of IFRIC 4. Also if a first-time adopter made the same determination under Canadian GAAP as that required by IFRIC 4, the first time adopter need not assess that determination when it adopts IFRS.

The Company is still assessing the impact to financial statements.

Borrowing costs (IAS 23)

Allows an entity to apply the transitional provisions of IAS 23 in lieu of full retrospective application. The IAS 23 transitional provisions allow an entity to choose the date to apply capitalization of borrowing costs related to qualifying assets. The effective date in this instance is considered to be the later of January 1, 2009 and the date of transition.

The Company will elect to apply IAS 23 on a prospective basis on the date of transition.

The available Mandatory exemption is as follows:

Estimates

Requires estimates at the date of transition to be consistent with estimates made for the same date in accordance with the previous GAAP unless there is objective evidence that those estimates were in error. In short, this precludes the use of hindsight.

Business combinations, consolidated financial statements and non-controlling interests

In January 2009, the CICA issued the following new Handbook sections: Section 1582, Business Combinations, Section 1601, Consolidated Financial Statements and Section 1602, Non-Controlling Interests which replace Section 1581, Business Combinations and Section 1600, Consolidated Financial Statements. These new Sections will be applicable to financial statements relating to fiscal years beginning on or after January 1, 2011. Early adoption is permitted to the extent the three new Sections are adopted simultaneously. Together, the new Sections establish standards for the accounting for a business combination, the preparation of consolidated financial statements and the accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. The Company is currently evaluating the impact of the adoption of these new Sections on its consolidated financial statements. The Company does not expect that the adoption of these new Sections will have a material impact on its consolidated financial statements

In December 2009, the CICA issued EIC 175, Multiple Deliverable Revenue Arrangements, replacing EIC 142, Revenue Arrangements with Multiple Deliverables. This abstract provides updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated and the consideration allocated; require, in situations where a vendor does not have vendor-specific objective evidence (VSOE) or third party evidence of selling price, that the entity allocate revenue in an arrangement using estimated selling prices of deliverables;

eliminate the use of residual method and require an entity to allocate revenue using the relative selling price method; and require expanded qualitative and quantitative disclosures regarding significant judgments made in applying this guidance. This EIC is effective for future years beginning on or after January 1, 2011. The Company is currently evaluating the impact of the adoption of these new standards on its consolidated financial statements.

FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

a) Establishing Fair Value

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 June 30, 2010 and December 31, 2009:

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

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

b) Fair value hierarchy

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

- a. Level 1 - valuation based on quoted prices (unadjusted) in active markets for identical assets or liabilities;

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

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

The following table presents the financial instruments recorded at fair value in the Consolidated Balance Sheet, classified using the fair value hierarchy described above:

	Level 1	Level 2	Level 3	Total financial assets and financial liabilities at fair value
Financial assets				
Cash	\$ 936,640	\$ -	-	\$ 936,640
Total financial assets	\$ 936,640	\$ -	-	\$ 936,640
Financial liabilities				
Total financial liabilities	-	-	-	-

During the year, there has been no significant transfer of amounts between Level 1 and Level 2.

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	
Bank Indebtedness	Yes	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 June 30, 2010, the largest single customer represented approximately 40.7% of recorded revenue. For the six months ended June 30, 2010, the largest single customer represented approximately 43.5 % of recorded revenue.

Cash

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

Accounts receivable

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

The carrying amount of accounts receivable 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 June 30, 2010, the largest single customer represented approximately 24.8% of accounts receivable. Subsequent to June 30, 2010 the full amount from the largest single customer was paid in full.

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

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

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

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

(b) *Liquidity Risk*

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's objective in managing liquidity risk is to maintain sufficient readily available reserves in order to meet its liquidity requirements at any point in time. In order to meet its financial liabilities, the Company has recently relied on collecting its accounts receivable.

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

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

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

(c) *Market Risk*

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

Foreign exchange

The functional currency of the parent company is Canadian dollars and the reporting currency is Canadian dollars. As at June 30, 2010, the Company had non-Canadian dollar net monetary liabilities of approximately US\$103,976 and €165,120 (December 31, 2009 - approximately US\$271,400 and €136,000). Any changes in the respective exchange rates as at June 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. At June 30, 2010, cash totalled \$936,640 (2009 - \$640,045). An increase of 100 basis points in the market interest rate would have increased the net loss by approximately \$9,366 (a 100 basis point decrease would have had the equal but opposite effect) for the three months ended June 30, 2010.

