



Consolidated Financial Statements of

Route1 Inc.

December 31, 2010 and 2009

Independent Auditor's Report

To the Shareholders of Route1 Inc.:

We have audited the accompanying consolidated financial statements of Route1 Inc. and its subsidiaries, which comprise the consolidated balance sheets as at December 31, 2010 and December 31, 2009, and the consolidated statements of operations, comprehensive loss and deficit, and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Route1 Inc, and its subsidiaries as at December 31, 2010 and December 31, 2009, and its financial performance and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 1 in the financial statements which indicates that the Company incurred a net loss of \$1,758,070 and \$3,408,902 during the years ended December 31, 2010 and 2009 and, as of December 31, 2010, the Company's accumulated deficit was \$35,966,949. These conditions, along with other matters as set forth in Note 1, indicate the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern.

“Deloitte & Touche LLP”

Chartered Accountants
Licensed Public Accountants
Toronto, Ontario
March 23, 2011

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December 31, 2010 and 2009

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CONSOLIDATED BALANCE SHEETS

Route1 Inc.

As at December 31

	2010	2009
Assets		
Current		
Cash	\$ 484,457	\$ 640,045
Accounts receivable	475,302	88,583
Other receivables	27,471	34,954
Notes receivable (note 6)	-	173,000
Inventory (note 17)	840,916	900,775
Prepaid expenses	216,076	128,630
Total current assets	2,044,222	1,965,987
Capital assets (note 7)	227,292	74,571
Total assets	\$ 2,271,514	\$ 2,040,558
Liabilities		
Current		
Bank indebtedness (note 4 and 5)	\$ -	\$ 854,717
Accounts payable and accrued liabilities	988,443	1,197,258
Current portion of deferred revenue	1,695,990	1,535,823
Total current liabilities	2,684,433	3,587,798
Accrued liabilities – long term (note 20)	153,333	-
Deferred revenue	26,151	32,861
Total liabilities	2,863,917	3,620,659
Commitments and contingencies (note 12)		
Shareholders' deficiency		
Common shares (note 8)	24,112,764	23,977,296
Warrants (note 8)	1,746,027	2,949,072
Contributed surplus (note 8)	9,515,755	5,702,410
Deficit	(35,966,949)	(34,208,879)
Total shareholders' deficiency	(592,403)	(1,580,101)
	\$ 2,271,514	\$ 2,040,558

Approved by the Board of Directors:

Director:

● *"signed"* _____

Michael F. Doolan

Director:

● *"signed"* _____

Tony Busseri

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

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

Route1 Inc.

Years ended December 31

	2010	2009
Revenue		
Devices and Appliances	\$ 665,790	\$ 2,572,148
Services	4,704,030	2,637,307
	5,369,820	5,209,455
Cost of revenue (note 17)	672,219	1,793,134
Gross margin	4,697,601	3,416,321
Operating Expenses		
General administration	2,233,833	2,417,449
Research and development	1,829,534	1,831,780
Selling and marketing	814,682	1,492,868
Amortization	105,729	121,311
	4,983,778	5,863,408
Operating loss	(286,177)	(2,447,087)
Other expenses		
Stock-based compensation	(864,273)	(209,825)
Interest (expense) income	(16,518)	12,229
Foreign exchange loss	(131,102)	(249,525)
Proxy contest charges (note 19)	-	(514,694)
Severance charges (note 20)	(460,000)	-
Net loss and comprehensive loss for the year	(1,758,070)	(3,408,902)
Deficit, beginning of year	(34,208,879)	(30,799,977)
Deficit, end of year	\$(35,966,949)	\$(34,208,879)
Basic and diluted loss per share (note 11)	\$(0.00)	\$(0.01)
Weighted average number of common shares outstanding	382,245,648	350,388,115

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

CONSOLIDATED STATEMENTS OF CASH FLOW

Route1 Inc.

