



*Consolidated Financial Statements of*

**Route1 Inc.**

*June 30, 2007*

*(Restated)*

The Company has prepared the unaudited interim consolidated balance sheets, statements of operations and deficit, and cash flows and notes thereto as at and for the three and six months ended June 30, 2007. 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, 2006 audited consolidated financial statements.

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Route1 Inc.

June 30, 2007

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## CONSOLIDATED BALANCE SHEETS

### Route1 Inc.

As at June 30, 2007 (Unaudited) and December 31, 2006

	June 30 2007	December 31 2006
	Restated, See Note 2	
<b>ASSETS</b>		
Current		
Cash and cash equivalents	\$ 2,419,686	\$ 1,486,364
Accounts receivable	727,319	546,244
Other receivables	13,076	18,324
Employee loans	64,657	53,657
Notes receivables	32,800	32,800
Inventory	625,514	508,047
Prepaid expenses	176,874	117,542
	<b>4,059,926</b>	<b>2,762,978</b>
Investments	75,003	75,003
Capital assets (note 3)	711,820	751,482
	<b>\$ 4,846,749</b>	<b>\$ 3,589,463</b>
<b>LIABILITIES</b>		
Current		
Accounts payable and accrued liabilities	\$ 1,292,648	\$ 1,331,690
Deferred revenue	351,880	165,995
Current portion of obligations under capital lease (note 4)	188,143	218,447
	<b>1,832,671</b>	<b>1,716,132</b>
Non current		
Deferred revenue	13,799	14,236
Obligations under capital lease (note 4)	7,942	90,869
	<b>1,854,412</b>	<b>1,821,237</b>
Commitments and Contingencies (note 6)		
<b>SHAREHOLDERS' EQUITY</b>		
Common shares (note 5)	19,849,050	13,065,386
Warrants (note 5)	3,409,582	5,277,983
Contributed surplus (note 5)	1,429,109	1,313,732
Deficit	(21,695,404)	(17,888,875)
	<b>2,992,337</b>	<b>1,768,226</b>
	<b>\$ 4,846,749</b>	<b>\$ 3,589,463</b>

# CONSOLIDATED STATEMENTS OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT

## Route1 Inc.

### For the three and six months ended June 30, 2007 and 2006 (Unaudited)

	Three Months Ended June 30, 2007	Three Months Ended June 30, 2006	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006
	Restated, See Note 2		Restated, See Note 2	
<b>Revenues</b>	<b>\$ 320,869</b>	\$ 153,746	<b>\$ 728,654</b>	\$ 280,816
<b>Cost of revenues</b>	<b>414,420</b>	418,207	<b>781,630</b>	806,444
<b>Gross margin (loss)</b>	<b>(93,551)</b>	(264,461)	<b>(52,976)</b>	(525,628)
<b>Expenses</b>				
General administration	635,465	745,180	1,110,200	1,351,140
Research and development	678,829	674,870	1,157,616	1,204,988
Selling and marketing	640,110	659,473	1,384,192	1,087,861
Amortization	74,323	81,669	136,025	168,324
	<b>2,028,727</b>	2,161,192	<b>3,788,033</b>	3,812,313
<b>Loss before the following items</b>	<b>(2,122,278)</b>	(2,425,653)	<b>(3,841,009)</b>	(4,337,941)
<b>Interest income</b>	<b>24,688</b>	16,123	<b>34,480</b>	25,747
<b>Loss from continuing operations</b>	<b>(2,097,590)</b>	(2,409,530)	<b>(3,806,529)</b>	(4,312,194)
<b>Income (loss) from discontinued operations</b>	<b>-</b>	-	<b>-</b>	457,000
<b>Net loss and comprehensive loss for the period (note 1)</b>	<b>(2,097,590)</b>	(2,409,530)	<b>(3,806,529)</b>	(3,855,194)
<b>Deficit, beginning of period</b>	<b>(19,597,814)</b>	(10,460,327)	<b>(17,888,875)</b>	(9,014,663)
<b>Deficit, end of period</b>	<b>\$ (21,695,404)</b>	\$ (12,869,857)	<b>\$ (21,695,404)</b>	\$ (12,869,857)
<b>Loss per share from continuing Operations</b>	<b>\$ (0.01)</b>	\$ (0.01)	<b>\$ (0.01)</b>	\$ (0.03)
<b>Loss per share</b>	<b>\$ (0.01)</b>	\$ (0.01)	<b>\$ (0.01)</b>	\$ (0.02)
<b>Weighted average number of common shares outstanding</b>	<b>280,138,402</b>	176,397,999	<b>269,764,770</b>	170,842,443

