



Consolidated Financial Statements of

Route1 Inc.

For the three and six months ended

June 30, 2008

The Company has prepared the unaudited interim consolidated balance sheets, statements of operations, comprehensive loss and deficit, and cash flows and notes thereto as at and for the three and six months ended June 30, 2008. The auditors of the Company, Deloitte & Touche LLP, have not audited or reviewed these unaudited interim consolidated financial statements. The accompanying notes are an integral part of these unaudited interim consolidated financial statements and should be read in conjunction with the Company's December 31, 2007 audited consolidated financial statements.

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June 30, 2008 (unaudited)

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CONSOLIDATED BALANCE SHEETS

Route1 Inc.

As at June 30, 2008 (unaudited) and December 31, 2007

	June 30, 2008	December 31, 2007
ASSETS		
Current		
Cash	\$ 2,816,523	\$ 6,303,351
Accounts receivable	395,692	585,545
Other receivables	20,593	19,399
Notes receivables (note 5)	192,610	163,833
Inventory	1,006,017	607,796
Prepaid expenses	284,230	174,633
	4,715,665	7,854,557
Investments (note 6)	4	4
Capital assets (note 7)	312,184	470,761
	\$ 5,027,853	\$ 8,325,322
LIABILITIES		
Current		
Accounts payable and accrued liabilities	\$ 977,654	\$ 1,193,872
Deferred revenue	467,141	376,239
Current portion of obligations under capital lease (note 8)	8,689	88,169
	1,453,484	1,658,280
Non current		
Deferred revenue	22,345	12,098
Obligations under capital lease (note 8)	-	2,700
	1,475,829	1,673,078
Commitments and Contingencies (note 13)		
SHAREHOLDERS' EQUITY		
Common shares (note 9)	23,903,599	23,905,243
Warrants (note 9)	4,847,971	6,527,888
Contributed surplus (note 9)	3,466,444	1,572,409
Deficit	(28,665,990)	(25,353,296)
	3,552,024	6,652,244
	\$ 5,027,853	\$ 8,325,322

Approved by the Board of Directors:

Director:

<<signed>>

Michael F. Doolan

Director:

<<signed >>

K. Andrew White

CONSOLIDATED STATEMENTS OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT

Route1 Inc.

For the three and six months ended June 30, 2008 (unaudited) and 2007 (unaudited)

	For the three months ended June 30		For the six months ended June 30	
	2008	2007	2008	2007
Revenues				
Devices	\$ 55,190	\$ 250,030	\$ 131,814	\$ 543,920
Services	129,746	70,839	247,419	184,734
	184,936	320,869	379,233	728,654
Cost of revenues	182,544	414,420	359,140	781,630
Gross margin (loss)	2,392	(93,551)	20,093	(52,976)
Expenses				
General administration	714,034	635,465	1,431,314	1,110,200
Research and development	543,426	678,829	1,125,441	1,157,616
Selling and marketing	385,663	640,110	712,947	1,384,192
Amortization	61,859	74,323	127,705	136,025
	1,704,982	2,028,727	3,397,407	3,788,033
Loss before the following items	(1,702,590)	(2,122,278)	(3,377,314)	(3,841,009)
Interest income	22,446	24,688	64,620	34,480
Net loss and comprehensive loss for the period	(1,680,144)	(2,097,590)	(3,312,694)	(3,806,529)
Deficit, beginning of period	(26,985,846)	(19,597,814)	(25,353,296)	(17,888,875)
Deficit, end of period	\$(28,665,990)	\$(21,695,404)	\$(28,665,990)	\$(21,695,404)
Loss per share (note 12)	\$ (0.00)	\$ (0.01)	\$ (0.01)	\$ (0.01)
Weighted average number of common shares outstanding	349,388,115	280,138,402	349,388,115	269,764,770

CONSOLIDATED STATEMENTS OF CASH FLOW

Route1 Inc.