Years ended December 31

	2010	2009
Net cash inflow (outflow) related to the following activities		
Operating activities		
Loss from operations	\$ (1,758,070)	\$ (3,408,902)
Items not affecting cash		
Amortization	105,729	148,315
Stock-based compensation (note 8)	864,273	209,825
	(788,068)	(3,050,762)
Net changes in working capital balances		
Accounts receivable	(386,719)	27,037
Other receivables	7,483	(16,081)
Inventory	59,859	432,652
Prepaid expenses	(87,446)	99,843
Accounts payable and accrued liabilities	(55,482)	276,717
Deferred revenue	153,457	(138,309)
	(1,096,916)	(2,368,903)
Investing activities		
Acquisition of capital assets	(258,450)	(16,422)
Notes receivable	173,000	53,020
	(85,450)	36,598
Financing activities		
Repayment of obligations under capital lease	-	(2,700)
Bank indebtedness (repayment)	(854,717)	854,717
Issuance of common shares and warrants – net	1,881,495	-
	1,026,778	852,017
Net outflow for the year	(155,588)	(1,480,288)
Cash, beginning of year	640,045	2,120,333
Cash, end of year	\$ 484,457	\$ 640,045
Supplementary information		
Interest paid	\$ 20,111	\$ 8,833

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

December 31, 2010

1. BASIS OF PRESENTATION

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

Going concern assumption

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

For the years ended December 31, 2010 and 2009, the Company incurred losses of \$1,758,070 and \$3,408,902 respectively and has an accumulated deficit of \$35,966,949 as at December 31, 2010.

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

2. SIGNIFICANT ACCOUNTING POLICIES

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

The significant accounting policies of the Company are as follows:

Principles of consolidation

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

Foreign currency translation

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

For the year ended December 31, 2010, the Company incurred foreign currency losses of \$131,102 compared to a loss of \$249,525 for the year ended December 31, 2009.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

December 31, 2010

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Cash

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

Financial instruments

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

Classification

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

Held for trading

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

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

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

Loans and receivables

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

Other liabilities

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

Effective interest method

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

December 31, 2010

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Allowance for doubtful accounts

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

Inventory

Inventory is valued at the lower of cost and net realizable value with cost being calculated on a weighted average basis. The Company revalues any inventory at its net realizable value up to its cost.

Investments

Investments not subject to significant influence are recorded at cost less any permanent impairment to their value.

Capital assets

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

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

Revenue recognition

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

Devices

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

Appliances

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

December 31, 2010

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Service

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

Multiple-element arrangements

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

Research and development

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

Earnings (loss) per share

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

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

Income taxes

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

December 31, 2010

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Use of estimates

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

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

Stock-based compensation

The Company has a stock-based compensation plan, which is described in note 8. The Company adopted the recommendation of the Canadian Institute of Chartered Accountants ("CICA") with respect to stock-based compensation issued to employees. The fair value of stock options granted under the stock option plan is determined using the Black-Scholes Option Pricing Model and is amortized to income on a straight-line basis over the vesting period and a corresponding increase to contributed surplus. Any consideration paid by the employees or non-employees on exercise of the options is credited to share capital, and the contributed surplus balance is reduced as stock options are exercised and credited to share capital.

3. RECENT ACCOUNTING PRONOUNCEMENTS ISSUED NOT YET ADOPTED

International Financial Reporting Standards

The Canadian Accounting Standards Board ("AcSB") has determined that profit-oriented publicly accountable enterprises will be required to adopt International Financial Reporting Standards ("IFRS"). IFRS will replace current Canadian GAAP for those enterprises. The Company has elected to adopt IFRS effective for interim and annual periods commencing January 1, 2011, including the preparation and reporting of one year of comparative figures.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

December 31, 2010

4. BANK INDEBTEDNESS

The Company had a \$1,000,000 (December 31, 2009 - \$2,500,000) 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 (December 31, 2009 - \$854,717). The credit facility terminated on the repayment.

As at December 31, 2010 the Company had recorded interest expense related to this credit facility for the twelve months ended December 31, 2010 of \$18,591 (2009 - \$8,003).

5. CREDIT FACILITY

On October 5, 2010, the Company entered into a \$500,000 (December 31 2009 - \$nil) credit facility with a banking and financial services organization consisting of a revolving \$450,000 demand operating facility and a \$50,000 credit card limit. The credit facility will carry an interest rate equal to the lender's prime rate of interest plus 2.00%. The credit facility will be secured by the assets of the Company with access to the demand operating facility component based on the balance and term of the Company's trade accounts receivables outstanding plus its available cash. The Company is required to maintain a current ratio in excess of 0.75:1.0 while any portion of the demand facility is outstanding.