# CONSOLIDATED STATEMENTS OF CASH FLOW

## Route1 Inc.

### For the three and six months ended June 30, 2007 and 2006 (Unaudited)

	Three Months Ended June 30, 2007	Three Months Ended June 30, 2006	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006
	Restated, See Note 2		Restated, See Note 2	
<b>Net cash inflow (outflow) related to the following activities</b>				
Continuing operations				
Loss from continuing operations	\$ (2,097,590)	\$ (2,409,530)	\$ (3,806,529)	\$ (4,312,194)
Items not affecting cash				
Amortization	148,702	163,110	289,198	346,831
Stock based compensation	56,431	49,129	115,377	81,233
	<b>(1,892,457)</b>	<b>(2,197,291)</b>	<b>(3,401,954)</b>	<b>(3,884,130)</b>
Net changes in working capital balances				
Accounts receivable	(326,216)	(81,238)	(181,075)	16,678
Other receivables	9,147	(49,661)	5,248	(91,425)
Inventory	44,461	79,139	(117,467)	89,112
Prepaid expenses	(32,090)	(20,103)	(59,332)	(22,029)
Accounts payable and accrued liabilities	(20,834)	134,153	(39,042)	98,387
Deferred revenue	178,053	119,505	185,448	156,092
	<b>(2,039,936)</b>	<b>(2,015,496)</b>	<b>(3,608,174)</b>	<b>(3,637,315)</b>
Discontinued operations				
Net change in working capital balances	-	-	-	(457,000)
Income from discontinued operations	-	-	-	457,000
	-	-	-	-
Investing				
Employee loans	(5,000)	(47,366)	(11,000)	(40,102)
Acquisition of capital assets	(69,513)	(146,000)	(249,536)	(152,605)
Note receivables	-	55,000	-	73,000
	<b>(74,513)</b>	<b>(138,366)</b>	<b>(260,536)</b>	<b>(119,707)</b>
Financing				
Repayment of obligations under capital lease	(56,639)	(50,187)	(113,231)	(99,627)
Issuance of share capital – net	756,169	(3,263)	4,915,263	4,538,416
	<b>699,530</b>	<b>(53,450)</b>	<b>4,802,032</b>	<b>4,438,789</b>
<b>Net cash inflow (outflow)</b>	<b>(1,414,919)</b>	<b>(2,207,312)</b>	<b>933,322</b>	<b>681,767</b>
<b>Cash and cash equivalents, beginning of period</b>	<b>3,834,605</b>	<b>3,727,441</b>	<b>1,486,364</b>	<b>838,362</b>
<b>Cash and cash equivalents, end of period</b>	<b>\$ 2,419,686</b>	<b>\$ 1,520,129</b>	<b>\$ 2,419,686</b>	<b>\$ 1,520,129</b>
<b>Supplementary information</b>				
Capital assets financed under capital lease	\$ -	\$ 602,247	\$ -	\$ 602,247
Interest paid	\$ 2,411	\$ 1,909	\$ 5,162	\$ 4,989

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## Route1 Inc.

June 30, 2007 (Unaudited)

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### 1. BASIS OF PRESENTATION

These unaudited interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”) for interim financial reporting, and the accounting policies used, are consistent with the most recent annual consolidated financial statements. These unaudited interim consolidated financial statements do not contain all disclosures required by Canadian GAAP for annual consolidated financial statements, and accordingly, should be read together with the audited annual consolidated financial statements, accompanying notes and management discussion and analysis.

#### **Changes in accounting policies including initial adoption:**

On January 1, 2007, the Company adopted the following standards: CICA Sections 3855 “Financial Instruments – Recognition and Measurement”, and 1530 “Comprehensive Income”. These sections require certain financial instruments to be recorded at their fair value. They also introduce the concept of comprehensive income and accumulated other comprehensive income.

CICA Section 3855 “Financial Instruments – Recognition and Measurement” establishes standards for recognizing and measuring financial assets, financial liabilities and non-financial derivatives. All financial instruments must be classified into defined categories. This classification determines how each instrument is measured and how gains and losses are recognized. In addition, the recommendations define derivatives and embedded derivatives which meet certain criteria.

