

## **ROUTE1 INC.**

### **MANAGEMENT DISCUSSION AND ANALYSIS**

**FOR THE THIRD QUARTER ENDED SEPTEMBER 30, 2008**

**AS AT NOVEMBER 24, 2008**

The following discussion and analysis of the interim financial condition and results of operations (“MD&A”) of Route1 Inc. (also referred to as “we”, “us”, “our”, “Route1”, or the “Company”) is prepared in accordance with National Instrument 51-102F1, and has been reviewed and approved by the Company’s Board of Directors prior to filing and should be read in conjunction with the Company’s unaudited interim consolidated financial statements and related notes as at and for the three and nine months ended September 30, 2008, the Company’s audited annual consolidated financial statements and related notes as at and for the years ended December 31, 2007 and 2006, which have been prepared in accordance with Canadian Generally Accepted Accounting Principles (“GAAP”), and the Company’s annual management discussion and analysis dated April 28, 2008.

#### **FORWARD-LOOKING STATEMENTS**

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

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

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

## OVERVIEW

Route1 delivers award-winning security and identity management solutions to customers world-wide. These solutions provide universal, secure access to all digital resources and sensitive data. At the heart of Route1's solutions is MobiNET, a communications and service delivery platform focused on identity management and entitlement-based access to resources. Route1's patent-pending solutions are based on FIPS-140-2 cryptographic modules, and simplify the process of meeting increasingly stringent regulatory requirements around privacy and security.

## HIGHLIGHTS

- In July 2008, presented at the Qwest High Performance Networking Summit in Littleton, Colorado.
- In August 2008, participated with Qwest at the FAS/ITS 2008 Network Services Conference in Dallas, Texas. The Network Services Conference showcases the FAS/ITS portfolio of network services products, services and solutions. Federal, state and local IT professionals will become intimately familiar with the latest network technologies and services that are enabling a global, fully interoperable, secure, and seamless government network services infrastructure.
- In October 2008, Route1 announced it will deliver its highly secure identity management platform to the United States Customs and Border Protection (CBP), a part of the Department of Homeland Security (DHS). The initial three-year deal is valued in excess of \$2 million and is being delivered through Route1's reseller partner, Qwest Government Services Inc. under the Washington Interagency Telecommunications System (WITS) 2001 Crossover contract. This agreement is the beginning of a multi-year implementation and covers the license of a DEFIMNET™ with the first 500 TruOFFICE™ subscriptions included and delivered in September. DHS has the option to acquire up to 95,000 additional subscriptions for TruOFFICE and other Route1 services over the life of the contract on the initial hardware.
- In October 2008, Route1 announced the September delivery of an additional 1,438 Route1 MobiKEYs and TruOFFICE subscription-based services to the United States Customs and Border Protection (CBP), a part of the Department of Homeland Security (DHS). DHS will deploy these additional 1,438 MobiKEYs to their civilian agency workers who will be able to securely access their digital resources and sensitive data from anywhere, and at any time.
- In October 2008, Route1 announced that Cadillac Fairview selected Route1's TruOFFICE™ subscription-based service powered by its MobiNET™ for its disaster recovery and business continuity solution for its operational and management staff. This will allow Cadillac Fairview's operational and management staff to simply and securely connect to their digital resources from anywhere, at any time, as if they never left the office. In the event of any business disruption, whether it's a blackout, snow storm, transit failure or illness, staff members are able to seamlessly continue business operations from home using TruOFFICE.
- In November 2008, the company announced that it has entered into an Advisory Agreement with Spinnaker Capital Markets. Their focus will be on developing and expanding the network of investors, analysts and financial institutions interested in following the Route1 Inc growth and investment story.

## SELECTED FINANCIAL INFORMATION

The following table sets out selected unaudited interim financial information of the Company on a consolidated basis for the three and nine months ended September 30, 2008 and 2007.

