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**ROUTE1 INC.****MANAGEMENT'S DISCUSSION AND ANALYSIS****FOR THE THREE MONTHS AND YEAR ENDED DECEMBER 31, 2016****As at April 13, 2017**

The following discussion and analysis of the financial condition and results of operations (this “**MD&A**”) of Route1 Inc. (also referred to as “**we**”, “**us**”, “**our**”, “**Route1**”, or the “**Company**”), should be read in conjunction with the Company’s interim condensed consolidated financial statements and related notes as at and for the year ended December 31, 2016. The Company’s 2016 audited consolidated financial statements and the accompanying notes form part of the annual audited consolidated financial statements to be prepared in accordance with the International Financial Reporting Standards (“**IFRS**”).

This Management Discussion & Analysis (“**MD&A**”) has been reviewed and approved by the Company’s Board of Directors prior to filing.

The information in this MD&A is current to April 13, 2017, unless otherwise noted.

**FORWARD-LOOKING STATEMENTS**

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

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

eight quarters, and details of related party transactions. The Company does not believe that any of the additional information provided, and that has not been otherwise disclosed in other filings, is material in nature.

## **INTELLECTUAL PROPERTY NOTICES**

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The DEFIMNET and MobiNET platforms, the MobiKEY, MobiKEY Classic, MobiKEY Classic 2, MobiKEY Classic 3, MobiKEY Fusion, MobiKEY Fusion2, and MobiKEY Fusion3 devices, and MobiLINK are protected by U.S. Patents 7,814,216, 7,739,726, 9,059,962, 9,059,997 and 9,319,385, Canadian Patent 2,578,053, and other patents pending. The MobiKEY Classic 2 and MobiKEY Classic 3 devices are also protected by U.S. Patents 6,748,541 and 6,763,399, and European Patent 1001329 of Aladdin Knowledge Systems Ltd. and used under license. Other patents are registered or pending in various countries around the world. Route1 Inc. is the owner of, or licensed user of, all copyright in this document, including all photographs, product descriptions, designs and images. No part of this document may be reproduced, transmitted or otherwise used in whole or in part or by any means without prior written consent of Route1 Inc.

## **OVERVIEW**

Route1 delivers industry-leading security and identity management solutions to corporations and government agencies that need universal, secure access to all digital resources and sensitive data. These customers depend on The Power of MobiNET - Route1's communications and service delivery platform. MobiNET provides identity assurance and individualized access to networks and data. Route1's patented solutions simplify the process of meeting increasingly stringent regulatory requirements for privacy and security.

## **HIGHLIGHTS**

- On January 14, 2016, the Company announced that the U.S. Department of the Interior (DOI), after completing its accreditation process, issued an authority to operate (ATO) for the MobiKEY technology and the DEFIMNET platform that the U.S. Fish and Wildlife Service (FWS) installed at a secure DOI hosting facility in March 2015.
- On January 28, 2016, the Company provided an operations update as follows:
  - As of December 31, 2015, Route1 had 16,286 paying, active subscribers. An increase of 297 subscribers from the quarter ended September 30, 2015 and an increase of 1,494 users from December 31, 2014.
  - Route1 continued to see strong interest in its MobiKEY technology from civilian, intelligence and defense components within the U.S. government. As announced on January 14, 2016 the U.S. Department of the Interior, after completing its accreditation process, issued an authority to operate for the MobiKEY technology and the DEFIMNET platform. The Company has been working with the U.S. Fish and Wildlife Service (FWS) to harden and deploy updates to the DEFIMNET

infrastructure to bring it fully online, and is in the process of swapping out MobiKEY Fusion devices for the latest generation MobiKEY Fusion3 devices. The reported June 2015 data breaches at the Office of Personnel Management has had a renewed interest in the MobiKEY technology from certain components of the U.S. government including the Office of the CIO with the Department of Commerce; a number of components with the Department of Agriculture (USDA) have engaged Route1 in the potential use and procurement of MobiKEY; and, most recently, Route1 advanced an active pilot with the Transportation Security Administration (TSA), a component of the U.S. Department of Homeland Security. Route1 continues to benefit from growing awareness of MobiKEY within the U.S. Department of Defense (DOD). During the 2015 calendar year, Route1 worked with a number of groups within the U.S. Air Force, the U.S. Marine Corps, and a component of the U. S. Army that is leading a Certificate of Networthiness accreditation process to use the MobiKEY technology on the U.S. Army network.

- An announcement of certain product development updates including releases during the fourth quarter of 2015 and planned technology releases during the first quarter of 2016.
  - The newly announced NCIB on September 22, 2015 has had a total of 2,592,000 common shares purchased for cancellation, as of December 31, 2015
- On March 16, 2016, the Company announced that the MobiKEY technology is now available on GSA IT Schedule 70 through Patriot Technologies, Inc. Purchases of the MobiKEY solution and related products can now be made using GSA Schedule Number GS-35F-4363D on GSA Advantag!® website. At the same time, the Company also announced the release of its latest version of MobiKEY for iOS – version 5.0. As found in the Apple App Store, there are three MobiKEY apps – Route1 MobiKEY, MobiKEY A2T and MobiKEY TAC.
  - On April 5, 2016, the Company announced its fourth quarter and full year financial results. Along with the fourth quarter and full year financial results the company provided an update on the Normal Course Issuer Bid (“NCIB”). The NCIB announced on September 22, 2015 has had a total of 4,357,000 common shares repurchased for cancellation as of March 31, 2016.
  - On April 19, 2016, the Company provided an operations update as follows:
    - As of March 31, 2016, Route1 had 16,490 paying, active subscribers. An increase of 204 subscribers from the quarter ended December 31, 2015 and an increase of 1,478 users from March 31, 2015.
    - The Company announced a number of vendor days, conferences, webinars and tradeshow it will be attending over the next 90 days.
    - The NCIB announced on September 22, 2015 has had a total of 4,495,000 common shares purchased for cancellation, as of April 15, 2016.
  - On May 12, 2016, the Company announced its first quarter financial results. Along with the first quarter financial results the company provided an update on the Normal Course Issuer Bid (“NCIB”). The NCIB announced on September 22, 2015 has had a total of 7,746,000 common shares repurchased for cancellation as of May 4, 2016.
  - On May 17, 2016, the Company announced a total of 2,350,000 stock options at an exercise price of \$0.05 per share were recently granted to Yamian Quintero, the Company’s Chief Technology Officer. The stock options will expire on May 13, 2021 and will vest thirty percent on the first anniversary, thirty percent on the second anniversary and the remainder on the third anniversary.

