YANGAROO INC.

ANNUAL REPORT 2007

To Our Shareholders:

YANGAROO experienced remarkable growth in 2007. Highlights of the year include the largest financing in the company's history, an increase in revenues of 22%, the launch of our U.K. based service, expansion of our product offerings, re-branding of the company, bolstering the management and technology team, moving the company's stock exchange listing up to Tier 1, vigorously prosecuting our patent infringement claim against a competitor, moving to larger premises to accommodate growth, and aggressively pursuing our pending US patent application.

YANGAROO achieved its fifth consecutive year of revenue growth in 2007, driven by higher volumes of deliveries made by existing customers through our Digital Media Distribution System (DMDS) and the addition of new customers. In the U.S. market, the volume of U.S. deliveries made by DMDS grew by 266% to 1.3 million, marking another historic milestone in the technology's adoption. In the fourth quarter of 2007, the number of U.S. deliveries made on DMDS doubled over the fourth quarter of 2006 to 437,000. Through our continued expansion in Canada, the U.S. and the U.K., we expect revenues to continue to grow through 2008.

Cash and cash equivalents were at a record high of $6,497,000 at the year end, exceeding budgeted targets and considerably greater than in any previous year. Planned additions to operating expenses, which were under budget for both the year and the fourth quarter, were the primary reason for the increase in the loss in 2007. The majority of the increase in operating expenses stemmed from the planned augmentation of human resources and from continuing to enforce and expand YANGAROO'S intellectual property rights.

I encourage you to read the following Management Discussion and Analysis and the financial statements for an in-depth perspective on the advances made in the year. A key factor in the company's progress is the sustained support and dedication of our employees, partners and shareholders for which we are grateful. The significant achievements made in 2007 strengthen our confidence that we will see our business flourish in 2008 and beyond.

John Heaven
President & Chief Executive Officer

Management Discussion and Analysis
For the Year Ended December 31, 2007

At the annual and special shareholders meeting of Musicrypt Inc. held on June 25, 2007 the shareholders of Musicrypt Inc. approved the change of the company's name to YANGAROO Inc. The name change was approved by the TSX Venture Exchange July 16, 2007 and YANGAROO Inc. ("YANGAROO") began trading on the TSX Venture Exchange under the symbol YOO (TSX-V: YOO) and in the USA on the OTCBB under the symbol YOOIF on July 18, 2007.

Musicrypt Inc. was previously listed on the TSX Venture Exchange under the symbol MCT and was traded in the USA on the OTCBB under the symbol MCYPF. Additional information on the company is available at www.yangaroo.com and www.sedar.com.

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1) Date of MD&A April 14, 2008.

Note Regarding Forward Looking Statements

This document may contain or refer to certain forward-looking statements relating but not limited to YANGAROO's expectations, intentions, plans and beliefs. Forward-looking information can often be identified by forward-looking words such as "anticipate", "believe", "expect", "goal", "plan"," intend", "estimate", "may" and "will" or similar words suggesting future outcomes, or other expectations, beliefs, plans, objectives, assumptions, intentions or statements about future events or performance. Forward-looking information is based on current expectations that involve a number of business risks and uncertainties. Forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results to differ materially from expected results. Potential shareholders and prospective investors should be aware that these statements are subject to known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from those suggested by the forward-looking statements. Shareholders are cautioned not to place undue reliance on forward-looking information. By its nature, forward-looking information involves numerous assumptions, inherent risks and uncertainties, both general and specific, that contribute to the possibility that the predictions, forecasts, projections and various future events will not occur.

2) Description of Business

YANGAROO is focused on being the leading global provider of secure, user-friendly B2B (business-to-business) digital media distribution via the internet. The principal business objective of YANGAROO is the development and marketing of its patented Digital Media Distribution System ("DMDS") technology solution.

The company's strategy is to use its technology to supplant traditional means of delivering content (such as copying to CD/tapes and delivering via courier) by leveraging the now widely available infrastructure of the high speed internet and evermore powerful desktop computers to enable faster, more secure, less expensive, and environmentally friendly digital content delivery.

DMDS is a web-based delivery system that pioneers secure digital file distribution by incorporating biometrics, high-value encryption and watermarking. DMDS currently replaces the physical distribution of musical recordings and advertising to radio, media, retailers and other authorized recipients with more accountable, effective and far less costly digital delivery of broadcast quality media via the Internet.