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

	As at and for the three months ended				As at and for the nine months ended			
	Sept. 30, 2008	Sept 30, 2007	Change		Sept.30, 2008	Sept 30, 2007	Change	
			\$	%			\$	%
<b>STATEMENT OF OPERATIONS</b>								
Devices	\$ 287	\$ 43	\$ 244	567	\$ 419	\$ 587	\$ (168)	(29)
Services	171	92	79	86	418	276	142	51
Total revenues	458	135	323	239	837	863	(26)	(3)
Cost of revenues	287	254	33	13	646	1,035	(389)	(38)
Gross margin	171	(119)	290	244	191	(172)	363	211
<b>OPERATING EXPENSES</b>								
General and administrative	678	557	121	22	2,110	1,667	443	27
Research and development	413	564	(151)	(27)	1,538	1,722	(184)	(11)
Selling and marketing	344	500	(156)	(31)	1,057	1,884	(827)	(44)
Amortization	50	76	(26)	(34)	178	212	(34)	(16)
Loss before undernoted	(1,314)	(1,816)	502	(28)	(4,692)	(5,657)	965	(17)
Interest income	10	15	(5)	(33)	75	49	26	53
Net loss for the period	\$ (1,304)	\$ (1,801)	\$ 497	28	\$ (4,617)	\$ (5,608)	\$ 991	18
Loss per share	\$ (0.00)	\$ (0.01)	\$ 0.01	100	\$ (0.01)	\$ (0.02)	\$ 0.01	100
<b>CASH FLOW INFORMATION</b>								
Operating activities	\$ (1,328)	\$ (1,730)	\$ 402	23	\$ (4,637)	\$ (5,338)	\$ 701	13
Investing activities	(3)	-	(3)	(100)	(96)	(260)	164	63
Financing activities	99	85	14	16	15	4,887	(4,872)	(100)
Net cash inflow (outflow)	(1,232)	(1,645)	(413)	(25)	(4,718)	(711)	(4,007)	(564)
Cash, beginning of period	2817	2,420	397	16	6,303	1,486	4,817	324
Cash, end of period	\$ 1,585	\$ 775	\$ 810	105	\$ 1,585	\$ 775	\$ 810	105
<b>BALANCE SHEET INFORMATION AS AT SEPTEMBER 30</b>								
Working capital	\$ 2,162	\$ 803	\$ 1,359	169	\$ 2,162	\$ 803	\$ 1,359	169
Total assets	\$ 4,382	\$ 2,931	\$ 1,451	50	\$ 4,382	\$ 2,931	\$ 1,451	50
Obligation under capital lease	\$ 8	\$ 144	\$ (136)	(94)	\$ 8	\$ 144	\$ (136)	(94)
Shareholders' equity	\$ 2,403	\$ 1,443	\$ 960	67	\$ 2,403	\$ 1,443	\$ 960	67

## COMPARISON FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2008 TO THE THREE MONTHS ENDED SEPTEMBER 30, 2007

### Revenue

Revenues for the three months ended September 30, 2008 were \$458,075, an increase of \$323,297 or 239%, from \$134,778 for the same period in 2007.

Revenues from our device segment for three months ended September 30, 2008 were \$287,175, an increase of \$243,975 or 567%, from \$43,200 for the same period in 2007. During the current quarter, large quantities of devices (i.e. MobiKEYs) were sold to the Dutch Government's Ministry of Foreign Affairs and to the United States Government's Department of Homeland Security, Customs and Border Patrol Agency.

Revenues from our services segment for the three months ended September 30, 2008 were \$170,900, an increase of \$79,322 or 86%, from \$91,578 for the same period in 2007. The services revenue represents a combination of the new subscribers in the current quarter for MobiNET subscription-based services and renewed services from prior year, reflecting the Company's increasing MobiNET subscriber base.

Deferred revenue for the current quarter increased by \$853,473 to \$1,342,959 from \$489,486 as at June 30, 2008, this revenue will be recognized into income when such services are delivered and/or performed in future periods.

### **Gross Margin**

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

The cost of revenues increased by \$33,517 or 13% to \$287,190 for the three months ended September 30, 2008 as compared to \$253,673 for the same period in 2007. The increase can be mostly attributable to the large number of devices that were sold in the third quarter of 2008 as compared to 2007, offset in large part by a decrease in operating salaries and benefits as a result of a reduction in head count, and a reduction in the declining balance amortization expense as related to the computer hardware associated with operating the MobiNET.