OTHER MD&A REQUIREMENTS

Disclosure of Outstanding Share Data

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

- 388,388,115 common shares issued and outstanding
- 38,000,000 common share purchase warrants (“Warrants”) convertible into 38,000,000 common shares
 - 38,000,000 Warrants at \$0.15/share expiring on February 26, 2015
- 35,350,000 common share purchase options (“Options”) convertible into 35,350,000 common shares issued under the Company’s stock option plan
 - 6,500,000 Options issued on September 24, 2009 at \$0.10/share expiring September 24, 2014
 - 1,500,000 Options issued on October 13, 2009 at \$0.10/share expiring October 13, 2014
 - 5,250,000 Options issued on February 26, 2010 at \$0.10/share expiring on February 26, 2015
 - 4,250,000 Options issued on February 26, 2010 at \$0.15/share expiring on February 26, 2015
 - 12,525,000 Options issued on March 24, 2010 at \$0.13/share expiring on March 24, 2015
 - 500,000 Options issued on April 7, 2010 at \$0.13/share expiring April 7, 2015
 - 500,000 Options issued on April 7, 2010 at \$0.15/share expiring April 7, 2015
 - 325,000 Options issued on May 19, 2010 at \$0.13/share expiring May 19, 2015
 - 2,000,000 Options issued on June 7, 2010 at \$0.15/share expiring June 7, 2015
 - 2,000,000 Options issued on June 7, 2010 at \$0.20/share expiring June 7, 2015

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, if needed, on reasonable terms. Access to such financing at acceptable commercial terms will be dependent on the timing of recognition and receipt of cash from our current receivables and contracts, on our ability to demonstrate execution of our business strategy and the general condition of the credit and/or equity markets. Such additional financing may be dilutive in nature to existing shareholders.
- The Company's access to credit or capital could be further restricted by the ongoing 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 expected to partially arise from a US\$1.4 million renewal of a large number of TruOFFICE service subscriptions and a DEFIMNET™ maintenance agreement with the US Government ("USG"). If the USG were to discontinue its relationship with the Company, such event may have a material adverse impact on the Company's financial results.
- The Company's ability to collect payment on a timely basis for services delivered may have a material adverse impact on the Company's liquidity position.
- There is no assurance that any forward-looking statement will materialize. 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 net working capital deficiency at June 30, 2010 of \$391,739, 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, may 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, may harm the Company's competitive advantage in the secure remote access industry;
- Route1's ability to obtain rights to use certain software or components which are supplied by third parties, may not be sufficient to support future sales volumes;
- The ability to run 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 its existing customer base, could also slow the Company's continued growth;
- The occurrence of a breach or perception of a breach of Route1's secure product and service offering, may impact on the credibility of the Company's product and services;
- The inappropriate disclosure of confidential information of the Company may impact on the credibility of the Company's product and services;
- Competition, both with existing providers as well as with any future providers entering the marketplace, within the secure remote access industry may hamper future sales growth;
- Route1's reliance on its suppliers and the risk that suppliers will not be able to deliver required components on a timely basis, which may slow future sales growth;
- Any future government(s) regulation of the secure remote access industry, including but not limited to restrictions on encryption of MobiKEY® and the MobiNET® may hamper future growth;

-
- Any significant economic downturn, in geographic areas where Route1 engages in business activities, that may cause those government agencies to reduce discretionary budget spending in areas such as secure identity solutions.

Audit Committee

Two of the three members of the Audit Committee are independent and all meet the qualifications of a financial expert.

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 MobiKEY®s that were delivered in 2007 for which revenue of approximately \$333,000 was recorded during 2007 on the strength of these agreements.

The Company reached a settlement with one of the reseller customers mutually waiving any Statements of Claim or Counterclaims that had been filed. The amount that the Company was seeking for non-payment of invoices was for approximately \$174,000 in revenue. The settlement involved the Company restocking a portion of the inventory for a restocking fee.

The Company has arrived at a mutual agreement with the other reseller to restock the inventory the Company previously claimed as owing in their legal claim. The claim against the reseller expired on May 20, 2010. The Company will not be pursuing further legal action against the reseller.

SUBSEQUENT EVENTS

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

Additional Information

Additional information about Route1 is available from Route1's website at www.route1.com, the SEDAR website at 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).