For the three and six months ended June 30, 2008 (unaudited) and 2007 (unaudited)

	For the three months ended June 30		For the six months ended June 30	
	2008	2007	2008	2007
Net cash inflow (outflow) related to the following activities				
Operating activities				
Loss from operations	\$(1,680,144)	\$(2,097,590)	\$(3,312,694)	\$(3,806,529)
Items not affecting cash				
Amortization	105,322	148,702	222,973	289,198
Stock based compensation	65,575	56,431	214,118	115,377
	(1,509,247)	(1,892,457)	(2,875,603)	(3,401,954)
Net changes in working capital balances				
Accounts receivable	189,868	(326,216)	189,853	(181,075)
Other receivables	(1,816)	9,147	(1,194)	5,248
Inventory	(389,867)	44,461	(398,221)	(117,467)
Prepaid expenses	33,532	(32,090)	(109,597)	(59,332)
Accounts payable and accrued liabilities	(201,528)	(20,834)	(216,218)	(39,042)
Deferred revenue	95,018	178,053	101,149	185,448
	(1,784,040)	(2,039,936)	(3,309,831)	(3,608,174)
Investing activities				
Acquisition of capital assets	(44,232)	(69,513)	(64,396)	(249,536)
Note receivables	(2,805)	(5,000)	(28,777)	(11,000)
	(47,037)	(74,513)	(93,173)	(260,536)
Financing activities				
Repayment of obligations under capital lease	(29,500)	(56,639)	(82,180)	(113,231)
Issuance of share capital – net	-	756,169	(1,644)	4,915,263
	(29,500)	699,530	(83,824)	4,802,032
Net cash inflow (outflow)	(1,860,577)	(1,414,919)	(3,486,828)	933,322
Cash, beginning of period	4,677,100	3,834,605	6,303,351	1,486,364
Cash, end of period	\$ 2,816,523	\$ 2,419,686	\$ 2,816,523	\$ 2,419,686
Supplementary information				
Interest paid	\$ 1,330	\$ 2,411	\$ 3,703	\$ 5,162

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

June 30, 2008 (unaudited)

1. BASIS OF PRESENTATION

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

Route1 is the trusted provider of security and identity management network solutions that are redefining today’s digital landscape. 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. Leveraging the power of MobiNET is the award-winning MobiKEY, an ultra-portable computing device that securely connects users to the myriad of MobiNET services from any Internet-enabled Windows-based PC. This patent-pending computing solution is embedded on a smart-card enabled, cryptographic USB device, making it one of the most powerful and easy-to-use secure computing solutions available today. MobiKEY provides secure remote access to data, applications, network resources, and web content with services such as TruOFFICE and PurLINK. Route1’s patent-pending solutions, based on FIPS-140-2 cryptographic modules, meet the stringent security needs and high standards mandated by all levels of government. They have been evaluated by ICSA Labs and certified by the CSE. As a Company with high regard for intellectual property, Route1 continues to encourage and nurture innovation across its talented team.

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

Going concern assumption

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

For the three and six months ended June 30, 2008 and 2007, the Company incurred losses of \$1,680,144 and \$3,312,694 for 2008 respectively, and \$2,097,590 and \$3,806,529 for 2007 respectively, and has an accumulated deficit of \$28,665,990 as at June 30, 2008. The Company’s continued existence is dependent upon its ability to obtain additional financing and ultimately achieve profitable operations. However there can be no assurance that the Company will be able to achieve profitable operations, nor that financing efforts will continue to be successful.

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

June 30, 2008 (unaudited)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Principles of consolidation

These 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 at into Canadian dollars 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 statement of operations in the period in which they occur.

Cash and cash equivalents

Cash and cash equivalents consist of cash balances with banks and investments in term deposits and money market instruments that are readily convertible into cash.

Allowance for Doubtful Accounts

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

Inventory

Inventory is valued at the lower of cost and net realizable value with cost being calculated on a weighted average basis as per guidelines of the Canadian Institute of Chartered Accountants (“CICA”) Handbook Section 3031 “Inventories”.

Investments

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

June 30, 2008 (unaudited)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 collectibility is reasonably assured. In addition to this general policy, the following paragraphs describe the specific revenue recognition policies for each major category of revenue.

Devices

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

Service

Revenue from service is recognized rateably on a monthly basis when the service is provided. In instances where the Company bills the customer prior to performing the service, the prepayment amount is recorded as deferred revenue.