Gross margin for the three months ended September 30, 2008 was \$170,885, representing an improvement of \$289,780, from a loss of \$118,895 for the same period in 2007. As discussed above, the improvement is directly related to the increase in device revenue net of the cost of these revenues.

### **Operating Expenses**

Operating expenses consist of general administration, research and development, selling and marketing, and amortization. Operating expenses for the three months ended September 30, 2008 were \$1,486,133, a decrease of \$211,197 or 12%, from \$1,697,330 for the same period in 2007; the decrease is discussed in detail below.

#### *General administration*

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

General administration expenses for the three months ended September 30, 2008 were \$679,203, an increase of \$122,327 or 22%, from \$556,876 for the same period in 2007 and can be summarized as follows:

- Professional fees increased by approximately \$56,000 for the three months ended September 30, 2008 from the same period in 2007;
- Salaries and benefits increased by approximately \$19,000 for the three months ended September 30, 2008 from the same period last year, this is attributed to cost of living adjustments made to salaries in 2008 as well as stock-based compensation increases;
- Legal and accounting fees increased by approximately \$57,000 due to various regulatory and legal matters; and
- Other overhead type expenses such as telephone, postage & courier and computer related expenses along with exchange gains on foreign currency transactions decreased by approximately \$10,000 from the same period last year

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### *Research and development*

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

Research and development expenses for the three months ended September 30, 2008 were \$412,754, a decrease of \$151,344 or 27%, from \$564,098 for the same period in 2007 and can all be attributed to:

- a decrease in salaries and benefits expenses as a result of a decrease in head count in this department.

### *Selling and marketing*

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

Selling and marketing expenses for the three months ended September 30, 2008 were \$344,023, a decrease of \$156,430 or 31%, from \$500,453 for the same period in 2007 and can be summarized as follows:

- Salaries and benefits decreased by approximately \$41,000 for the three months ended September 30, 2008 from the same period in the previous year, this is attributed to a decrease in head count in this department and the salaries and benefits associated with such;
- No agent fees were paid during for the three months ended September 30, 2008 resulting in a decrease of approximately \$43,000 from the same period in the previous year, this is attributed to the termination of these relationships during the latter part of 2007;
- Marketing costs decreased by approximately \$60,000 for the three months ended September 30, 2008, from the same period in the previous year. This is attributed to the timing of the annual report and AGM expenses which were recorded in the second quarter this year and in the third quarter in the previous year, as well as savings in investor relations expenses and lead generation expenses;
- Travel, meals and entertainment decreased by approximately \$28,000 for the three months ended September 30, 2008 from the same period in the previous year, this is attributed to a decrease in head count in this department and the expenses associated with those employees travel and entertainment;
- Product giveaways expense decreased by approximately \$13,000 from the same period in the previous year; and
- Sales commissions' expense increased by approximately \$13,000 for the three months ended September 30, 2008 from the same period in the previous year, due to higher revenues in the current quarter as compared to the same period in the prior year.

### *Amortization*

Amortization expense for the three months ended September 30, 2008 was \$50,153, a decrease of \$15,753, from \$75,906 for the same period in 2007 due to a reduction in the calculation of amortization expense using the declining-balance method.

### *Interest income*

Interest income for the three months ended September 30, 2008 was \$10,796, a nominal decrease of \$3,982, from \$14,778 for the same period in 2007. This decrease was primarily due to lower average cash balance in the three months ended September 30, 2008 compared to the same period in the previous year, resulting in a decrease of \$6,787 offset by the interest recorded on the notes receivable of \$2,805 for the three months ended September 30, 2008.

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## Net loss

Net loss from for the three months ended September 30, 2008 was \$1,304,452 or \$nil per share, an improvement of \$496,995, or 28%, from a net loss of \$1,801,447 or \$0.01 per share for the same period in 2007.