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- On August 3, 2016, the Company provided an operations update as follows:
    - As of June 30, 2016, Route1 had 16,800 paying, active subscribers. An increase of 310 subscribers from the quarter ended March 31, 2016 and an increase of 1,390 users from June 30, 2015.
    - Cybersecurity initiatives within the U.S. government continue to create substantial deployment opportunities for Route1’s suite of patented technology solutions. After the close of Q2 2016 Route1 received purchase orders from (i) a component of the DOD for 2,000 MobiKEY Fusion3 devices; the devices will replace certain of the client’s MobiKEY Fusion and MobiKEY Fusion2 devices, and (ii) the Navy Bureau of Medicine and Surgery (BUMED) for 100 MobiKEY Fusion3 devices and 100 MobiKEY application software subscribers with contractual options to expand the BUMED user base to 300 subscribers. Further, Route1 has been working with a new branch of the U.S. Armed Forces to set up the MobiKEY technology on an enterprise-wide contract vehicle. Route1 anticipates the contracting process to be complete by no later than early Q4 2016. Upon MobiKEY being available for procurement, Route1 expects sales in the first 90 days of 100-250 users and additional further growth on a monthly basis similar to our experience with the U.S. Department of the Navy.
    - On August 9, 2016, Route1 will release MobiENCRYPT, a new Route1 technology offering that enables a secure mobile workforce by leveraging identity card-based credentials to protect government organizations from data-at-rest loss and security breaches.
    - In September 2016 Route1 will release its first standalone user authentication offering. The offering will enhance authentication via mobile devices with the levels of security necessary for U.S. government. Route1’s release of this offering is in response to a user shift towards greater mobility and BYOD, and the fact that physical smart cards are an inconvenience for the user when using a mobile device.
    - On July 8, 2016, Route1 released MobiKEY for Android 5.0 and MobiKEY A2T for Android 5.0. MobiKEY A2T for Android 5.0. Planned MobiKEY application software releases for during the remainder of the 2016 year are (i) MobiKEY for Android 5.1 and MobiKEY A2T for Android 5.1: Support for Android 5.x and 6.x, and support for Android 4.4 and 5.x with Knox 2.x respectively, and (ii) MobiKEY 5.2: New desktop management protocol, support of audio in both directions
    - The NCIB announced on September 22, 2015 has had a total of 12,144,000 common shares purchased for cancellation, as of August 1, 2016.
  - On August 9, 2016, the Company announced the launch of MobiENCRYPT, a hardware solution delivering remote and local full disk encryption (FDE) access that exceeds the most stringent government and military privacy and security standards. MobiENCRYPT enables a secure mobile workforce by leveraging identity card-based credentials to protect government organizations from data-at-rest loss and security breaches. MobiENCRYPT integrates with government-issued CAC and PIV identity card technology, offering true multi-factor authentication. The technology provides fast and seamless pre-boot authentication that allows government employees to access their workspaces quickly, without compromising on security.
  - On August 11, 2016, the Company announced its second quarter financial results. Along with the second quarter financial results, it was announced that effective August 29, 2016, Peter Chodos will become Route1’s Executive Vice President and Chief Financial Officer. Concurrent with Peter’s appointment as Route1’s CFO, Louis De Jong will join Route1’s Audit Committee, Mark Boensel will take over the role of Chair of the Compensation Committee and David Fraser will join the Compensation Committee. Peter will continue to be a member of Route1’s Board of Directors but will no longer serve as an independent Director.
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- On August 30, 2016, the Company announced a total of 2,525,000 stock options at an exercise price of \$0.05 per share were recently granted to Peter Chodos, the Company's Executive Vice President and Chief Financial Officer. The stock options will expire on August 29, 2021 and will vest thirty percent on the first anniversary, thirty percent on the second anniversary and the remainder on the third anniversary.
  - On September 16, 2016, the Company announced that it had provided the TSX Venture Exchange its Notice of Intention to move forward with a further NCIB, subject to approval by the Exchange. The notice provides that Route1 may, during the 12 month period commencing September 27, 2016 and ending September 26, 2017, purchase on the Exchange up to 17,563,870 common shares in total, being approximately 5% of the outstanding common shares. The price which Route1 will pay for any such shares will be the market price at the time of acquisitions, provided, however, that Route1 will not pay more than \$0.06 per common share. From September 27, 2015 to September 16, 2016, the Company had purchased a total of 13,974,000 common shares under the current normal course issuer bid at an average price of \$0.047 per share. The Company also announced that it will hold its annual meeting of its shareholders on November 28, 2016. The meeting will be held at 9 am eastern at the offices of Fasken Martineau DuMoulin LLP, 333 Bay Street, Toronto, Ontario. The record date for the determination of shareholders entitled to receive notice of and to vote at the annual meeting is September 29, 2016.
  - On October 18, 2016, the Company provided an operations update as follows:
    - As of September 30, 2016, Route1 had 17,344 paying, active subscribers. This represents an increase of 544 subscribers from the quarter ended June 30, 2016 and an increase of 1,355 users from September 30, 2015.
    - Cybersecurity initiatives within the U.S. government continue to create substantial deployment opportunities for Route1's suite of patented technology solutions. During Q3 2016, Route1 received purchase orders including one from a component of the DOD for 2,000 MobiKEY Fusion3 devices to replace certain of the client's MobiKEY Fusion and MobiKEY Fusion2 devices. Further, Route1 has been working with a new branch of the U.S. Armed Forces to set up the MobiKEY technology on an enterprise-wide contract vehicle. Route1 anticipates the contracting process to be complete in early Q4 2016.
    - On August 9, 2016, Route1 released MobiENCRYPT, a new Route1 technology offering that enables a secure mobile workforce by leveraging identity card-based credentials to protect government organizations from data-at-rest loss and security breaches.
    - In Q4 2016, Route1 expects to release DerivID, its first standalone user authentication offering. The offering will enhance authentication via mobile devices with the levels of security necessary for the U.S. government. Route1's release of this offering is in response to a user shift towards greater mobility and BYOD.
    - On July 8, 2016, Route1 released MobiKEY for Android 5.0 and MobiKEY A2T for Android 5.0. MobiKEY A2T for Android 5.0. Planned MobiKEY application software releases for during the remainder of the 2016 year are (i) MobiKEY for Android 5.1 and MobiKEY A2T for Android 5.1: Support for Android 5.x and 6.x, and support for Android 4.4 and 5.x with Knox 2.x respectively, and (ii) MobiKEY 5.2: New desktop management protocol, support of audio in both directions.
  - On November 2, 2016, the Company announced that it had been invited to attend the Imperial Capital Security Investor Forum, which was held on December 7-8, 2016 at the Waldorf Astoria New York hotel. Tony Busseri, CEO and Peter Chodos, CFO, were hosting one-on-one meetings with investors throughout the day on December 8.
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- On November 22, 2016, the Company announced its third quarter financial results. Along with the third quarter financial results, the Company provided an update on the Normal Course Issuer Bid (“NCIB”). For the nine months ended September 30, 2016, the Company in aggregate repurchased for cancellation 11,582,000 of its common shares for a consideration of \$543,710, at an approximate average price of \$0.047 per share under the NCIB.
  - On November 28, 2016, the Company announced that it has been verified for trading on the OTCQB Venture Market in the United States under the symbol ROIUF. The OTCQB market offers public companies transparency and ease of trading to engage both retail and institutional investors. OTCQB’s streamlined rules and regulations provide international companies with a timely and cost-efficient method of trading their securities in the United States.
  - On November 28, 2016, the Company announced that it received approval for all proposals submitted to shareholders at the Company’s annual and special meeting of shareholders which was held on November 28, 2016 in Toronto, Ontario. The matters voted on and approved include: Mark S. Boensel, Peter F. Chodos, Tony P. Busseri, Louis De Jong, Michael F. Doolan, David Fraser and Michael D. Harris were elected as the Company’s Directors; Collins Barrow LLP, Chartered Accountants were appointed as the Company’s auditors in respect of the year ending December 31, 2016; Route1’s stock option plan was reapproved; and the resolution authorizing the consolidation of the common shares of Route1 Inc. on the basis of up to 20 pre-consolidation common shares for every 1 post-consolidation common share, at the discretion of the Board of Directors of the Company, was also approved.
  - On December 6, 2016, the Company announced the launch of DerivID, an industry first derived credential solution for personal identity verification (PIV) and Common Access Card (CAC) users that validates the identity of mobile users seamlessly, simply and securely. DerivID exceeds U.S. National Institute of Standards and Technology (NIST) and Defense Information Systems Agency (DISA) security standards, and eliminates the need for an external card reader. Part of the Route1 suite of patented security solutions, DerivID leverages deployed and fully accredited infrastructures (DEFIMNETs) that are available to both the U.S. Department of Defense (DoD) and civilian government, ensuring that the technology can be seamlessly deployed and scaled. The solution exceeds the highest federal security requirements and incorporates two-factor authentication, all at a lower cost than competitive offerings. It supports multiple user credentials per mobile device and supports unique credentials for a user’s multiple devices.
  - On February 9, 2017, the Company provided an operations update as follows:
    - As of December 31, 2016, Route1 had 17,883 paying, active subscribers. This represents an increase of 539 subscribers from the quarter ended September 30, 2016 and increase of 1,597 users from December 31, 2015.
    - Route1 appointed John Marino as a board director to assist the Company in working with the Trump administration, and the leadership of agencies in which Route1 has a strong interest in that agency’s continued use and/or expansion of MobiKEY technology and the adoption of DerivID.
    - A total of 1,000,000 stock options at an exercise price of \$0.05 per share were granted to John Marino. The stock options expire on February 8, 2022 and will vest thirty percent on the first anniversary, thirty percent on the second anniversary and the remainder on the third anniversary.
    - As of February 7, 2017, the Company purchased 2,884,000 common shares pursuant to the NCIB announced on September 27, 2016.
  - On February 28, 2017, the Company announced its first MobiKEY order from the U.S. Marine Corps (USMC) for 50 MobiKEY application software licenses and 50 MobiKEY Fusion3 devices. The
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MobiKEY technology is now available on an enterprise-wide contract vehicle that allows all components of the USMC to procure MobiKEY. Route1 expects sales in the first ninety days of 100-250 users and additional further growth on a monthly basis similar to the Company's experience with the US Department of the Navy.