Multiple-element arrangements

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

June 30, 2008 (unaudited)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Research and development

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

Earnings (loss) per share

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

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

Income taxes

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

Use of estimates/measurement uncertainty

In preparing the Company's 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; and
- the recoverability of investments.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

June 30, 2008 (unaudited)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Stock compensation

The Company has a stock-based compensation plan, which is described in note 9. The Company adopted the recommendation of the Canadian Institute of Chartered Accountants (“CICA”) with respect to stock-based compensation issued to employees. The fair value of stock options granted under the stock option plan is determined using the Black-Scholes Option Pricing Model and is amortized to income on a straight-line basis over the vesting period and to contributed surplus. Any consideration paid by the employees or non-employees on exercise of the options is credited to share capital, and the contributed surplus balance is reduced as stock options are exercised and credit to share capital.

3. ADOPTION OF NEW ACCOUNTING STANDARDS

On January 1, 2008, the Company adopted three new accounting standards; CICA Handbook Section 1535 “Capital Disclosures”, Section 3031 “Inventories”, and Section 3862 “Financial Instruments - Disclosures”. These standards have been adopted prospectively and comparative amounts for the prior year have not been restated.

Capital Disclosures

In November 2006, the Canadian Institute of Chartered Accountants (“CICA”) issued the new handbook Section 1535 “Capital Disclosures”. This section requires an entity disclose information that enables users of its financial statements to evaluate an entity’s objectives, policies and processes for managing capital. The new standard applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007, specifically January 1, 2008 for the Company. This new standard does not have a material effect on the Company’s financial statements.

Inventories

In June 2007, the Canadian Institute of Chartered Accountants (“CICA”) issued the new handbook Section 3031 “Inventories” replacing Section 3030 “Inventories”. The new Section will be applicable to financial statements relating to fiscal years beginning on or after January 1, 2008. Accordingly, the Company will adopt the new standard for its fiscal year beginning January 1, 2008. The new standard requires inventories to be measured at the lower of cost and net recognizable value. This new standard does not have a material effect on the Company’s financial statements.

Financial Instruments

Effective January 1, 2008, the Company will be required to adopt two new standards issued by the Canadian Institute of Chartered Accountants (“CICA”), Section 3862 “Financial Instruments – Disclosure,” and Section 3863 “Financial Instruments - Presentation,” which will replace Section 3861 “Financial Instruments – Disclosures and Presentation”. This new presentation standard carry forward the former presentation requirements and increase the emphasis on the disclosure of risks associated with both recognized and unrecognized financial instruments and how those risks are managed. This new standard does not have a material effect on the Company’s financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

June 30, 2008 (unaudited)

4. FUTURE ACCOUNTING PRONOUNCEMENTS

International Financial Reporting Standards

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

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

As the International Accounting Standards Board currently, and expectedly, has projects underway that should result in new pronouncements that continue to evolve IFRS; this Canadian convergence initiative is in its infancy. As of the date of these unaudited consolidated financial statements, the financial reporting impact of the transition to IFRS cannot be reasonably estimated.

Goodwill and Intangible Assets

In February 2008, the CICA issued Handbook Section 3064, Goodwill and Intangible Assets which establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. CICA Handbook Section 1000, Financial Statement Concepts, was also amended to provide consistency with this new standard. The new and amended standards are effective for the Company beginning January 1, 2009.

The Company is currently assessing the impact of these standards on its consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

June 30, 2008 (unaudited)

5. NOTES RECEIVABLES

Notes receivable consist of the following:

	<u>June 30, 2008</u>	<u>December 31, 2007</u>
Due from an officer of the Company, secured and repayable no later than December 28, 2009 with interest at 6%	\$ 87,550	\$ -
Due from an officer of the Company, secured and repayable no later than December 28, 2008 with interest at 6%	53,560	52,000
Due from an employee of the Company, secured and repayable no later than December 28, 2008 with interest at 6%	51,500	50,000
Due from an officer of the Company, unsecured and due on demand with interest at 6%	-	60,000
Due from an employee of the Company, secured, due on demand and non-interest bearing	-	1,000
Due from an employee of the Company, secured and repayable no later January 15, 2008 with interest at 6%	-	833
	<u>\$ 192,610</u>	<u>\$ 163,833</u>

6. INVESTMENTS

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

	<u>June 30, 2008</u>	<u>December 31, 2007</u>
Hypernet Inc.	\$ 1	\$ 1
Other	3	3
	<u>\$ 4</u>	<u>\$ 4</u>