## COMPARISON FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2008 TO NINE MONTHS ENDED SEPTEMBER 30, 2007

### Revenue

Revenues for the nine months ended September 30, 2008 were \$837,309, a decrease of \$26,123 or 3%, from \$863,432 for the same period in 2007.

Revenues from our device segment for nine months ended September 30, 2008 were \$418,989, a decrease of \$168,131 or 29%, from \$587,120 for the same period in 2007. In the prior year, large quantities of devices (i.e. MobiKEYs) were sold to two customers totaling approximately \$337,000 which did not recur in the current periods. Increased sales during the third quarter of current year offset some of last year's decreases as large quantities of devices were sold to Dutch Government's Ministry of Foreign Affairs and the United States Government's Department of Homeland Security, Customs and Border Patrol Agency totaling approximately \$167,000.

Revenues from our services segment for the nine months ended September 30, 2008 were \$418,320, an increase of \$142,008 or 51%, from \$276,312 for the same period in 2007. The services revenue represents a combination of the new subscribers for the nine months ended September 30, 2008 for MobiNET subscription-based services and renewed services from prior year, reflecting the Company's increasing MobiNET subscriber base.

### Gross Margin

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

The cost of revenues decreased by \$388,973 or 38% to \$646,330 for the nine months ended September 30, 2008 as compared to \$1,035,303 for the same period in 2007 and can be mostly attributable to the reduced number of devices that were sold in the first nine months of 2007 as compared to the same period in 2008, plus a decrease in operating salaries and benefits as a result of a reduction in head count, and a reduction in amortization expense as related to the computer hardware associated with operating the MobiNET.

Gross margin for the nine months ended September 30, 2008 was \$190,979, an improvement of \$362,850, from a loss of \$171,871 for the same period in 2007. As discussed above the improvement is related to the decrease in device revenue net of the cost of these revenues.

### Operating Expenses

Operating expenses consist of general administration, research and development, selling and marketing, and amortization. Operating expenses for the nine months ended September 30, 2008 were \$4,883,542, a decrease of \$601,821 or 11%, from \$5,485,363 for the same period in 2007; the decrease is discussed in detail below.

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### *General administration*

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

General administration expenses for the nine months ended September 30, 2008 were \$2,110,518, an increase of \$443,445, or 27%, from \$1,667,073 for the same period in 2007 and can be summarized as follows:

- Salaries and benefits increased by approximately \$70,000 for the nine months ended September 30, 2008 from the same period last year;
- Stock-based compensation expense increased by approximately \$44,000 for the nine months ended September 30, 2008 from the same period last year;
- Legal and accounting fees increased by approximately \$206,000 for the nine months ended September 30, 2008 due to various regulatory and legal matters;
- Professional fees increased by approximately \$168,000 for the nine months ended September 30, 2008; and
- Other overhead type expenses such as telephone, postage & courier and computer related expenses along with exchange gains on foreign currency transactions decreased by approximately \$44,000 from the same period last year.

### *Research and development*

Research and development expenses consists of salaries and benefits for the research and development department, and other professional fees associated with sub-contracting of some of the development work.

Research and development expenses for the nine months ended September 30, 2008 were \$1,538,195, a decrease of \$183,519 or 11%, from \$1,721,714 for the same period in 2007 and can be summarized as follows:

- Salaries and benefits decreased by approximately \$219,000 for the nine months ended September 30, 2008 from the same period the preceding year, this is attributed to a net decrease in head count in this department and the salaries and benefits associated with such.
- Other professional fees increased approximately \$36,000 for the nine months ended September 30, 2008 from the same period the preceding year, as an offset to assist in the development work that would have normally been carried out by employees.