- On March 27, 2017, the Company filed a complaint against AirWatch LLC (AirWatch) in the U.S. District Court for the District of Delaware for infringement of U.S. Patent No. 7,814,216, seeking damages and an injunction. The damages the Company will be seeking are material when compared to Route1's market capitalization. Route1 contends that AirWatch infringes on U.S. Patent No. 7,814,216 in violation of 35 U.S.C. § 271 through at least the operation of a cloud-based controller of what AirWatch refers to as "The AirWatch Enterprise Mobility Management System" (AirWatch EMM System) in order to facilitate secure communications between remote computing devices such as cell phones and tablets and resources residing on corporate networks, such as email and corporate intranets, and application programs such as spreadsheets and word processors.
- On March 28, 2017, the Company announced that the Company expects to renew all of its material contracts with its U.S. government clients with the exception of the U.S. Customs and Border Protection (CBP). Recent leadership changes in the office of the CIO at CBP, and a move by current technology leadership at CBP to closely align CBP's mobility plan with that set out by the recently resigned CIO at the Department of Homeland Security, CBP will not be renewing its license for 7,000 MobiKEY subscribers after its current subscription term ends on April 30, 2017. Despite the loss of CBP, Route1 believes that it will continue to generate positive EBITDA in calendar year 2017. The Company's plan for growth consists of organic growth from MobiKEY and DerivID sales, and the release of new technologies, as well as through acquisitions, which collectively will serve as the roadmap to accelerated revenue and cash flow growth in calendar 2017.

**NON-IFRS FINANCIAL MEASURE: Adjusted EBITDA**

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

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

The table below reconciles Adjusted EBITDA to Operating profit before stock-based compensation for the quarters presented.

<i>In thousands of Canadian dollars</i>	<b>For the Quarters Ended</b>				
	<b>Dec 31 2016</b>	Sept 30 2016	June 30 2016	Mar 31 2016	Dec 31 2015
Adjusted EBITDA	<b>\$307</b>	\$447	\$278	\$172	\$279
Depreciation and amortization	<b>115</b>	107	106	134	127
Operating profit before stock-based compensation and patent litigation	<b>\$192</b>	\$340	\$172	\$38	\$152



## SELECTED FINANCIAL INFORMATION

The following table outlines selected unaudited financial information of the Company on a consolidated basis for the three months and years ended December 31, 2016 and 2015.

<i>(in thousands of Canadian dollars, except per share amounts)</i>	For the Three Months Ended		For The Year Ended	
	Dec 31 2016	Dec 31 2015	Dec 31 2016	Dec 31 2015
<b>STATEMENT OF OPERATIONS</b>				
<b>Revenue</b>				
Devices and appliances	\$21	\$9	\$363	\$156
Services	1,865	1,616	7,080	6,218
Other	-	-	4	23
<b>Total revenue</b>	<b>1,886</b>	<b>1,625</b>	<b>7,447</b>	<b>6,397</b>
Cost of revenue	338	284	1,475	1,164
<b>Gross profit</b>	<b>1,548</b>	<b>1,341</b>	<b>5,972</b>	<b>5,233</b>
<b>Operating expenses</b>				
General administration	774	792	3,106	2,868
Research and development	268	176	1,185	976
Selling and marketing	314	221	939	671
<b>Total operating expenses</b>	<b>1,356</b>	<b>1,189</b>	<b>5,230</b>	<b>4,515</b>
<b>Operating profit before stock-based compensation and patent litigation</b>	<b>192</b>	<b>152</b>	<b>742</b>	<b>718</b>
Patent litigation	(56)	-	(56)	-
Stock-based compensation	(81)	(128)	(368)	(410)
<b>Operating profit after stock-based compensation and patent litigation</b>	<b>55</b>	<b>24</b>	<b>318</b>	<b>308</b>
Foreign exchange translation and interest income	36	39	12	(155)
<b>Total comprehensive gain (loss) for the period before income tax</b>	<b>\$91</b>	<b>\$63</b>	<b>\$330</b>	<b>\$153</b>
Income tax recovery	-	314	-	575
<b>Total comprehensive gain (loss) for the period after income tax</b>	<b>\$91</b>	<b>\$377</b>	<b>\$330</b>	<b>\$728</b>
<b>Earnings (loss) per share</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>
<b>CASH FLOW INFORMATION</b>				
Operating activities	\$(704)	\$(1,011)	\$1,587	\$876
Investing activities	(102)	(52)	(198)	(672)
Financing activities	(147)	(119)	(695)	(486)
Net cash inflow	(953)	(1,182)	694	(282)
Cash, beginning of period	2,898	2,433	1,251	1,533
<b>Cash, end of period</b>	<b>\$1,945</b>	<b>\$1,251</b>	<b>\$1,945</b>	<b>\$1,251</b>
Working capital	\$411	\$164	\$411	\$164
Total assets	\$4,190	\$3,656	\$4,190	\$3,656
Shareholders' equity	\$1,600	\$1,597	\$1,600	\$1,597

## COMPARISON FOR THE THREE MONTHS ENDED DECEMBER 31, 2016 AND 2015

### Revenue

Revenue for the three months ended December 31, 2016 was \$1,886,404, representing an increase of \$261,116, from \$1,625,288, for the same period in 2015. The comparison, discussed by segment, is as follows:

#### *Devices and Appliances*

Revenue from MobiKEY devices (MobiKEY Classic device, MobiKEY Classic 3 device, the MobiKEY Fusion device, the MobiKEY Fusion2 device and the MobiKEY Fusion3 device) and appliances (the DEFIMNET platform and the MobiNET Aggregation Gateway) for the three months ended December 31, 2016 was \$21,569, representing an increase of \$12,802, from \$8,767 for the same period in 2015.

Devices and appliances revenue as a percentage of total revenue represents 1.1% of total revenue for the current period as compared to 0.5% for the prior year period.

#### *Services*

Revenue from the services segment (MobiKEY application software, the DEFIMNET platform and other appliance licensing or yearly maintenance) for the three months ended December 31, 2016, was \$1,864,659, representing an increase of \$248,215 from \$1,616,444, for the same period in 2015. The increase is largely a result of an increase in the number of paid, active MobiKEY application software users with the U.S. government and improved exchange rates.

Services revenue, as a percentage of total revenue, represented 98.8% for the current period as compared to 99.5% for the prior year period.

<b>Services revenue by quarters</b> <i>(in thousands of Canadian dollars)</i>	<b>Dec 31 2016</b>	Sept 30 2016	June 30 2016	Mar 31 2016	Dec 31 2015
MobiKEY application software revenue	<b>\$1,702</b>	\$1,639	\$1,591	\$1,496	\$1,467
Other services revenue	<b>163</b>	169	169	152	149
Total	<b>\$1,865</b>	\$1,808	\$1,760	\$1,648	\$1,616

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

<b>MobiKEY Subscribers</b> <i>(in thousands of Canadian dollars for Revenue)</i>	<b>Dec 31 2016</b>	Sept 30 2016	June 30 2016	Mar 31 2016	Dec 31 2015
Closing Number	<b>17,883</b>	17,344	16,800	16,490	16,286
Average Number <sup>(1)</sup>	<b>17,534</b>	17,112	16,629	16,292	16,246
Revenue per Subscriber <sup>(2)</sup>	<b>\$388</b>	\$383	\$383	\$367	\$361
Revenue	<b>\$1,702</b>	\$1,639	\$1,591	\$1,496	\$1,467

(1) Calculated by taking the average of the closing MobiKEY subscriber number at the end of the month for each of the three months during the quarter.