CICA Section 1530, “Comprehensive Income” introduces a statement of comprehensive income in the full set of interim and annual consolidated financials statements. Comprehensive income will present certain gains and losses outside net income.

The adoption of these standards was on a prospective basis with no retroactive restatement of prior periods and had no material impact on the unaudited interim consolidated financial statements. At present, the Company’s financial instruments comprise of the following:

- a. Cash and cash equivalents, accounts payable and accrued liabilities, and obligations under capital are classified as “Assets held for trading.” They are measured at fair value and the gains or losses resulting from the revaluation at the end of each period, are recognized in net earnings (loss).
- b. Accounts receivable, other receivable, employee loans, notes receivable are classified as “Loans and receivables”. They are recorded at cost, which upon their initial measurement is equal to their fair value. Subsequent measurements of accounts receivable, other receivable, employee loans, and notes receivable are recorded at amortized cost which usually corresponds to the amount initially recorded less any allowance for doubtful accounts or provisions.

There is no financial impact on these unaudited interim financial statements due to the adoption of the new accounting recommendations concerning financial instruments and other comprehensive income.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### Route1 Inc.

June 30, 2007 (Unaudited)

#### 2. RESTATEMENT

The Company has proceeded with a restatement of its second quarter unaudited interim consolidated financial statements as at and for the three months and six months ended June 30, 2007. The restatement of the Company's unaudited interim consolidated financial statements followed an internal review of the Company's revenue recognition policy. As a result of this review, it identified an overstatement of the consolidated revenues of \$167,224 and cost of revenues of \$82,233, and understatement of deferred revenues of \$167,224, and an understatement of its inventory of \$82,233.

The restated unaudited interim consolidated net loss for the three months and six months ended June 30, 2007 is \$2,097,590 and \$3,806,529 respectively, as compared to the previously reported unaudited interim consolidated net loss for the three months and six months ended June 30, 2007 of \$2,012,599 and \$3,721,538 respectively, resulting in a net increase in the net loss of \$84,991. The Company's restated unaudited interim consolidated basic net loss per share for the three months and six months ended June 30, 2007 is \$0.01 and \$0.01 respectively, and did not change as a result of the restatement.

#### 3. CAPITAL ASSETS

	June 30, 2007		
	Cost	Accumulated Amortization	Net Book Value
Furniture and equipment	\$ 233,848	\$ 156,964	\$ 76,884
Computer equipment	1,293,132	700,715	592,417
Computer software	578,648	576,218	2,430
Leasehold improvements	69,769	29,680	40,089
	<u>\$ 2,175,397</u>	<u>\$ 1,463,577</u>	<u>\$ 711,820</u>

  

	December 31, 2006		
	Cost	Accumulated Amortization	Net Book Value
Furniture and equipment	\$ 227,417	\$ 119,260	\$ 108,157
Computer equipment	1,052,272	510,104	542,168
Computer software	576,403	522,312	54,091
Leasehold improvements	69,769	22,703	47,066
	<u>\$ 1,925,861</u>	<u>\$ 1,174,379</u>	<u>\$ 751,482</u>

Included in computer equipment are assets held under finance leases with a cost of \$657,847 (December 31, 2006 - \$657,847), accumulated amortization of \$443,445 (December 31, 2006 - \$329,389) and net book value of \$214,402 (December 31, 2006 - \$328,458).

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### Route1 Inc.

June 30, 2007 (Unaudited)

#### 4. OBLIGATIONS UNDER CAPITAL LEASE

The Company has obligations under capital lease as follows:

	<b>June 30 2007</b>	December 31 2006
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	<b>\$21,232</b>	\$35,471
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	<b>81,068</b>	128,999
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	<b>73,119</b>	109,476
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	<b>10,384</b>	15,413
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	<b>18,900</b>	24,300
Computer equipment lease agreement in the amount of \$22,564, repayable in monthly instalments of \$2,199 including interest calculated at 5.4%, with a bargain purchase option at maturity on April 30, 2007	-	8,798
Total amount of future minimum lease payments	<b>204,703</b>	322,457
Executory costs and interest included in instalments	<b>8,618</b>	13,141
	<b>196,085</b>	309,316
Current portion	<b>188,143</b>	218,447
	<b>\$7,942</b>	\$90,869
Future minimum lease payments under the capital leases in each of the next three years are as follows:		
2007		\$105,216
2008		88,169
2009		2,700
		<b>\$196,085</b>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### Route1 Inc.