### *Selling and marketing*

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

Selling and marketing expenses for the nine months ended September 30, 2008 were \$1,056,971, a decrease of \$827,674 or 44%, from \$1,884,645 for the same period in 2007 and can be summarized as follows:

- Salaries and benefits decreased by approximately \$366,000 or 36% for the nine months ended September 30, 2008 from the same period in the previous year, this is attributed to a decrease in head count in this department and the salaries and benefits associated with such;

- No agent fees were paid during for the nine months ended September 30, 2008 resulting in a decrease of approximately \$141,000 from the same period in the previous year, this is attributed to the termination of these agreements in 2007;
- Marketing and tradeshow decreased by approximately \$100,000 for the nine months ended September 30, 2008, from the same period in the previous year, this is attributed to two less tradeshow attended to date during 2008 compared to the same period in the previous year and reduction in consulting fees;
- Travel, meals and entertainment decreased by approximately \$135,000 for the nine months ended September 30 from the same period in the previous year, this is attributed to a decrease in head count of sales personnel in this department and the travel to two fewer trade-shows during this current period;
- Sales commissions' expense decreased by approximately \$59,000 for the nine months ended September 30, 2008 from the same period in the previous year, due to changes in the compensation program in the current period as compared to the same period in the prior year; and
- Product giveaways expense decreased by approximately \$26,000 from the same period in the previous year.

#### *Amortization*

Amortization expense for the nine months ended September 30, 2008 was \$177,858, a decrease of \$34,073, from \$211,931 for the same period in 2007. The decrease can be attributed to some computer hardware assets becoming fully amortized since last year, and due to a reduction in the calculation of amortization expense using the declining-balance method.

#### *Interest income*

Interest income for the nine months ended September 30, 2008 was \$75,417, an increase of \$26,159, from \$49,258 for the same period in 2007, primarily due to a higher average cash balance for the nine months ended September 30, 2008 as a result of a private placement completed in November 2007 as compared to a private placement completed in March 2006, and from \$8,415 of interest recorded on the notes receivable for the current period.

#### **Net loss**

Net loss from for the nine months ended September 30, 2008 was \$4,617,146 or \$0.01 per share, an improvement of \$990,830, or 18%, from a net loss of \$5,607,976 or \$0.02 per share for the same period in 2007.

## SUMMARY OF QUARTERLY RESULTS

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

	As at and for the three months ended							
	<i>(in thousand of Canadian dollars, except per share data)</i>							
	Sep 30 2008	June 30 2008	Mar 31 2008	Dec 31 2007	Sep 30 2007 <sup>(1)</sup>	Jun 30 2007 <sup>(1)</sup>	Mar 31 2007	Dec 31 2006
<b>STATEMENT OF OPERATIONS</b>								
Devices	\$287	\$55	\$78	\$46	\$43	\$251	\$294	\$4
Services	171	130	116	98	92	70	114	79
Total revenues	458	185	194	144	135	321	408	83
Cost of revenues	287	183	176	257	254	415	367	228
Gross (loss) margin	171	2	18	(113)	(119)	(94)	41	(145)
<b>OPERATING EXPENSES</b>								
General and administrative	678	714	717	667	557	635	475	1,019
Research and development	413	543	582	523	564	679	479	565
Selling and marketing	344	386	328	424	500	640	744	1,050
Amortization	50	62	66	72	76	74	62	48
Loss before under noted	(1,314)	(1,703)	(1,675)	(1,799)	(1,816)	(2,122)	(1,719)	(2,827)
Write-off of investment	-	-	-	(75)	-	-	-	-
Interest income	10	23	42	18	15	25	10	25
Net loss for the period	\$(1,304)	\$(1,680)	\$(1,633)	\$(1,856)	\$(1,801)	(2,097)	(1,709)	\$(2,802)
Loss per share	\$(0.00)	\$(0.00)	\$(0.00)	\$(0.00)	\$(0.01)	\$(0.01)	\$(0.01)	\$(0.01)
<b>CASH FLOW INFORMATION</b>								
Operating activities	\$(1,328)	\$(1,784)	\$(1,526)	\$(1,381)	\$(1,730)	\$(2,040)	\$(1,568)	\$(2,410)
Investing activities	(3)	(47)	(46)	(75)	-	(75)	(186)	43
Financing activities	99	(30)	(54)	6,984	85	700	4,103	(81)
Net cash inflow (outflow)	(1,232)	(1,861)	(1,626)	5,528	(1,645)	(1,415)	2,349	(2,448)
Cash, beginning of period	2,817	4,677	6,303	775	2,420	3,835	1,486	3,935
Cash, end of period	\$1,585	\$2,816	\$4,677	\$6,303	\$775	\$2,420	\$3,835	\$1,486
<b>BALANCE SHEET INFORMATION</b>								
Working capital	\$2,162	\$3,262	\$4,807	\$6,196	\$718	\$2,227	\$3,465	\$1,047
Total assets	\$4,382	\$5,028	\$6,778	\$8,325	\$3,013	\$4,847	\$6,031	\$3,589
Shareholders' equity	\$2,403	\$3,552	\$5,167	\$6,652	\$1,358	\$2,992	\$4,277	\$1,768