The Company holds first preferred shares in Hypernet Inc. ("Hypernet"), which Hypernet shall redeem all or a portion of the first preferred shares based on a percentage Hypernet revenues exceeding a certain level. During 2007, a write-down of \$74,999 was recorded to reflect an impairment in the carrying value of Hypernet.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

June 30, 2008 (unaudited)

7. CAPITAL ASSETS

	June 30, 2008		
	Cost	Accumulated Amortization	Net Book Value
Furniture and equipment	\$ 235,950	\$ 222,123	\$ 13,827
Computer equipment	1,334,264	1,063,484	270,780
Computer software	607,691	606,249	1,442
Leasehold improvements	69,769	43,634	26,135
	<u>\$ 2,247,674</u>	<u>\$ 1,935,490</u>	<u>\$ 312,184</u>

	December 31, 2007		
	Cost	Accumulated Amortization	Net Book Value
Furniture and equipment	\$ 235,950	\$ 193,001	\$ 42,949
Computer equipment	1,269,868	885,227	384,641
Computer software	607,691	597,632	10,059
Leasehold improvements	69,769	36,657	33,112
	<u>\$ 2,183,278</u>	<u>\$ 1,712,517</u>	<u>\$ 470,761</u>

Included in computer equipment are assets held under finance leases with a cost of \$657,847 (December 31, 2007 - \$657,847), accumulated amortization of \$641,448 (December 31, 2007 - \$548,671) and net book value of \$16,399 (December 31, 2007 - \$109,176).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

June 30, 2008 (unaudited)

8. OBLIGATIONS UNDER CAPITAL LEASE

The Company has obligations under capital lease as follows:

	June 30, 2008	December 31, 2007
Computer equipment lease agreement in the amount of \$32,400, repayable in quarterly instalments of \$2,700 including interest calculated at 8.3%, with a bargain purchase option at maturity on March 1, 2009	\$ 8,100	\$ 13,500
Computer equipment lease agreement in the amount of \$26,920, repayable in monthly instalments of \$862 including interest calculated at 5.4%, with a bargain purchase option at maturity on July 26, 2008	856	5,137
Computer equipment lease agreement in the amount of \$214,097, repayable in monthly instalments of \$6,082 including interest calculated at 5.4%, with a bargain purchase option at maturity on June 30, 2008	-	36,492
Computer equipment lease agreement in the amount of \$274,270, repayable in monthly instalments of \$8,249 including interest calculated at 5.4%, with a bargain purchase option at maturity on April 30, 2008	-	32,250
Computer equipment lease agreement in the amount of \$86,960, repayable in monthly instalments of \$2,471 including interest calculated at 5.4%, with a bargain purchase option at maturity on March 31, 2008	-	7,094
Total amount of future minimum lease payments	8,956	94,473
Executory costs and interest included in instalments	267	3,604
	8,689	90,869
Current portion	8,689	88,169
	\$ -	\$ 2,700
Future minimum lease payments under the capital leases in each of the next two years are as follows:		
2008	\$ 5,989	\$ 88,169
2009	2,700	2,700
	\$ 8,689	\$ 90,869

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

June 30, 2008 (unaudited)

9. SHARE CAPITAL, WARRANTS AND CONTRIBUTED SURPLUS

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

Unlimited number of common shares with voting rights.

Unlimited number of non-cumulative, non-voting first preferred shares with no fixed dividend rate, issuable in series.

Unlimited number of non-cumulative, non-voting second preferred shares with no fixed dividend rate, issuable in series.

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

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

	<u>Number of Shares</u>	<u>Share Capital</u>
Balance, January 1, 2007	241,707,617	\$ 13,065,386
Shares issued on exercise of warrants (a)	42,959,832	7,086,064
Shares issued on private placement (b)	64,720,666	3,781,593
Other	-	(27,800)
Balance, December 31, 2007	<u>349,388,115</u>	<u>23,905,243</u>
Other	-	(1,644)
Balance, June 30, 2008	<u>349,388,115</u>	<u>\$ 23,903,599</u>

During the year ended December 31, 2007, the following share transactions took place:

- a. 15,214,159 warrants were exercised at \$0.155 per share for total proceeds of \$2,358,195 and 27,745,673 warrants were exercised at \$0.10 per share for total proceeds of \$2,774,567. Included in the stated share capital amount is \$1,953,302 reallocated from contributed surplus as related to the valuation of the warrants exercised under the Black-Scholes option pricing model.
- b. On November 6, 2007, the Company issued through a private placement 64,720,666 units at a price of \$0.12 per unit for total net proceeds of \$6,984,800. Each unit consisted of one common share and one-half common share purchase warrant which is exercisable into one common share at a price of \$0.155 per share for a period of 2 years. \$3,781,593 of these proceeds has been recorded as common shares and \$3,203,207 has been recorded as warrants. In addition, 3,883,240 common share purchase warrants have been issued as Broker Warrants exercisable into one common share at a price of \$0.155 per share for a period of 2 years. The value of the warrants was derived under the Black-Scholes pricing model using the following assumptions: a risk free interest rate of 4.75%, an expected life of 2.0 years, an expected volatility of 100% and a dividend yield of nil.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

June 30, 2008 (unaudited)

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

Escrow requirements

As at June 30, 2008, approximately 28,213,000 common shares of the Company were held in an Exchange escrow agreement dated October 14, 2004. These shares are to be released over a period of seventy two (72) months at six (6) month intervals in accordance with the requirements of the TSX Venture Exchange.

Stock options

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

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

	Six months ended June 30, 2008		Year ended December 31, 2007	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Options Outstanding				
Balance, beginning of the period	10,598,660	\$ 0.26	9,201,500	\$ 0.30
Options granted during the period	1,125,000	0.08	5,390,160	0.17
Options cancelled during the period	(4,772,000)	0.20	(3,993,000)	0.23
Balance, end of the period	6,951,660	\$ 0.25	10,598,660	\$ 0.26

Exercise Price	Options Outstanding June 30, 2008		Options Exercisable June 30, 2008	
	Number of Options	Weighted Average Life (Years)	Number of Options	Weighted Average Life (Years)
\$ 0.08	1,125,000	4.7	-	-
\$ 0.125	1,410,000	2.8	-	-
\$ 0.20	1,685,000	1.5	-	-
\$ 0.205	1,790,160	4.0	-	-
\$ 0.30	941,500	2.8	682,931	2.8
	6,951,660	2.2	682,931	2.8

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

June 30, 2008 (unaudited)

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

Exercise Price	Options Outstanding December 31, 2007		Options Exercisable December 31, 2007	
	Number of Options	Weighted Average Life (Years)	Number of Options	Weighted Average Life (Years)
\$ 0.125	2,300,000	3.3	-	-
\$ 0.20	2,685,000	2.0	-	-
\$ 0.205	1,790,160	4.5	-	-
\$ 0.30	986,500	3.3	328,833	3.3
\$ 0.40	1,693,500	0.3	1,693,500	0.3
\$ 0.50	1,143,500	0.3	1,143,500	0.3
	<u>10,598,660</u>	<u>2.4</u>	<u>3,165,833</u>	<u>1.1</u>

During the three and six months ended June 30, 2008, the Company recorded stock-based compensation expense of \$65,575 and \$214,118 (June 30, 2007 - \$56,431 and \$115,377) respectively, as derived using the Black-Scholes option valuation model. The table below shows the assumptions used in determining stock based compensation expense, as derived under the Black-Scholes option pricing model:

	2008	2007
Risk free interest rate	4.25%	4% to 4.75%
Expected life (years)	5	3 to 5
Expected volatility	100%	100%
Dividend yield	Nil	nil
Weighted average fair value of options granted	<u>\$ 0.06</u>	<u>\$ 0.11</u>

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

Contributed surplus

Contributed surplus represents the fair value of stock options granted under the stock option plan is determined using the Black-Scholes Option Pricing Model and is amortized to income on a straight-line basis over the vesting period and also 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 also credit to share capital. On March 9, 2008, 29,369,174 warrants issued as part of a private placement on March 9, 2006 expired with a value of \$1,679,917 which was reallocated to contributed surplus from warrants.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

June 30, 2008 (unaudited)

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

Warrants

At June 30, 2008 there were 78,379,191 warrants outstanding with the following terms:

Warrants Outstanding	Number of warrants	Weighted average exercise price
Balance, January 1, 2007	114,464,624	\$0.121
Issued	36,243,573	0.155
Exercised	(42,959,832)	0.120
Balance, December 31, 2007	107,748,365	0.134
Expired	(29,369,174)	0.155
Balance, June 30, 2008	78,379,191	\$0.125

- (a) 42,135,618 warrants expiring September 20, 2008 with an exercise price of \$0.10 per share and value of \$1,644,764.
- (b) 36,243,573 warrants expiring November 6, 2009 with an exercise price of \$0.155 per share and value of \$3,203,207.