As at December 31, 2010 the Company did not have any amounts outstanding against this credit facility.

6. NOTES RECEIVABLE

Notes receivable consist of the following:

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

(a) This note receivable was reclassified from equity in the prior year in accordance with EIC 132, Share Purchase Financing as an interest component and security was attached to the Note receivable during the fourth quarter of 2009.

The Notes Receivables were paid in full to the Company during the year ended December 31, 2010.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

December 31, 2010

7. CAPITAL ASSETS

	December 31, 2010		
	Cost	Accumulated Amortization	Net Book Value
Furniture and equipment	\$ 235,950	\$ 235,950	\$ -
Computer equipment	1,538,063	1,362,759	175,304
Computer software	662,236	620,885	41,351
Leasehold improvements	87,187	76,550	10,637
	<u>\$ 2,523,436</u>	<u>\$ 2,296,144</u>	<u>\$ 227,292</u>

	December 31, 2009		
	Cost	Accumulated Amortization	Net Book Value
Furniture and equipment	\$ 235,950	\$ 234,178	\$ 1,772
Computer equipment	1,351,576	1,283,982	67,594
Computer software	607,691	607,691	-
Leasehold improvements	69,769	64,564	5,205
	<u>\$ 2,264,986</u>	<u>\$ 2,190,415</u>	<u>\$ 74,571</u>

8. SHARE CAPITAL, WARRANTS AND CONTRIBUTED SURPLUS

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

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

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

	Number of Shares	Common Shares
Balance, January 1, 2010	350,388,115	\$ 23,977,296
Shares issued – February 26, 2010	38,000,000	135,468
Balance, December 31, 2010 and December 31, 2009	<u>388,388,115</u>	<u>\$ 24,112,764</u>

During the year ended December 31, 2010, the following share transactions took place:

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

December 31, 2010

8. SHARE CAPITAL, WARRANTS AND CONTRIBUTED SURPLUS (continued)

On February 26, 2010, the Company issued through a non-brokered private placement of 38,000,000 units at a price of \$0.05 per unit for total proceeds of \$1,900,000 less issuance costs of \$18,505 for net proceeds of \$1,881,495. Each unit consisted of one common share and one common share warrant which is exercisable into one common share at a price of \$0.15 per share for a period of 60 months. \$135,468 of these proceeds has been recorded as common shares and \$1,746,027 has been recorded as warrants. The value of the warrants was derived under the Black-Scholes pricing model.

The table below shows the assumptions used in determining common shares and warrants, as derived under the Black-Scholes option pricing model as at February 26, 2010:

	<u>2010</u>
Risk free interest rate	2.26%
Expected life (years)	5
Expected volatility	127%
Dividend yield	Nil
Weighted average fair value of common shares and warrants granted	<u>\$ 0.05</u>

Escrow requirements

As at December 31, 2010, nil (December 31, 2009 – 11,285,000) common shares of the Company were held in an Exchange escrow agreement dated October 14, 2004. These shares were released over a period of seventy two (72) months at six (6) month intervals in accordance with the requirements of the TSX Venture Exchange. As of December 31, 2010, all of the escrow common shares held by the Company have been released.

Stock options

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

December 31, 2010

8. SHARE CAPITAL, WARRANTS AND CONTRIBUTED SURPLUS (continued)

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

	December 31, 2010		December 31, 2009	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Options Outstanding				
Balance, beginning of the year	12,020,360	\$ 0.13	5,949,660	\$ 0.18
Options granted during the year	30,000,000	0.14	17,135,716	0.08
Options expired during the year	(1,200,000)	0.21	-	-
Options cancelled during the year	(2,820,360)	0.20	(7,501,786)	0.06
Options forfeited during the year	(3,275,000)	0.12	(3,563,230)	0.11
Balance, end of the year	<u>34,725,000</u>	<u>\$ 0.16</u>	<u>12,020,360</u>	<u>\$ 0.11</u>

The cancelled stock options represent those options that were granted below the allowable TSX Venture Exchange exercise price of \$0.10 and were cancelled in December 2009, as well as options that were not properly filed with TSX Venture Exchange which were cancelled January 23, 2010.