(2) Calculated by dividing the MobiKEY revenue during the quarter by the average number of users and multiplying by four.

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## Gross Profit

Gross profit is equivalent to revenue minus the cost of revenue. The cost of revenue primarily includes the cost of our devices and appliances sold to clients, as well as the cost of shipping and packaging, plus the cost to operate and maintain the Route1 MobiNET platform.

The cost of revenue for the three months ended December 31, 2016 was \$337,735, representing an increase of \$53,555 from \$284,180 for the same period in 2015. A large portion of the increase in cost of revenue for the three months ended December 31, 2016 is the result of an increase in head count, and increased device and appliance sales compared to the same period in the prior year.

Gross profit for the three months ended December 31, 2016 was \$1,548,669 or 82.1% of gross revenue, representing an increase of \$207,561 from a gross profit of \$1,341,108 or 82.5% of gross revenue for the same period in 2015.

## Expenses

Operating expenses consist of general administration, research and development, and selling and marketing. Operating expenses for the three months ended December 31, 2016 were \$1,356,489, representing an increase of \$167,329, from \$1,189,160, for the same period in 2015.

### *General administration*

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

General administration expenses for the three months ended December 31, 2016 were \$774,678 representing a decrease of \$17,355, from \$792,033 for the same period in 2015. The majority of the change can be summarized as follows:

- Professional fees decreased by approximately \$11,500 for the three months ended December 31, 2016 as compared to the same period in 2015. The decrease was the result of lower costs incurred for the Company's annual general meeting.

### *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 December 31, 2016 were \$267,804, representing an increase of \$91,654, from \$176,150, for the same period in 2015. The majority of the change can be summarized as follows:

- The Scientific Research and Experimental Development credit decreased by approximately \$116,000 for the three months ended December 31, 2016; the decrease of the credit is the result of a change to recognizing the credit as projects become eligible throughout the year.
- Salaries and benefits expenses decreased by approximately \$24,500 for the three months ended December 31, 2016 as compared to the same period in 2015; the decrease is primarily the result of a reduction in head count.

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### *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 December 31, 2016 were \$314,007, representing an increase of \$93,030 from \$220,977, for the same period in 2015. The majority of the change can be summarized as follows:

- Commission costs increased by approximately \$26,500 for the three months ended December 31, 2016 as compared to the same period in 2015 as a result of increased sales.
- Business development costs, including travel expenses and tradeshow fees, increased by approximately \$23,000 as compared to the same period in 2015 as a result of increased presence at tradeshow.
- Corporate advisory services increased by approximately \$20,000 for the three months ended December 31, 2016 as compared to the same period in 2015 as a result of services related to merger and acquisition opportunities.

### **Other Items**

#### *Stock-based compensation*

Stock-based compensation was \$81,284 for the three months ended December 31, 2016, a decrease of \$47,130 from \$128,414 for the same period in 2015. The contributing factor to the lower expense was the reduction of options vesting during the three months ended December 31, 2016 as compared to the same period in 2015.

#### *Patent litigation*

Patent litigation expenses consist of legal fees and other third party costs incurred to prosecute cases of alleged patent infringement. Legal costs to prosecute the alleged patent infringement case are expensed as incurred with any potential gain on settlement to be recognized on realizations.

Patent litigation expenses for the three months ended December 31, 2016 were \$56,292 compared to \$nil for the three months ended December 31, 2015. These expenses were incurred in preparation for the filing of a patent infringement complaint as described below.

On March 27, 2017, the Company filed a complaint against AirWatch LLC (AirWatch) in the US District Court for the District of Delaware for infringement of Route1's U.S. Patent No. 7,814,216 (the "216 Patent"), seeking damages and an injunction. Route1 alleges that AirWatch infringes on the 216 Patent through at least the operation of a cloud-based controller of what AirWatch refers to as "The AirWatch Enterprise Mobility Management System" (AirWatch EMM System) in order to facilitate secure communications between remote computing devices such as cell phones, remote computing devices and resources residing on corporate networks such as email and corporate intranets and application programs such as spreadsheets and word processors.

#### *Foreign exchange gain (loss)*

Foreign exchange gains or losses are primarily attributable to fluctuations in the Canadian/U.S. dollar exchange rates. The gain attributable to foreign exchange translation on balance sheet items such as Accounts Receivable, Accounts Payable and bank accounts denominated in foreign currencies was \$36,510

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for the three months ended December 31, 2016, a decrease of \$2,958 from a gain of \$39,468 for the same period in 2015. There was volatility and fluctuation of the Canadian dollar against the U.S. dollar during the fourth quarter of 2016, from a low of 1.3005 to a high of 1.3598.

As required by IFRS, foreign denominated monetary balances are revalued at the foreign exchange rate at each period end, and the translation gains or losses are recorded in the current period. A portion of these gains/losses are unrealized. As at December 31, 2016, the Company had non-Canadian dollar net monetary assets of approximately US\$1,048,037 (CAD\$1,407,199). Gains or losses in the U.S. to Canadian dollar exchange rate by 5% as at December 31, 2016 would have resulted in a gain in the amount of \$70,360 or a loss of \$70,360. Any gain or loss would have been included in the foreign exchange translation.

From time to time, the Company may enter into U.S. dollar forward contracts to mitigate possible foreign exchange risk. The timing and amount of foreign exchange contracts are estimated based on existing or anticipated sales, current conditions in the Company's markets, the estimated timing of payments denominated in Canadian dollars and the Company's past experience. The Company's policy is not to utilize financial instruments for trading or speculative purposes.

#### *Income tax recovery - Income tax expense and deferred tax recovery*

For the three months ended December 31, 2016 the Company recognized an income tax expense of \$449,043, an increase of \$4,451 from \$444,592 for the same period in 2015.

For the three months ended December 31, 2016, the Company also recognized a deferred tax asset of \$449,043, a decrease of \$309,249 from \$758,292 for the same period in 2015. The recognized deferred tax asset relates to unused tax losses that are considered to be offset against the Company's taxable profits expected to arise in future fiscal years. Management has based their recognition of the deferred tax asset on the operating budget previously approved, the Company's ability to meet this budget and its operating forecast moving forward.

#### **Comprehensive (Loss) Gain After Taxes**

Comprehensive gain for the three months ended December 31, 2016 was \$91,114 or \$0.00 per share, representing a decrease of \$285,588 from a comprehensive gain of \$376,702 or \$0.00 per share for the same period in 2015.

#### **COMPARISON FOR THE YEAR ENDED DECEMBER 31, 2016 AND 2015**

##### **Revenue**

Revenue for the year ended December 31, 2016 was \$7,447,488, representing an increase of \$1,050,119 from \$6,397,369 for the same period in 2015. The comparison, discussed by segment, is as follows:

##### *Devices and appliances*

Revenue from MobiKEY devices (MobiKEY Classic device, MobiKEY Classic 3 device, the MobiKEY Fusion device, the MobiKEY Fusion2 device and the MobiKEY Fusion3 device) and appliances (the DEFIMNET platform and the MobiNET Aggregation Gateway) segment for the year ended December 31, 2016 was \$363,031 representing an increase of \$206,983 from \$156,048 for the same period in 2015. The largest contributing factor to the increase in devices and appliances revenue for the year ended December

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31, 2016, was a purchase of 2,000 MobiKEY Fusion3 devices by a component of the U.S. Department of Defense in the third quarter.

Devices and appliances revenue as a percentage of total revenue represents 4.9% of total revenue for the current period as compared to 2.4% for the same period in the prior year.

### *Services*

Revenue from the services segment (MobiKEY application software, and the DEFIMNET platform and other appliance licensing or yearly maintenance) for the year ended December 31, 2016, was \$7,080,462, representing an increase of \$862,178 from \$6,218,284 for the same period in 2015. Services revenue, as a percentage of total revenue, represents 95.0% for the current period as compared to 97.2% for the same period in the prior year. A significant portion of the increase in service revenue is the result of an increase in the number of paid, active MobiKEY application software users with the U.S. government, and improved exchange rates.