10. CAPITAL MANAGEMENT

The Company's capital currently consists of shareholders' equity. The Company's capital management objectives are to safeguard its ability to continue as a going concern, in order than it can provide future returns for shareholders. Management intends to accomplish this objective with the least dilution to our shareholders. The Company manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. There were no changes in the Company's approach to capital management during the six months ended June 30, 2008. The Company is not subject to externally imposed capital requirements.

11. RELATED PARTY TRANSACTIONS

On June 30, 2008, the Company had notes receivable from officers and employees in the amount of \$214,800 (December 31, 2007- \$191,633) exclusive of accrued interest. Some of these notes are secured and unsecured, and some with interest at six percent (6%) and others being non-interesting bearing (see note 5).

12. LOSS PER SHARE

The Company uses the treasury stock method to calculate basic and diluted earnings (loss) per share. Basic earnings (loss) per share have been calculated based on the weighted average number of common shares without the inclusion of dilutive effects. Diluted earnings (loss) per share are calculated based on the weighted average number of common shares plus dilutive common share equivalents outstanding which consist of options and warrants to purchase common shares. For the three and six months ended June 30, 2008 and 2007, the loss per share was \$nil and \$0.01 for 2008, and \$0.01 and \$0.01 for 2007, respectively.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

June 30, 2008 (unaudited)

13. COMMITMENTS AND CONTINGENCIES

(i) *Operating leases*

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

2008	\$ 52,000
2009	120,000
2010	12,000
	<u>\$ 184,000</u>

(ii) *Legal matters*

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

14. INDEMNIFICATIONS

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

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The carrying amount of financial instruments including cash and cash equivalents, accounts receivable, other receivables, notes receivable and accounts payable and accrued liabilities approximates fair value because of the limited term of these instruments. The carrying amount of obligations under capital lease approximates fair value due to the market rate of interest associated with the instrument.

The Company is exposed to the following risks related to its financial assets and liabilities:

Credit risk

Credit risk arises from the possibility that the Company's customers may experience financial difficulty and be unable to fulfill their financial obligations. The Company, in the normal course of business, monitors the financial condition of its customers and reviews the credit history of each new customer. The Company establishes an allowance for doubtful accounts that corresponds to specific credit risk of its customers, historical trends, and economic circumstances.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Route1 Inc.

June 30, 2008 (unaudited)

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

Interest rate risk

The Company interest rate risk is due to volatility in interest rates. This risk has been mitigated by borrowing at fixed rates.

Foreign exchange

A portion of our revenues and cost of sales has a functional currency other than the Canadian dollar; accordingly we are exposed to foreign exchange rate risk inherent in our revenues and cost of sales. Fluctuations in exchange rates may harm our operations and could result in exchange losses. The impact of future exchange rate fluctuations cannot be predicted with certainty; however our exposure to foreign currency rate risk is primarily associated with fluctuations in the Euro, and the United States dollar.

Although the Company has the ability to address these risks through the use of options, futures and forward contracts, it currently has not entered into such arrangements to reduce these risks.

16. SEGMENTED INFORMATION

The Company is organized and managed as a single reportable business entity with two distinct revenue segments, being devices and services. The Company considers revenue or 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 June 30, 2008, the Company had \$489,486 (December 31, 2007 - \$388,337) of deferred revenues. Prior year's figures for revenue have been reclassified to conform to the current years' presentation for segmentation as follows:

	For the three months ended June 30		For the six months ended June 30	
	2008	2007	2008	2007
Revenues				
Devices	\$ 55,190	\$ 250,030	\$ 131,814	\$ 543,920
Services	129,746	70,839	247,419	187,734
	<u>\$ 184,936</u>	<u>\$ 320,869</u>	<u>\$ 379,233</u>	<u>\$ 728,654</u>