Exercise Price	Options Outstanding December 31, 2010		Options Exercisable December 30, 2010	
	Number of Options	Weighted Average Life (Years)	Number of Options	Weighted Average Life (Years)
\$ 0.10	13,250,000	3.9	2,400,000	3.7
\$ 0.13	10,375,000	4.2	-	-
\$ 0.15	6,950,000	4.3	-	-
\$ 0.20	3,500,000	4.6	-	-
\$ 0.275	650,000	5.0	-	-
	<u>34,725,000</u>	<u>4.2</u>	<u>2,400,000</u>	<u>3.7</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

December 31, 2010

8. SHARE CAPITAL, WARRANTS AND CONTRIBUTED SURPLUS (continued)

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

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

During the year ended December 31, 2010, the Company recorded stock-based compensation expense of \$864,273 (December 31, 2009 - \$209,825), as derived using the Black-Scholes option valuation model. As a result of the cancelled stock option grants the compensation expense of \$77,987 for the 2009 year on the 7,501,786 stock option grants was reversed in December 2009.

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

	2010	2009
Risk free interest rate	2.19%	2.62%
Expected life (years)	5	5
Expected volatility	125%	129%
Dividend yield	Nil	Nil
Weighted average fair value of options granted	<u>\$ 0.10</u>	<u>\$ 0.06</u>

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

December 31, 2010

8. SHARE CAPITAL, WARRANTS AND CONTRIBUTED SURPLUS (continued)

Contributed surplus

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

	<u>December 31, 2010</u>	<u>December 31, 2009</u>
Balance beginning of year	\$ 5,702,410	\$ 5,149,384
Options expensed in year	864,273	209,825
Warrants expired in year	2,949,072	343,201
Balance end of year	<u>\$ 9,515,755</u>	<u>\$ 5,702,410</u>

Warrants

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

	<u>Number of Warrants</u>	<u>Weighted Average Exercise Price</u>
Balance, January 1, 2010	32,360,333	\$ 0.155
Warrants expired (a)	(32,360,333)	(\$ 0.155)
Warrants granted	38,000,000	\$ 0.150
Balance, December 31, 2010 (b)	<u>38,000,000</u>	<u>\$ 0.150</u>

(a) 38,000,000 warrants were granted on February 26, 2010 with an exercise price of \$0.15 per share and value of \$1,746,027 expiring February 25, 2015. The Company used the Black Scholes model to fair value the warrants.

(b) 32,360,333 warrants expired on May 7, 2010 with an exercise price of \$0.155 per share and value of \$2,949,072.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

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9. Income Taxes

The tax effect of significant temporary differences is as follows:

	<u>2010</u>	<u>2009</u>
Future income tax assets (liabilities)		
Capital assets	\$ 584,739	\$ 187,325
Unamortized financing fees	44,785	127,850
Eligible capital property	90,721	90,794
Tax losses carry-forwards	8,296,000	9,075,500
Unamortized Scientific Research and Development Pools	474,615	-
Investment Tax Credit	507,154	-
Unpaid severance	67,083	-
	<u>10,065,097</u>	<u>9,481,469</u>
Valuation allowance	<u>(10,065,097)</u>	<u>(9,481,469)</u>
Future income tax asset	<u>\$ -</u>	<u>\$ -</u>

A valuation allowance of 100% has been established in respect of the net future income tax assets due to the uncertainty of the Company's utilization of such future income tax assets.

A reconciliation between the Company's statutory and effective tax rates is as follows:

	<u>2010</u>	<u>2009</u>
Tax recovery at statutory rate	31.0 %	33.0 %
Permanent differences	(15.5)%	(2.1)%
Temporary difference due to non-recognition of tax loss carry forwards	(15.5) %	(30.9) %
Effective tax rate	<u>0.0 %</u>	<u>0.0 %</u>

The Company has non-capital losses for tax purposes of approximately \$33,184,000 that may be used to reduce Canadian taxable income in the future. The potential tax benefits pertaining to these tax losses have not been recognized in the financial statements. If not utilized, these losses will expire as follows:

2013	2,574,000
2014	990,000
2015	5,912,000
2026	9,109,000
2027	7,319,000
2028	4,231,000
2029	2,503,000
2030	546,000
	<u>\$ 33,184,000</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

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10. RELATED PARTY TRANSACTIONS