DMDS utilizes YANGAROO’s patented Biometric Rights Management (“BRM”) technology to authenticate the recipient of, and grant specified access rights to, the media being distributed. BRM is a unique combination of biometrics, high-value encryption and digital rights management. This biometric verification system identifies the recipient by his or her user name, password and distinctive personal characteristics. The biometric technology currently deployed in DMDS is keystroke dynamics, which identifies a user by their typing rhythm. BRM technology works to prevent unauthorized access and password sharing by verifying individual recipients, and requires no additional hardware for either the sender or the recipient, providing completely portable secure access to users.

The Canadian Record Industry used DMDS to become the world leader in the transition to digital delivery of promotional recordings to radio, internally and to other destinations such as consultants, managers, artists, satellite radio, internet radio, media, and reviewers.

In the US and Europe, where record labels have been primarily delivering promotional releases to radio stations using traditional methods, the record industry is now moving to digital delivery. The traditional methods require the pressing of promotional CD's (known in the industry as CD-PRO's) then packaging, labelling, and sending these with related printed materials by mail or courier to radio and other destinations. This is very costly, time consuming, insecure and harmful to the environment.

In recent years, leaks of new singles by superstar artists such as Britney Spears, Lenny Kravitz, Radiohead, U2, Madonna and Justin Timberlake before their planned public launch dates underscored the need for improved security for new releases. Further, increasing financial pressures in the record business are leading them to look for ways to reduce costs.

Similarly, the advantages of DMDS can be obtained for the distribution of audio advertising to radio stations. DMDS puts the control of when and to whom radio ads are distributed directly in the hands of the advertising firm. DMDS can provide significant costs savings, greater efficiencies, direct control, and individual accountability compared to the distribution of radio ads on either CD’s, FTP or satellite based systems. YANGAROO is also adapting DMDS with the goal of providing these same benefits for the distribution of music videos and TV commercials, which also offer attractive market opportunities for the company.

3) Selected Annual Information

The table below shows selected financial information for the three most recent fiscal years ended December 31.

$	2007	2006	2005
Revenue	524,956	430,142	296,152
Loss	2,665,159	2,113,587	2,061,976
Loss per share	0.04	0.07	0.09
Total assets	8,467,927	1,640,431	1,911,692

The company has no long term financial liabilities and has not declared any dividends on its shares.

4) <u>Review of Results of Operations for the Year Ended December 31, 2007</u>

In 2007 YANGAROO achieved its' fifth consecutive year of revenue growth and had the highest year end cash balance in its history. Revenues for the year ended December 31, 2007 were 22% higher than revenues for fiscal 2006, due to increased use of DMDS by existing customers and the addition of new domestic and international customers. Cash and cash equivalents were $6,497,000 at December 31, 2007, considerably higher than at the end of 2006 ($72,000), or in any preceding years.

The loss for 2007 increased 26% from 2006, which was mainly a result of higher total expenses, which increased by $913,000 (36%). The company utilized funds from the financing completed in February 2007 to reinforce areas that were previously under-resourced due to funding constraints. The higher total expenses are primarily due to planned increases in operating expenses, which came in under the budgeted target for 2007.

The majority of the increase in operating expenses in 2007 stemmed from the company's planned augmentation of its human resources and from continuing to enforce and expand its intellectual property rights. In 2007, the salaries and consulting expense for the company increased $498,000 (35%) from 2006, and expenses related to protection of intellectual property rights, which are classified under general and administrative expense, increased $173,000 (218%). Expenditures related to asserting the company's intellectual property rights are a non-recurring operating expense, as it is expected that these will not be necessary once the matter under litigation is resolved.

The bulk of the increase in salaries and consulting expense occurred in the technology department, where it rose by $230,000 (159%) in 2007. The company commenced bolstering its technology team with necessary human resources in late 2006, adding two developers and a technical support representative. In the second quarter of 2007 the company recruited a Director of Engineering and a graphic designer, and in the fourth quarter added a developer and a quality assurance person. These additions, which were needed to support the company's growth, doubled the number of personnel in the technology and support team by the fourth quarter of 2007, resulting in the higher salaries and consulting expense. A reduced rate of capitalization for technology salaries as deferred development costs, reflecting work related to non-capital maintenance of previously released products, also contributed to the increase in this expense.