Deferred revenue as at December 31, 2016 increased by \$482,248 to \$2,182,668 from \$1,700,420 as at December 31, 2015. The increase in the carrying amount of deferred revenue is primarily driven by increased MobiKEY application software subscription sales to components of the U.S. Department of the Navy and U.S. Department of the Interior.

### *Other revenue*

Other revenue for the year ended December 31, 2016 was \$3,995, representing a decrease of \$19,042 from \$23,037 for the same period in 2015. Other revenue for the year ended December 31, 2015 included working with a component of the U.S. Department of Homeland Security to deliver secure remote scanning capabilities as a feature addition to Route1's flagship technology, MobiKEY.

### **Gross profit**

Gross profit is revenue minus the cost of revenue. The cost of revenue primarily includes the cost of our devices and appliances sold to clients, as well as the cost of their shipping and packaging, plus the cost to operate and maintain the Route1 MobiNET platform.

The cost of revenue for the year ended December 31, 2016 was \$1,474,951, representing an increase of \$310,429 from \$1,164,522 for the same period in 2015. A large portion of the increase in cost of revenue for the year ended December 31, 2016 is the result of an increase in head count, and increased device and appliance sales compared to the same period in the prior year.

Gross profit for the year ended December 31, 2016 was \$5,972,537 or 80.2% of gross revenue, representing an increase of \$739,690 from a gross profit of \$5,232,847 or 81.8% of gross revenue for the same period in 2015.

For the year ended December 31, 2016, the Company incurred a devices and appliances write-down of \$7,716 which was included in the cost of revenue. For the year ended December 31, 2015, the Company incurred a devices and appliances write-down of \$22,255 which was included in the cost of revenue. Additional information regarding the write-down see, "**DEVICES AND APPLIANCES HELD FOR SALE**" of this MD&A.

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## Expenses

Operating expenses consist of general administration, research and development, and selling and marketing. Operating expenses for the year ended December 31, 2016 were \$5,230,537, representing an increase of \$715,416, from \$4,515,121 for the same period in 2015.

### *General administration*

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

General administration expenses for the year ended December 31, 2016 were \$3,105,935, representing an increase of \$238,219, from \$2,867,716 for the same period in 2015. The majority of the change can be summarized as follows:

- Professional fees increased by approximately \$90,000 for the year ended December 31, 2016 as compared to the same period in 2015. The increase was largely the result of hiring contractors to perform capital market activities.
- Bonuses increased by approximately \$64,000 for the year ended December 31, 2016 as compared to the same period in 2015.
- Depreciation expense increased by approximately \$27,000 for the year ended December 31, 2016 as compared to the same period in 2015.
- Salaries and benefits increased by approximately \$28,000 for the year ended December 31, 2016 as compared to the same period in 2015; the increase is due to increased headcount.
- Other operating costs, including telephone and computer related expenses, increased by \$20,000 as a result of increased expenses to support the U.S. office and client DEFIMNET platforms.

### *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 year ended December 31, 2016 were \$1,184,926, representing an increase of \$208,679, from \$976,247 for the same period in 2015 and the change can be summarized as follows:

- The Scientific Research and Experimental Development credit decreased by approximately \$187,000 in 2016 as compared to 2015; the decrease of the credit is the result of a change to recognizing the credit as projects become eligible throughout the year.
- Salaries and benefits expenses increased by approximately \$21,500 for the year ended December 31, 2016 as compared to the same period in 2015; the increase is primarily the result of additional personnel in the U.S. office.

### *Selling and marketing*

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

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Selling and marketing expenses for the year ended December 31, 2016 were \$939,676, representing an increase of \$268,518, from \$671,158 for the same period in 2015 and the majority of the change can be summarized as follows:

- Marketing costs increased by approximately \$128,000 for the year ended December 31, 2016 as compared to the same period in 2015; the Company hired additional sales and marketing personnel.
- Business development costs, including travel expenses and tradeshow fees, increased by approximately \$61,000 as compared to the same period in 2015 due to an increased presence at tradeshows.
- Sales commission expenses increased by approximately \$47,000 for the year ended December 31, 2016 compared to the same period in 2015 as a result of increased sales.
- Corporate advisory services increased by approximately \$20,000 for the year ended December 31, 2016 as compared to the same period in 2015 as a result of services related to merger and acquisition opportunities.

### **Other items**

#### *Stock-based compensation*

Stock-based compensation was \$368,197 for the year ended December 31, 2016, a decrease of \$41,448 from \$409,645 for the same period in 2015. The contributing factor to the lower expense was the reduction of options vesting during the year ended December 31, 2016 as compared to the same period in 2015.

#### *Patent litigation*

Patent litigation expenses consist of legal fees and other third party costs incurred to prosecute cases of alleged patent infringement. Legal costs to prosecute the alleged patent infringement case are expensed as incurred with any potential gain on settlement to be recognized on realizations.

Patent litigation expenses for the year ended December 31, 2016 were \$56,292 compared to \$nil for the year ended December 31, 2015. These expenses were incurred in preparation for the filing of a patent infringement complaint as described below.

On March 27, 2017, the Company filed a complaint against AirWatch LLC (AirWatch) in the US District Court for the District of Delaware for infringement of Route1's U.S. Patent No. 7,814,216 (the "216 Patent"), seeking damages and an injunction. Route1 alleges that AirWatch infringes on the 216 Patent through at least the operation of a cloud-based controller of what AirWatch refers to as "The AirWatch Enterprise Mobility Management System" (AirWatch EMM System) in order to facilitate secure communications between remote computing devices such as cell phones, remote computing devices and resources residing on corporate networks such as email and corporate intranets and application programs such as spreadsheets and word processors.

#### *Foreign exchange translation*

Foreign exchange gains or losses are primarily attributable to fluctuations in the Canadian/U.S. currency exchange rates. The gain attributable to foreign exchange translation on balance sheet items such as Accounts Receivable, Accounts Payable and foreign currency bank accounts was \$11,980 for the year ended December 31, 2016, an increase of \$167,431 from a loss of \$155,451 for the same period in 2015. There was volatility and fluctuation of the Canadian dollar against the U.S. dollar during the same period in 2015.



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As required by IFRS, foreign denominated monetary balances are revalued at the foreign exchange rate at each period end, and the translation gains or losses are recorded in the current period. A portion of these gains/losses are unrealized. As at December 31, 2016, the Company had non-Canadian dollar net monetary assets of approximately US\$1,048,037 (CAD\$1,407,199) have resulted in a gain in the amount of \$70,360 or a loss of \$70,360. Any gain or loss would have been included in the foreign exchange translation.

From time to time, the Company may enter into U.S. dollar forward contracts to mitigate possible foreign exchange risk. The timing and amount of foreign exchange contracts are estimated based on existing or anticipated sales, current conditions in the Company's markets, the estimated timing of payments denominated in Canadian dollars and the Company's past experience. The Company's policy is not to utilize financial instruments for trading or speculative purposes.

#### *Income tax expense and deferred tax recovery*

For the year ended December 31, 2016 the Company recognized an income tax expense with a related recovery of \$682,568, an increase of \$54,159 from \$628,409 for the same period in 2015.

For the year ended December 31, 2016, the Company also recognized a deferred tax asset of \$742,067 (December 31, 2015 - \$742,067). The recognized deferred tax asset relates to unused tax losses that are considered to be offset against the Company's taxable profits expected to arise in the current and coming year. Management has based their assessment on the budget previously approved, the Company's ability to meet this budget and its forecast moving forward.

#### **Comprehensive Income After Taxes**

Comprehensive income for the year ended December 31, 2016 was \$329,742 or \$0.00 per share, a decrease of \$398,357 from a comprehensive income of \$728,099 or \$0.00 per share for the same period in 2015.