The Company had the following transactions and/or outstanding amounts with related parties for the year ended December 31, 2010:

- Recorded interest income of \$1,488 for the year ended December 31, 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. The transaction was measured at the 'exchange amount' agreed upon by the parties.
- Recorded interest income of \$1,000 for the year ended December 31, 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. The transaction was measured at the 'exchange amount' agreed upon by the parties.
- Recorded interest income of \$556 for the year ended December 31, 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 transaction was measured at the 'exchange amount' agreed upon by the parties.
- The Company made payments to 541215GPP for a success fee for services provided by Mr. Gus P. Pergantis, an officer of the Company in the amount of \$30,000 in the year ended December 31, 2010. The transaction was measured at the 'exchange amount' agreed upon by the parties.
- 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 \$245,850 in the year ended December 31, 2010. The transaction was measured at the 'exchange amount' agreed upon by the parties.

11. LOSS PER SHARE

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

	<u>December 31, 2010</u>	<u>December 31, 2009</u>
Net loss	\$ (1,758,070)	\$ (3,408,902)
Weighted average number of common shares outstanding	<u>382,245,648</u>	<u>350,388,115</u>
Basic and diluted loss per share	<u>\$ (0.00)</u>	<u>\$ (0.01)</u>

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

December 31, 2010

12. COMMITMENTS AND CONTINGENCIES

(i) *Operating leases*

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

2011	\$ 96,000
	<u>\$ 96,000</u>

(ii) *Legal matters*

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

13. INDEMNIFICATIONS

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

14. FINANCIAL INSTRUMENTS

a) *Establishing fair value*

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

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14. FINANCIAL INSTRUMENTS (continued)

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

	December 31, 2010		December 31, 2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
FINANCIAL ASSET				
Held for trading				
Cash (i)	\$ 484,457	\$ 484,457	\$ 640,045	\$ 640,045
Loans and receivables				
Accounts receivable (i)	\$ 475,302	\$ 475,302	\$ 88,583	\$ 88,583
Other receivables (i)	\$ 27,471	\$ 27,471	\$ 34,954	\$ 34,954
Notes receivable (i)	\$ -	\$ -	\$ 173,000	\$ 173,000
FINANCIAL LIABILITIES				
Other liabilities				
Accounts payable and accrued liabilities (i)	\$ 1,141,776	\$ 1,141,776	\$ 1,197,258	\$ 1,197,258
Bank indebtedness(i)	\$ -	\$ -	\$ 854,717	\$ 854,717

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

b) Fair value hierarchy

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

- 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 (ie 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

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

15. CAPITAL MANAGEMENT

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

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

Capital management objectives, policies and procedures have not changed over the preceding year.

Under its borrowing agreement, the Company must satisfy certain restrictive covenants as to minimum financial ratios such as current ratio.

As at December 31, 2010, the Company was not in violation of any of its financial covenants, specifically its minimum current ratio (current assets divided by current liabilities).

16. FINANCIAL INSTRUMENTS - RISK MANAGEMENT

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

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

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

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16. FINANCIAL INSTRUMENTS - RISK MANAGEMENT (continued)

(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 year ended December 31, 2010, the largest single customer represented approximately 36.3% (a reseller with more than one customer) 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 December 31, 2010, the Company had cash consisting of cash on hand and deposits with banks of \$484,457 (December 31, 2009 - \$640,045). During the year ended December 31, 2010, the Company did not hold any investments in asset-backed commercial paper.

Accounts receivable

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

The carrying amount of accounts receivable is reduced through the use of an allowance for doubtful accounts and the amount of the loss is recognized in the statement of operations. When a receivable balance is considered uncollectible, it is written off against the allowance for accounts receivable. Subsequent recoveries of amounts previously written off reduce other expenses in the statement of operations. As at December 31, 2010 the Company had fully written-off prior year allowances of invoices and does not anticipate that any accounts receivable at December 31, 2010 will be uncollectable. At December 31, 2010, the largest single customer's accounts receivable represented approximately 54.2% of the total accounts receivable. Subsequent to December 31, 2010 the total outstanding amount from the largest single customer's accounts receivable was paid in full.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

December 31, 2010

16. FINANCIAL INSTRUMENTS - RISK MANAGEMENT (continued)

Accounts receivable (continued)

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

	December 31, 2010	December 31, 2009
Current	\$ 17,160	\$ 31,427
Past due		
1 – 60 days	254,673	47,873
Greater than 60 days	203,469	27,743
Less: Allowance for doubtful accounts	-	(18,460)
Total accounts receivable, net	\$ 475,302	\$ 88,583

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

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

(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, which by nature, are due predominately from government agencies with a high level of certainty of collection.