The salaries and consulting expense for general and administration rose by $157,000 (25%) mainly as a result of an increase in salaries and wages of $116,000 (33%), a $45,000 expense for directors' fees which were recognized for the first time in 2007, and consulting fees that were higher by $51,000 (47%). These increases were offset by a $70,000 (50%) reduction in stock option expense in the year.

The sales and marketing department had a higher salaries and consulting expense for 2007, increasing by $111,000 (21%). Additions to the company's in-house and consulting human resources for sales and marketing led to salaries and wages rising $79,000 (66%) and consulting fees increasing $67,000 (18%). These were partly offset by a stock option expense that was $42,000 lower in 2007 for sales and marketing.

General and administrative expenses increased $307,000 (72%) in 2007, the majority of which was attributable to the $173,000 increase in expenses related to the protection of intellectual property rights mentioned above. Also affecting this expense were corporate legal services fees rising by $56,000; recruiting fees from the addition of human resources that rose $26,000; $20,000 higher rent for larger premises; and $17,000 higher listing fees.

Marketing and promotion expenses increased $85,000 (36%) in 2007 from 2006 because of greater travel costs for meeting international customers and partners, conference attendance, higher promotional and advertising activity; and enhanced public relations efforts.

In 2007 technology development expense increased $69,000 (171%) over 2006 primarily due to higher technology license costs and increased network management expenses. Total expenditures on technology development in 2007 were $550,000, of which $109,000 was expensed and $441,000 was capitalized. Amortization expense increased $105,000 (39%) due to that higher technology asset balances in 2007 that are subject to amortization.

The company met the deferral criteria for development costs under generally accepted accounting principles as the company is generating increasing revenues from the product and technology it has developed. During 2007 $441,000 of product development costs were capitalized (2006 - $446,000) and $216,000 was amortized (2006 - $133,000).

On February 6, 2007 YANGAROO completed a financing for gross proceeds of $10 million (net proceeds $9,113,000) through Sprott Securities Inc. (now Cormark Securities Inc.) with the sale of 40,000,000 common shares at a price of $0.25 per share. The company utilized this funding to make the substantial progress achieved throughout the balance of 2007.

In April 2007, Warner Bros. Records of Los Angeles chose DMDS to deliver superstar artist Linkin Park’s new single “What I’ve Done” to radio stations across the United States exclusively via DMDS. This historic delivery marked the first time that a major record label in the US has released a new superstar single entirely by digital means to radio, thereby eliminating the major expense of producing and shipping physical CDs. The song debuted at #1 on the BDS and Mediabase Alternative charts the same week it was released, confirming the effectiveness of DMDS as a promotional distribution tool.

In the second quarter of 2007 the company successfully applied for and received approval to be listed as a Tier 1 company on the TSX Venture Exchange. Tier 1 is the most senior level on the TSX Venture Exchange, providing listed companies with the benefits of regulations and governance that are similar to those of the Toronto Stock Exchange.

The success of the Linkin Park release via DMDS led Warner Bros. and Reprise Records to entrust DMDS exclusively with the subsequent release of superstar artist Green Day’s “Working Class Hero” in a digital only format to radio stations. These successes have led Warner Bros. and Reprise to use DMDS for virtually all of their major releases.

Through late winter and spring of 2007 the company successfully used its patent and market share advantages to defend the Canadian market from an attempted and abortive re-entry by a competitor. YANGAROO had previously won the Canadian market over the competitor and others, prior to the granting of any of the company’s patents.

In May the company reported that first quarter revenue rose by 40% compared to the first quarter of 2006 while US delivery volumes in the same period were up 700%.

In June the company completed renegotiation its biometric technology license, resulting in the removal of all market scope limitations and the replacement of a 5% revenue royalty with a lower cost per user license structure.

In the summer of 2007 YANGAROO launched the first phase of its radio advertising delivery service with the support of Los Angeles based Universal Music Group and The Gary Group, the largest advertising agency to the recording industry in the United States, with the first billable deliveries of radio advertising commencing in August 2007.

In July the company embraced a new corporate identity as YANGAROO Inc., which reflects the company's vision of being the global standard in secure B2B digital media delivery. This exciting new name will help the company to communicate with the many new markets for its products beyond the music industry.

During the second quarter the company refined the management team by recruiting a Senior Vice President Sales and adding of a Director of Engineering. Subsequently the company bolstered its technology team by adding a graphic designer in the second quarter, and in the third quarter a developer and quality assurance engineer. In conjunction with this the company moved to expanded premises and upgraded the system infrastructure for DMDS in order to accommodate current and future growth.