*Note:*

(1) Restated

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

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## LIQUIDITY AND CAPITAL RESOURCES

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

### *Cash flow used in continuing operating activities*

Cash flow used by operating activities for the three months ended September 30, 2008 was \$1,328,087, compared to \$1,730,006 in the same period in 2007, representing an improvement of \$401,919. Cash used by the underlying day to day operations for the three months ended September 30, 2008 improved by \$460,945 as compared to the same period in the prior year, which was offset by an increase in cash used in non-cash working capital activities of \$59,026, such as increases in accounts receivable of \$913,382, increase in cash used by accounts payable of \$190,309, offset by cash used in purchasing inventory of \$143,527, prepaids of \$44,160, deferred revenues of \$840,081 and other receivables of \$14,470.

Cash flow used by operating activities for the nine months ended September 30, 2008 was \$4,637,918, compared to \$5,338,180 in the same period in 2007, representing an improvement of \$700,262. Cash used by the underlying day to day operations for the nine months ended September 30, 2008 improved by \$987,296 as compared to the comparable period in the prior year, which was offset by an increase in cash used in non-cash working capital activities of \$287,034, such as increases in accounts receivable of \$542,454, inventory by \$134,800, prepaids by \$6,105, and by cash used by accounts payable of \$367,485, offset by deferred revenue of \$755,782 and other receivables of \$8,028.

### *Cash flow used in investing activities*

Cash flow used in investing activities for the three months ended September 30, 2008 was \$2,805, compared to \$443 in the same period in 2007, representing a increase of \$2,362. The majority of the increase can be attributed to interest of notes receivable of \$2,805 offset by a decrease in employee loans and the acquisition of capital assets.

Cash flow used in investing activities for the nine months ended September 30, 2008 was \$95,978, compared to \$260,093 in the same period in 2007, representing a decrease of \$164,115. The majority of the decrease can be attributed to a reduction in the acquisition of capital assets of \$186,364, offset by an increase for advance on notes receivable of \$22,249.

### *Cash flow provided by financing activities*

Cash flow provided by financing activities for the three months ended September 30, 2008 was \$99,252, compared to cash provided of \$84,916 for the same period in 2007, representing an increase in cash provided of \$14,336. This was due to a decrease in obligations to capital lease of \$51,837 compared to the same period in 2007 offset by a decrease to warrants that were exercised during the third quarter of 2008 of \$37,500.

Cash flow provided by financing activities for the nine months ended September 30, 2008 was \$15,429, compared to cash provided of \$4,886,948 for the same period in 2007, representing a decrease of \$4,871,519, due to net proceeds from warrants that were exercised during the same period in 2007 for \$5,052,763 compared to \$98,356 in the nine months ended September 30, 2008.

The cash position of the Company at September 30, 2008 was \$1,584,884 compared to \$6,303,351 at December 31, 2007. Current assets at September 30, 2008 were \$4,133,105 compared to \$7,854,557 at December 31, 2007. Working capital decreased by \$4,018,283 to \$2,177,994 as of September 30, 2008, from \$6,196,277 as of December 31, 2007.

The current business plan contemplates continued revenue growth in the last quarter of 2008 and into 2009, attributable primarily to an increase in the number of devices sold to customers combined with an increase in the services subscriber base. The Company believes that its recent announcement of its transaction with the United States Department of Homeland Security will lead to future opportunities within other departments in the United States Government and also abroad with other governments. Management believes that existing cash resources and cash generated from its current business plan is sufficient to fund operations in the short term, however the Company has maintained its rationalization plan which it started earlier this year for its operations and exploring other possible sources of financing.