#### **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 condensed interim consolidated financial statements that, in management's opinion, have been prepared on a basis consistent with the consolidated annual financial statements and are reviewed and approved by the Company's Board of Directors. The Company's quarterly operating results have varied substantially in the past and may vary substantially in the future. Accordingly, the information below is not necessarily indicative of results for any future quarter.

As at and for the three month period ended  
(in thousands of Canadian dollars, except per share data)

	Dec 31 2016	Sept 30 2016	June 30 2016	Mar 31 2016	Dec 31 2015	Sept 30 2015	June 30 2015	Mar 31 2015
<b>STATEMENT OF OPERATIONS</b>								
Revenue								
Devices and appliances	\$21	\$221	\$51	\$69	\$9	\$42	\$50	\$55
Services	1,865	1,808	1,760	1,648	1,616	1,572	1,569	1,461
Other	-	2	1	1	-	-	1	22
Total revenue	1,886	2,031	1,812	1,718	1,625	1,614	1,620	1,538
Cost of revenue	338	448	341	348	284	320	294	266
Gross margin	1,548	1,583	1,471	1,370	1,341	1,294	1,326	1,272
Operating expenses								
General administration	774	764	785	782	792	693	705	677
Research and development	268	285	299	333	176	334	340	126
Selling and marketing	314	194	215	217	221	143	153	155
Total operating expenses	1,356	1,243	1,299	1,332	1,189	1,170	1,198	958
Operating profit before stock-based compensation and patent litigation	192	340	172	38	152	124	128	314
Patent litigation	(56)	-	-	-	-	-	-	-
Stock-based compensation	(81)	(80)	(80)	(127)	(128)	(133)	(118)	(30)
Operating profit (loss) after stock-based compensation and patent litigation	55	260	92	(89)	24	(9)	10	284
Foreign exchange translation and interest income	36	46	107	(177)	39	111	(354)	48
Comprehensive income (loss) for the period before income tax expense	\$91	\$306	\$199	\$(266)	\$63	\$102	\$(344)	\$332
Income tax expense	449	132	103	-	444	63	-	121
Deferred tax recovery	(449)	(132)	(103)	-	(758)	(63)	-	(383)
Comprehensive income (loss) for the period after income tax expense	\$91	\$306	\$199	\$(266)	\$377	\$102	\$(344)	\$594
Earnings (loss) per share	\$0.00	\$0.00	\$0.00	\$(0.00)	\$0.00	\$0.00	\$(0.00)	\$0.00
Adjusted EBITDA	307	447	278	171	279	242	227	404
<b>CASH FLOW INFORMATION</b>								
Operating activities	\$(704)	\$(681)	\$3,730	\$(758)	\$(1,011)	\$(874)	\$2,621	\$140
Investing activities	(102)	(48)	(41)	(6)	(52)	(96)	(158)	(367)
Financing activities	(147)	(108)	(361)	(80)	(119)	(65)	(272)	(29)
Net cash inflow (outflow)	(953)	(837)	3,328	(844)	(1,182)	(1,035)	2,191	(256)
Cash, beginning of period	2,898	3,735	407	1,251	2,433	3,468	1,277	1,533
Cash, end of period	\$1,945	\$2,898	\$3,735	\$407	\$1,251	\$2,433	\$3,468	\$1,277
<b>BALANCE SHEET INFORMATION</b>								
Working capital (deficiency)	\$411	\$382	\$45	\$66	\$164	\$6	\$(185)	\$377
Total assets	\$4,190	\$5,230	\$6,116	\$5,296	\$3,656	\$4,466	\$5,494	\$4,631
Shareholders' equity	\$1,600	\$1,574	\$1,296	\$1,377	\$1,597	\$1,210	\$1,041	\$1,539

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

## LIQUIDITY AND CAPITAL RESOURCES

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

### *Cash used in operating activities*

Cash flow generated from operating activities for the year ended December 31, 2016 was \$1,586,741, compared to cash flow generated of \$876,165 in the same period in 2015, representing an increase of \$710,576. Non-cash working capital generated was \$419,685 for the year ended December 31, 2016 compared to \$142,538 used in the same period a year earlier. Therefore, net cash generated in the day-to-day operations for the year ended December 31, 2016 was \$1,167,056 compared to \$1,018,703 in the same period in 2015, representing an increase of \$148,353. The increase in net cash generated for the year ended December 31, 2016 compared to the same period in the prior year is mainly due to the increase in deferred revenue for the year ended December 31, 2016 and recognition of a deferred tax asset during the same period in the prior year.

### *Cash used in investing activities*

Cash used in investing activities for the year ended December 31, 2016 was \$197,640 compared to cash used of \$672,039 in the same period in 2015, representing a decrease of \$474,399. The decrease in cash outflow is the result of the purchase and installation of a DEFIMNET for the U.S. Department of the Interior during the prior year.

### *Cash used in financing activities*

Cash used in financing activities for the year ended December 31, 2016 was \$694,795 compared to cash used of \$485,786 for the same period in 2015. The increase in cash outflow is the result of the Company repurchasing its common shares for cancellation. For additional information see "**SHARE REPURCHASE PROGRAM**" of this MD&A.

The Company's current business plan projects revenue growth in 2016 and beyond. The Company believes that its success in securing sales contract vehicles with the U.S. government will lead to growth within the U.S. government and future opportunities abroad with other governments.

The Company's need for capital expenditures is limited to such items as computer hardware and software, expenditures to support sales, marketing and general administration activities and working capital. Since inception, the Company has financed its cash and/or capital requirements through operating cash flow, the issuance of equity from private placements, and through the issuance of obligations under capital leases.

On October 4, 2011, the Company entered into a \$550,000 credit facility with a banking and financial services organization consisting of a \$500,000 revolving demand operating facility and a \$65,000 VISA facility. On September 29, 2014 the credit facility was renewed. The revolving demand credit facility carries an interest rate equal to the lender's prime rate of interest plus 1.80%. The credit facility is secured by the assets of the Company. There is no minimum collateral asset value to access the first \$100,000; accessing an amount in excess of \$100,000 is based on the balance and term of the Company's trade accounts receivables outstanding plus the amount of SR&ED tax credits filed and refundable. The Company had not drawn on the facility as of December 31, 2016.

The following table discloses future payments as at December 31, 2016 committed by the Company over the next five (5) years and thereafter. It includes both principal and interest obligations required under capital lease agreements.

<b>Contractual Obligations</b>	No later than 1 year	Later than one year and not later than five years	Later than five years	Total
	Operating leases	\$161,223	\$641,944	\$10,654

## **DEVICES AND APPLIANCES HELD FOR SALE**

On a quarterly basis or when necessary, management reviews the carrying value of inventory. Under IFRS, inventory must be recognized at the lower of cost and net realizable value, which is the estimated selling price in the ordinary course of business less the estimated costs of completion and estimated costs necessary to make the sale. As a result, for the year ended December 31, 2016 the Company incurred a write-down of MobiKEY Classic devices in the amount of \$7,716. For the year ended December 31, 2015, the Company incurred a write-down of MobiKEY Classic devices in the amount of \$22,255.

## **RELATED PARTY TRANSACTIONS**

The Company has directors and officers who are considered related parties. The Company had the following transactions and/or outstanding amounts with related parties for the years ended December 31, 2016 and 2015 comparatives. All transactions are recorded at their exchange amounts.

- The Company made payments (including HST) to 1220764 Ontario Inc. for management services provided by Mr. Tony P. Busseri, a director and the CEO of the Company in the amount of \$425,633 for the year ended December 31, 2016 (December 31, 2015 - \$406,800). For the year ended December 31, 2016 the Company also incurred stock based compensation expense in the amount of \$109,690 (December 31, 2015 - \$136,576).
- The Company incurred expenses (including CPP and EHT) payable to and on behalf of the independent members of the Board of Directors of \$308,109 for the year ended December 31, 2016 (December 31, 2015 - \$317,673). These transactions are in the normal course of operations and are paid or payable for directorship services. As at December 31, 2016, accounts payable included \$70,049 owing to directors (December 31, 2015 - \$77,500). For the year ended December 31, 2016 the Company also incurred stock based compensation expense related to stock options granted to directors in the amount of \$122,219 (December 31, 2015 - \$174,686).
- The Company made payments to or incurred expenses for key management (President, Chief Technology Officer and the Chief Financial Officer) in the year ended December 31, 2016 as follows, with 2015 comparatives.