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 December 31, 2010:

	2011	2012	2013	Total
Accounts payable and accrued liabilities	\$ 988,443	\$ 153,333	\$ -	\$ 1,141,776
Operating lease commitments	96,000	-	-	96,000
	\$ 1,084,443	\$ 153,333	\$ -	\$ 1,237,776

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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16. FINANCIAL INSTRUMENTS - RISK MANAGEMENT (continued)

(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 December 31, 2010, the Company had non Canadian dollar net monetary liabilities of approximately US\$4,609 and €nil (December 31, 2009 - approximately US\$271,400 and €36,000). Any changes in the respective exchange rates as at December 31, 2010 would have resulted in non-material exchange gains or losses 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 December 31, 2010, cash totalled \$484,457 (December 31, 2009 - \$640,045). The Company has no amounts drawn on its credit facility as at December 31, 2010.

17. INVENTORY

For the year ended December 31, 2010, the cost of inventory recognized as an expense was \$215,585 (December 31, 2009 - \$1,271,060 which included a write-off of inventory of \$172,441). At December 31, 2010 the Company revalued the inventory of keys it received from past settlements at \$107,603 less \$26,901 that management estimates from damage for a net inventory adjustment of \$80,702.

18. SEGMENTED INFORMATION

The Company is organized and managed as a single reportable business entity with two distinct revenue streams, being devices and appliances, and services. The Company considers revenue realizable and earned when the product has been delivered or the services have been provided to the customer and collectability is reasonably assured. For sale of devices, revenue is recognized at the time of shipment of the device which constitutes transfer of ownership of the device. Revenue for the services component is reported as deferred revenue on the balance sheet and is recognized as earned revenue in the period which the service is provided. At December 31, 2010, the Company had \$1,722,141 (December 31, 2009 - \$1,568,684) in deferred revenue. The Company recognized during the year ended December 31, 2010 \$nil (2009 - \$1,162,948) in device revenue for the DEFIMNET hardware.

	2010		2009	
	Revenue	% of Total	Revenue	% of Total
Devices	\$ 665,790	12.4	\$ 2,572,148	49.4
Services	4,704,030	87.6	2,637,307	50.6
	\$ 5,369,820	100.0	\$ 5,209,455	100.0

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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18. SEGMENTED INFORMATION (continued)

For the year ended December 31, 2010, a reseller selling the Company's services and products to their multiple customers accounted for 33.8% of the Company's revenue stream.

	2010		2009	
	Revenue	% of Total	Revenue	% of Total
USA	\$ 3,596,527	67.0	\$ 3,200,837	61.4
Europe	1,228,951	22.9	1,508,173	29.0
Canada	544,342	10.1	500,445	9.6
	<u>\$ 5,369,820</u>	<u>100.0</u>	<u>\$ 5,209,455</u>	<u>100.0</u>

19. PROXY CONTEST CHARGES

The proxy contest charges of \$514,694 include legal fees, proxy solicitation fees and expenses, and other professional consulting fees relating to the September 24, 2009 Annual and Special Shareholders Meeting, which was a contested meeting. These charges were one time in nature.

20. SEVERANCE CHARGES

Severance charges for the year ended December 31, 2010 were \$460,000 (2009 - \$nil) and are a one-time expense the Company incurred to terminate the employment agreement of the Company's former President and CEO. The liability remaining as of December 31, 2010 has been recorded with both its short term (\$230,000) and long term components (\$153,333). Payment of this liability will be made over the coming 20 months, on a bi-monthly payment schedule and the liability will be fully discharged by August 31, 2012.

21. COMPARITIVE FIGURES

Certain of the comparative figures have been reclassified to conform to the presentation adopted in the current year. Stock-based compensation expense has been reclassified from Operating expenses to Other expenses on the consolidated statement of operations, comprehensive loss and deficit.

22. SUBSEQUENT EVENTS

No subsequent events to report.