June 30, 2007 (Unaudited)

#### 5. SHARE CAPITAL

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

	<u>Shares</u>	<u>Amount</u>
Balance, January 1, 2007	241,707,617	\$ 13,065,386
Shares issued on exercise of warrants (a)	40,784,832	6,783,664
Balance, June 30, 2007	<u>282,492,449</u>	<u>\$ 19,849,050</u>

During the six months ended June 30, 2007, the following share transactions took place:

- a. 40,784,832 warrants were exercised for total proceeds of \$4,915,262. Included in the stated share capital amount is \$1,868,402 reallocated from contributed surplus as related to the valuation of the warrants exercised under the Black-Scholes option pricing model.

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

	<u>Six months ended June 30, 2007</u>		<u>Year ended December 31, 2006</u>	
	<u>Number of Options</u>	<u>Weighted Average Exercise Price</u>	<u>Number of Options</u>	<u>Weighted Average Exercise Price</u>
Options Outstanding				
Balance, beginning of the period	9,201,500	\$ 0.30	7,194,000	\$ 0.44
Options granted during the period	1,300,000	0.20	6,346,500	0.23
Options cancelled during the period	(1,447,500)	0.20	(4,339,000)	0.43
Balance, end of the period	<u>9,054,000</u>	<u>\$ 0.29</u>	<u>9,201,500</u>	<u>\$ 0.30</u>

Exercise Price	<u>Options Outstanding June 30, 2007</u>		<u>Options Exercisable June 30, 2007</u>	
	<u>Number of Options</u>	<u>Weighted Average Life (Years)</u>	<u>Number of Options</u>	<u>Weighted Average Life (Years)</u>
\$ 0.20	4,745,000	2.5	-	-
\$ 0.30	1,357,000	3.8	452,334	3.8
\$ 0.40	1,751,000	0.8	1,167,334	0.8
\$ 0.50	1,201,000	0.8	800,667	0.8
	<u>9,054,000</u>	<u>2.2</u>	<u>2,420,335</u>	<u>1.4</u>

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### Route1 Inc.

June 30, 2007 (Unaudited)

#### 5. SHARE CAPITAL (continued)

Exercise Price	Options Outstanding December 31, 2006		Options Exercisable December 31, 2006	
	Number of Options	Weighted Average Life (Years)	Number of Options	Weighted Average Life (Years)
\$ 0.20	4,545,000	3.0	-	-
\$ 0.30	1,474,500	4.3	-	-
\$ 0.40	1,891,000	1.3	1,103,084	1.3
\$ 0.50	1,291,000	1.3	753,084	1.3
	<u>9,201,500</u>	<u>2.7</u>	<u>1,856,168</u>	<u>1.3</u>

During the three and six months ended June 30, 2007, the Company recorded stock-based compensation expense of \$56,431 and \$115,377 (2006 - \$49,129 and \$81,233) 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:

	June 30, 2007	December 31, 2006
Risk free interest rate	4.5%	4%-4.5%
Expected life (years)	3.75	3.75-5.0
Expected volatility	100%	100%
Dividend yield	Nil	Nil
Weighted average fair value of options granted	<u>\$0.10</u>	<u>\$0.08</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 use of the fair value-based method for stock-based compensation arrangements.

#### *Warrants*

At June 30, 2007 there were 73,679,792 warrants outstanding with the following terms:

- a. 29,369,174 warrants expiring March 9, 2008 with an exercise price of \$0.155 per share.
- b. 44,310,618 warrants expiring September 20, 2008 with an exercise price of \$0.10 per share.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

### Route1 Inc.

June 30, 2007 (Unaudited)

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#### 6. COMMITMENTS AND CONTINGENCIES

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

2007	\$	71,000
2008		120,000
2009		125,000
2010		120,000
2011		12,000
		<u>12,000</u>
	\$	<u>448,000</u>

#### 7. SUBSEQUENT EVENTS

On July 17, 2007, the Company issued to an employee and directors 1,790,160 options to purchase common shares of the Company with an exercise price of \$0.205 per share.