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

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

The following table discloses future payments as at September 30, 2008 committed by the Company over the next five (5) years. It includes both principal and interest obligation required under capital lease agreements and all other current contractual commitments.

Contractual Obligations	Payment Due by Period				
	Total	Less than 1 year	1 – 3 years	4 – 5 years	After 5 years
Obligations under capital leases	\$ 7,942	\$ 7,942	\$ -	\$ -	\$ -
Operating leases	167,000	52,000	115,000	-	-
Total contractual obligations	\$ 174,942	\$ 59,942	\$ 115,000	\$ -	\$ -

#### OFF-BALANCE SHEET ARRANGEMENTS

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

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## TRANSACTIONS WITH RELATED PARTIES

The Company had the following transactions and/or outstanding amounts with related parties as at or for the nine months ended September 30, 2008:

- Exercise of warrants by an employee on July 10, 2008 of 1,000,000 shares at \$0.10 per share for proceeds of \$100,000.
- \$85,000 advanced in terms of a promissory note dated January 8, 2008 to an officer of the Company, secured and repayable no later than December 28, 2009 with interest at 6%.
- \$60,000 full repayment of a note on January 7, 2008 by an officer of the Company.
- \$1,833 full repayment of a note on January 15, 2008 by an employee of the Company.
- \$52,000 advance in terms of a promissory note dated December 27, 2007 to an officer of the Company, secured and repayable no later than December 15, 2008 with interest at 6%.
- \$50,000 advance in terms of a promissory note dated December 28, 2007 to an officer of the Company, secured and repayable no later than December 28, 2008 with interest at 6%.

## PROPOSED TRANSACTIONS

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

## CRITICAL ACCOUNTING ESTIMATES

The Company's consolidated financial statements for the three and nine months ended September 30, 2008 have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). Management makes certain estimates and relies on certain assumptions relating to reporting the Company's assets and liabilities as well as operating results in order to prepare the consolidated financial statements in conformity with Canadian GAAP. On an on-going basis, the Company evaluates its estimates and assumptions including those related to revenue, the valuation of accounts receivable, the estimation of useful lives of the various classes of capital assets, investments, stock-based compensation expense, and the measurement of income tax valuation allowances. Actual results could differ from those estimates, which are as follows:

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

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## CHANGES IN ACCOUNTING POLICIES INCLUDING INITIAL ADOPTION

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.

### *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.

### **FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS**

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.

#### *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.

#### *Fair Value*

As at September 30, 2008, the carrying values of accounts receivable, other receivables, notes receivable, accounts payable and accrued liabilities approximate their fair values due to their immediate or short-terms to maturity. The carrying amount of cash and cash equivalents, classified as held-for-trading, approximates

cost, due to the short term nature of these instruments. The fair value of the investments in equity instruments classified as available for sale, specifically the Company's investment in Hypernet Inc, is estimated based on discounted revenue analysis to be \$1. Due to the use of judgment and uncertainties in the determination of estimated fair values, these values should not be interpreted as being realizable in the immediate term.

## **OTHER MD&A REQUIREMENTS**

### *Disclosure of Outstanding Share Data*

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

- 350,388,115 common shares issued and outstanding
- 36,243,573 common share purchase warrants ("Warrants")
  - 36,243,573 Warrants at \$0.155/share expiring November 6, 2009
- 6,263,660 common share purchase options ("Options") issued under the Company's stock option plan
  - 923,500 Options issued on April 27, 2006 at \$0.30/share expiring April 27, 2011
  - 1,385,000 Options issued on October 12, 2006 at \$0.20/share expiring January 12, 2010
  - 1,790,160 Options issued on July 12, 2007 at \$0.205/share expiring July 16, 2012
  - 1,040,000 Options issued on December 19, 2007 at \$0.125/share expiring March 19, 2011
  - 1,125,000 Options issued on February 21, 2008 at \$0.08/share expiring February 21, 2013