	Year Ended December 31, 2016	Year Ended December 31, 2015
Short-term employee benefit	\$800,424	\$714,329
Stock option expense	138,331	84,460
	<b>\$938,755</b>	<b>\$798,789</b>

## PROPOSED TRANSACTIONS

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

## CRITICAL ACCOUNTING ESTIMATES

The consolidated financial statements have been prepared in accordance with International Accounting Standard (“IAS”). 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 audited financial statements in conformity with IFRS. 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, 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 sales (i.e. MC3 device, MC2 device, the MobiKEY Classic device and the MobiKEY Fusion3 device, the MobiKEY Fusion2 device and the MobiKEY Fusion device) and subscription services (i.e. MobiKEY application software). The Company recognizes revenue in accordance with IAS 18, “Revenue”.
- In the determination of the valuation of accounts receivable, including the allowance for doubtful accounts, the Company relies on current customer information, payment history and trends as well as future business and economic conditions.
- The determination of inventory obsolescence allowance.
- The 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 recognition of SRED tax credits and government grants (if any).
- 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.

## FUTURE ACCOUNTING POLICY CHANGES

### *Financial Instruments*

IFRS 9, “Financial Instruments” (IFRS 9), was issued by the IASB in July 2014 and will replace IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward

unchanged to IFRS 9. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. Requirements relating to Hedge Accounting, representing a new hedge accounting model, have been added to IFRS 9 in November 2013. The new model represents a substantial overhaul of hedge accounting which will allow entities to better reflect their risk management activities in the financial statements. The most significant improvements apply to those that hedge non-financial risk, and so these improvements are expected to be of particular interest to non-financial institutions. The standard is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted. The Company is assessing the impact of adopting IFRS 9 on the consolidated financial statements.

#### *Revenue from Contracts with Customers*

IFRS 15, “Revenue from Contracts with Customers” (IFRS 15), was issued by the IASB in May 2014 and will supersede current revenue recognition guidance, which is currently found across several standards and interpretations including IAS 11, Construction Contracts and IAS 18, Revenue. IFRS 15 provides a framework for determining the nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with a customer. The standard is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted. The Company is in the process of assessing the impact of this standard on its consolidated financial statements.

#### *Leases*

IFRS 16, “Leases” (IFRS 16), is effective for years commencing on or after January 1, 2019, and replaces IAS 17, Leases. The standard provides a single lessee accounting model, requiring lessee to recognize assets and liabilities for almost all leases. The standard is effective for annual periods beginning on or after January 1, 2019, with early adoption permitted. The Company is assessing the impact of adopting IFRS 16 on the consolidated financial statements.

## **FINANCIAL INSTRUMENTS**

#### *Establishing fair value*

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

The following table sets out the classification, carrying amount, and fair value of the Company’s financial assets and liabilities as at December 31, 2016 and December 31, 2015:

	<b>December 31, 2016</b>		December 31, 2015	
	<b>Carrying Amount</b>	<b>Fair Value</b>	Carrying Amount	Fair Value
<b>FINANCIAL ASSETS</b>				
Cash and cash equivalents	<b>\$1,945,549</b>	<b>\$1,945,549</b>	\$1,251,242	\$1,251,242
Accounts receivable	<b>\$181,848</b>	<b>\$181,848</b>	\$142,521	\$142,521
<b>FINANCIAL LIABILITIES</b>				
Accounts payable and other liabilities	<b>\$345,048</b>	<b>\$345,048</b>	\$291,242	\$291,242

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## FINANCIAL INSTRUMENTS - RISK MANAGEMENT

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

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

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

	<b>Credit</b>	<b>Liquidity</b>	<b>Foreign Exchange</b>	<b>Interest Rate</b>
Cash and cash equivalents	Yes		Yes	Yes
Accounts receivable	Yes		Yes	
Accounts payable and other liabilities		Yes	Yes	

### *Credit risk*

Credit risk arises from cash held with banks and credit exposure to customers, including outstanding accounts receivable. The maximum exposure to credit risk is equal to the carrying value (net of allowances) of the financial assets. The objective of managing credit risk is to prevent losses on financial assets. The Company assesses the credit quality of counterparties, taking into account their financial position, past experience and other factors. During the year ended December 31, 2016, the largest single customer represented approximately \$2,888,259 of revenue (December 31, 2015 - \$2,672,082).

### *Cash and cash equivalents*

Cash and cash equivalents consist of bank balances. Credit risk associated with cash is minimized substantially by ensuring that these financial assets are held in highly rated financial institutions. At December 31, 2016, the Company had cash consisting of deposits with Schedule 1 banks in Canada and their subsidiaries in the U.S. of \$1,945,549 (December 31, 2015 - \$1,251,242).

### *Accounts receivable*

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

The carrying amount of accounts receivable is reduced through the use of an allowance for doubtful accounts and the amount of the loss is recognized in the statement of comprehensive income. When a receivable balance is considered uncollectible, it is written off against the allowance for accounts

receivable. Subsequent recoveries of amounts previously written off reduce other expenses in the statement of comprehensive income. As at December 31, 2016, the largest single customer's accounts receivable represented \$106,083 (December 31, 2015 – \$87,045) of the total accounts receivable. This receivable was fully collected after the year end.

The following table outlines the details of the aging of the Company's accounts receivable as at December 31, 2016 and December 31, 2015:

	<b>December 31, 2016</b>	December 31, 2015
Current	<b>\$181,848</b>	\$141,790
Past due		
1 – 60 days	-	731
Greater than 60 days	-	-
Less: Allowance for doubtful accounts	-	-
Total accounts receivable, net	<b>\$181,848</b>	\$142,521

For the year ended December 31, 2016 and year ended December 31, 2015, there was a \$nil balance for the allowance for doubtful accounts.

#### *Liquidity risk*

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's objective in managing liquidity risk is to maintain sufficient readily available reserves in order to meet its liquidity requirements at any point in time. In order to meet its financial liabilities, the Company has relied on collecting its accounts receivable, which by nature, are due predominately from government agencies with a high level of certainty of collection.

The Company's ability to manage its liquidity risk going forward will require some or all of the following: the ability to generate positive cash flows from operations and secure capital and/or credit facilities on reasonable terms in the current market place. The following table details the Company's contractual maturities for its financial liabilities and operating lease commitments, as at December 31, 2016:

	<b>2017</b>	<b>2018</b>	<b>2019 and Beyond</b>	<b>Total</b>
Accounts payable and other liabilities	\$345,048	\$-	\$-	\$345,048
Operating lease commitments	161,223	155,980	496,618	813,821
	<b>\$506,271</b>	<b>\$155,980</b>	<b>\$496,618</b>	<b>\$1,158,869</b>

#### *Market risk*

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

#### *Foreign exchange*

The functional currency of the parent company is Canadian dollars and the reporting currency is Canadian dollars. As at December 31, 2016, the Company had non-Canadian dollar net monetary assets of approximately US\$1,048,037 (December 31, 2015 - approximately US\$694,587). An increase or decrease in the U.S. to Canadian dollar exchange rate by 5% as at December 31, 2016 would have resulted in a gain



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in the amount of \$70,360 or a loss of \$70,360 (December 31, 2015 – gain or loss of \$48,065). Any gain or loss would have been included in the determination of net income.

#### *Interest rate*

The Company has cash balances which may be exposed to interest rate fluctuations. At December 31, 2016, cash totalled \$1,945,549 (December 31, 2015 - \$1,251,242) and the interest rate sensitivity is not material.

### **SHARE REPURCHASE PROGRAM**

On September 22, 2015, the Company announced with approval from the TSX Venture Exchange its intention to make another Normal Course Issuer Bid (“NCIB”). The NCIB permitted the Company to purchase for cancellation up to 5% of the common shares in the public float. The maximum number of shares allowed for repurchase was 18,262,570. Purchases for cancellation under the NCIB during the period from September 27, 2015 to September 26, 2016 were 14,174,000 common shares.