### *Risk Factors and Uncertainty*

Although management has a confident outlook for the Company and continually improves and adapts the Company's risk mitigation strategies, operating in the technology industry inherently involves a certain level of risk and uncertainty. The Company continues to expand and refine management controls, reporting systems, cost controls, and overall policies and procedures to minimize the impact of potential risks and uncertainties. In management's opinion, the following factors, among others, should be considered when evaluating the Company's business and its results of future operations:

- There is no assurance that any forward-looking statement will materialize.
- The results or events predicted herein may differ from the actual results or events.
- Unless otherwise indicated, forward-looking statements describe expectations as of the date of this document.
- Route1 disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.
- Route1 had a working capital surplus at September 30, 2008 of \$2,162,244, which may not be sufficient to support current operating levels and growth objectives for the current fiscal year;
- Third-party claims for infringement of intellectual property rights by Route1, and the outcome of any litigation with respect thereto, that could harm the Company's competitive advantage in the secure remote access industry;
- Route1's ability to successfully obtain patent or other proprietary or statutory protection for its technologies and products, that could also harm the Company's competitive advantage in the secure remote access industry;
- Route1's ability to obtain rights to use software or components supplied by third parties, which may not be sufficient to support future sales volumes;
- Route1's ability to enhance current products and develop and introduce new products; that could hinder the Company's continued growth;
- The efficient and uninterrupted operation of Route1's MobiNET, which could impact on the credibility of the Company's product and services;

- Route1's ability to establish new, and to build on existing its existing customer base, that could also hamper the Company's continued growth;
- The occurrence or perception of a breach of Route1's secure product and service offering, or an inappropriate disclosure of confidential information, which could also impact on the credibility of the Company's product and services;
- Intense competition within the secure remote access industry; that could hamper future sales volumes;
- Route1's reliance on its suppliers and the risk that suppliers will not be able to deliver components on a timely basis, which may not be sufficient to support future sales volumes;
- Effective management of growth and on-going development of the business;
- The market price of the Routel's common shares could be subject to wide fluctuations in response to Route1's financial results, changes in earnings estimates by analysts, changing conditions in the identity access management sector or changes in general market, economic or political conditions;
- Route1's articles permit the issuance of an unlimited number of common shares and if the Company was to issue a significant number of common shares, it would reduce the relative voting power of previously outstanding common shares. Such future issuances could be at prices less than the shareholders paid for their common shares of the Company. Significant issuance of Route1's common shares, or the perception that such issuances may occur, could impact, negatively or otherwise, the trading price of Route1's common shares;
- As of the date hereof, Route1's directors and executive officers and entities affiliated with them owned approximately 15% of the outstanding share of common shares, not including options or warrants to purchase shares of common shares. As a result, these shareholders, acting together, would be able to influence or control matters requiring approval by our shareholders, including the election of directors, the adoption of equity incentive plans and the approval of mergers or other extraordinary transactions. These shareholders may have interests that differ from shareholders with smaller holdings. The concentration of ownership of Route1's common shares could have the effect of delaying, preventing or deferring a change in control of Route1, deprive its shareholder of an opportunity to receive a premium for their common shares as part of a sale of Route1 and affect the market price of its common shares;
- Government regulation of secure remote access industry, including but not limited to restrictions on encryption of MobiKEY and the MobiNET.

#### *Audit Committee*

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

#### *Legal proceedings*

The Company filed Statements of Claim against certain reseller customers relating to non-payment of invoices. The reseller customers have maintained that based on non-sanctioned verbal representations made to them by certain employees of the Company who are no longer employed with the Company; they were not obligated to make payment in accordance with the terms of the written binding purchase agreements. As reflect in the Statements of Claim, the reseller customers entered into binding written agreements with Route1 to purchase MobiKEYs that were delivered in 2007 for which revenue of approximately \$333,000 was recorded during 2007 on the strength of these agreements. In April 2008, the Company successfully resolved one of these claims which represented approximately 1/2 of such amount.

#### *Subsequent Events*

Subsequent to September 30, 2008, the Company has received payment on \$996,113 of the accounts receivable outstanding as at September 30, 2008.

*Additional Information*

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