On September 16, 2016, the Company announced with approval from the TSX Venture Exchange its intention to make another NCIB. The NCIB permits the Company to purchase for cancellation up to 5% of the common shares in the public float. The maximum number of shares allowed for repurchase is 17,563,870. Purchases under the NCIB may occur during the 12 month period commencing September 27, 2016 and ending September 26, 2017, or the date upon which the maximum number of common shares have been purchased by the Company. Purchases for cancellation under the NCIB during the period from September 27, 2016 to December 31, 2016 were 2,884,000 common shares.

For the year ended December 31, 2016, the Company repurchased for cancellation 14,466,000 of its common shares for consideration of \$688,785, at an approximate average price of \$0.048 per share under the NCIB. The Company also incurred an expense of \$6,010 for regulatory cost to set up the new NCIB and to complete the share repurchases during the year. For the year ended December 31, 2015, the Company repurchased for cancellation 10,114,500 of its common shares for consideration of \$480,518 at an average price of \$0.048 per share under the NCIB. The Company also incurred an expense of \$5,268 for regulatory cost to set up the NCIB and to complete the repurchase during the year ended December 31, 2015.

### **SHARE CAPITAL, OPTIONS AND CONTRIBUTED SURPLUS**

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

- Unlimited number of common shares with voting rights and no par value.
- 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.

As of December 31, 2016, the following was outstanding:

	<u>Number of Common Shares</u>	<u>Common Shares \$</u>
Balance, January 1, 2016	362,659,414	\$22,864,205
Shares issued/repurchased for cancellation	(14,466,000)	(694,795)
Balance, December 31, 2016	<u>348,193,414</u>	<u>\$22,169,410</u>

- There are 32,689,000 common share purchase options (“Options”) outstanding and exercisable into 32,689,000 common shares.

## RISK FACTORS AND UNCERTAINTY

Although management has a positive outlook for the Company and continually improves and adapts the Company’s risk mitigation strategies, operating in the technology industry inherently involves a certain level of risk and uncertainty. In management’s opinion, the following risk factors, among others, should be considered when evaluating the Company’s business and its results of future operations:

- Management’s ability to secure additional financing, if needed, on reasonable terms. Access to such financing at acceptable commercial terms will be dependent on the timing of recognition and receipt of cash from our current receivables and contracts, on our ability to demonstrate execution of our business strategy and the general condition of the credit and/or equity markets. Such additional financing may be dilutive in nature to existing shareholders.
- The Company’s access to credit or capital could be restricted based on a global financial crisis which would restrict credit availability worldwide and could also impact its ability to continue operations.
- The Company’s projected revenue in the short-term is tied to approximately US\$2 million in renewals from MobiKEY application software subscriptions and a DEFIMNET platform maintenance agreement, with one or more U.S. Government (“USG”) accounts. If one or more USG accounts were to discontinue their relationship with the Company, such events may have a material adverse impact on the Company’s financial results.
- A significant portion of the Company’s revenues are derived from the United States and in particular from U.S. governmental agencies and departments. Immediately after elections, governmental agencies and departments often defer material changes in their operations and purchases of products and services until a new cabinet is appointed and the political direction is confirmed. This deferral and possible change in political direction following the election could have a material adverse effect on the prospects, operations and results of operations of the Company.
- The President has publicly supported certain policies, including those related to changes to international trade agreements and policies favouring U.S. persons and companies. There is uncertainty as to which measures and policies will actually be taken and/or implemented by the United States government, governmental agencies and departments in 2017 and beyond and when such measures and policies would be implemented. Certain of these measures could have a material and adverse effect on the Company.
- Certain Chief Information Officers of governmental agencies in the United States are required to resign following the election of a new President. There is no assurance that a resigning Chief Information Officer will be reappointed or that a newly appointed Chief Information Officer will be supportive (or continue to be supportive) of the Company’s products and services. A change in the senior officers and

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decision makers in the U.S. government and its agencies could have a material adverse effect on the Company.

- In addition, to the risks discussed above, the Company expects that as a consequence of this transition process the confirmation of the approval and/or renewal of the Company's products and services will be delayed and/or not subject to the approval process experienced in the past and that such delay and/or change in process will make it difficult for the Company to effectively forecast revenues for 2017 and to plan and budget its operations for 2017 and this could have a material adverse effect on the Company.
- The Company's ability to collect payment on a timely basis for services delivered may have a material adverse impact on the Company's liquidity position.
- There is no assurance that any forward-looking statement will materialize. Unless otherwise indicated, forward-looking statements describe expectations as of the date of this document.
- Route1 disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.
- Third-party claims for infringement of intellectual property rights by Route1, and the outcome of any litigation with respect thereto, may harm the Company's competitive advantage in the secure remote access industry;
- Route1's ability to successfully obtain patent or other proprietary or statutory protection for its technologies and products, may harm the Company's competitive advantage in the secure remote access industry;
- Route1's ability to obtain rights to use certain software or components which are supplied by third parties, may not be sufficient to support future sales volumes;
- The ability to run efficient and uninterrupted operation of Route1's MobiNET platform, which could impact on the credibility of the Company's product and services;
- Route1's ability to establish new, and to build on its existing customer base, could also slow the Company's continued growth;
- The occurrence of a breach or perception of a breach of Route1's secure product and service offering, may impact on the credibility of the Company's product and services;
- The inappropriate disclosure of confidential information of the Company may have an impact on the credibility of the Company's product and services;
- Competition, both with existing providers as well as with any future providers entering the marketplace, within the secure remote access industry may hamper future sales growth;
- Route1's reliance on its suppliers and the risk that suppliers will not be able to deliver required components on a timely basis, which may slow future sales growth;
- Any future government(s) regulation of the secure remote access industry, including but not limited to restrictions on encryption of the MobiKEY device and the MobiNET platform may hamper future growth;
- Any significant economic downturn, in geographic areas where Route1 engages in business activities, that may cause those government agencies to reduce discretionary budget spending in areas such as secure identity solutions.
- Any delays in the budget approval process by the U.S. government may delay the procurement and spending in areas such as digital security solutions.

The Company records transactions in Canadian dollars and conducts business both in Canada and internationally. The volatility of the Canadian dollar against currencies such as the U.S. dollar and the Euro can impact financial results negatively should the Canadian dollar appreciate significantly.

## Audit Committee

The three members of the Audit Committee are independent and all meet the qualifications of a financial expert and all are financially literate as such term is defined in National Instrument 52-110 – Audit Committees.

## Legal proceedings

In the normal course of operations, the Company may be subject to litigation claims from customers, suppliers, patent holders, resellers and former employees. A provision is recognized when the probability that the event will occur is greater than the probability that it will not. The Company regularly reviews any outstanding claims to see if they meet the criteria. A provision is calculated based on management’s best estimate of probable outflow of economic resources.

## REVENUE INFORMATION

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 statement of financial position and is recognized as earned revenue for the period in which the service is provided. At December 31, 2016, the Company had \$2,182,668 (December 31, 2015 - \$1,700,420) in deferred revenue.

The following table provides a component presentation of the Company’s revenue streams for the year ended December 31, 2016 and 2015:

	2016		2015	
	Revenue	% of Total	Revenue	% of Total
Devices and appliances	\$363,031	4.9	\$156,048	2.4
Services	7,080,462	95.0	6,218,284	97.2
Other	3,995	0.1	23,037	0.4
	<b>\$7,447,488</b>	<b>100.0</b>	<b>\$6,397,369</b>	<b>100.0</b>

The following table provides a geographical presentation of the Company’s revenue streams for the year ended December 31, 2016 and 2015:

	2016		2015	
	Revenue	% of Total	Revenue	% of Total
USA	\$7,263,308	97.5	\$6,164,505	96.4
Canada	184,180	2.5	232,864	3.6
	<b>\$7,447,488</b>	<b>100.0</b>	<b>\$6,397,369</b>	<b>100.0</b>

## 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 8 King Street East, Suite 600, Toronto, Ontario, Canada M5C 1B5 (telephone 416-848-8391).