The company continued to make progress with the successful examination of its second US patent application No. 10/431,854 titled "Content Distribution System and Method" through 2007. This is same application that the company has been granted patent #2,407,774 for in Canada. Management is optimistic that this US application will result in a patent being granted, just as it did in Canada, which would provide a barrier to entry against competitors in the US market.

The company continued to actively prosecute its Canadian patent infringement claim against a competitor, Destiny Media Technologies Inc., and its partners and to defend the concomitant action regarding the validity of its patent. Examinations for discovery of the company's and the competitor's executives have taken place and undertaking responses filed. The company has also examined for discovery the president of the competitor's former marketing partner, Promo Only Inc. The company firmly believes that it will prevail in this action to assert its Canadian patent rights. The company has filed a claim for damages for infringement of $15 million against Destiny Media Technologies Inc. and its partners.

Usage of DMDS by the US music industry accelerated through 2007. The one million US delivery threshold was achieved in October 2007, marking an historic milestone in the company's growth. US deliveries in the month of October alone were 211,000, a number that exceeded the total volume for the entire first six months of 2006. Over 60% of the October 2007 volume was from major label use of DMDS.

In September the company began a campaign to emphasize the environmental benefits of using DMDS. As the US delivery volumes above show, millions of CD's and the associated printed materials, packaging and transportation can be supplanted by digital delivery. The environmental impact of promotional music distribution can be significantly reduced through the use of DMDS.

In November the composition of the board changed when Mr. Len Gill resigned from and Mr. Howard Atkinson joined the company's board of directors. Howard Atkinson is a CFA and CIMA, and is President of BetaPro Funds Management Inc., where he focuses on management of the Horizons BetaPro Funds and Exchange Traded Funds. He brings 20 years of investment management industry experience to the board.

In December the company announced an agreement with INDIE911, one of the world's largest and fastest growing aggregators of independent music. INDIE911, based in Hollywood, California, features over 45,000 artists and labels, some 250,000 song and film titles, and 50,000 members, with close to four million monthly page views. INDIE911 will offer DMDS to its members, providing digital delivery of their music and promotional materials directly to radio stations across North America.

Also in December, the company announced two additions to its product offerings. DMDS BURN brings watermarked CD burning to the desktop, and Agentless Ad Delivery enables web-based access to DMDS for radio ad spots, eliminating the need to download the DMDS Agent. DMDS BURN, created in response to client needs, allows clients to use their DMDS Agent to produce audio CDs at their desktop that are individually watermarked with any data the user specifies. The entire process can be done in a few minutes, with the watermark data embedded into a CD quality audio file. Currently, record labels either have to purchase very expensive watermark burning hardware, or ship the tracks out to an external service to complete this task. Both of these alternatives are inefficient and time consuming.

Agentless Ad Delivery increases portability and expedites access to DMDS by allowing for radio ad spots and traffic details to be downloaded from any Internet-connected PC or Mac, anywhere in the world. Agentless Ad Delivery builds on the inherent portability of the DMDS technology which ensures security by linking a password to a specific person and not a computer or IP address. Clients can now securely download radio spots using DMDS without the need to download and install the DMDS agent software.

At the end of the fourth quarter of 2007 DMDS was the de-facto standard for B2B (business to business) digital delivery of new music files for the record and radio industry in Canada. No competitor's system was in commercial use at any major record label in Canada and usage of DMDS within the fast growing independent music sector continues to expand. DMDS is the only system that can deliver music internationally across the US, Canada and the UK.

By December 31, 2007, the volume of US deliveries made by DMDS in 2007 had increased 266% over 2006 to 1.3 million. US deliveries for the third quarter alone exceeded 300,000, a first for quarterly volumes. In the fourth quarter of 2007 the number of US deliveries made on DMDS doubled over the fourth quarter of 2006 to 437,000. These volumes demonstrate that the rate of adoption of DMDS in the US record and radio industries is growing at a rapid pace. The company expects to build and monetize this usage into additional revenues.

In January 2008 the company bolstered its management team with the appointment of Richard Klosa as Chief Technology Officer (CTO). Wojtek Hoch left the position of Vice President Technology after five years with company to pursue other opportunities. Richard Klosa brings more than a decade of technology development and management experience as an entrepreneur and digital media innovator to the company. In his previous role as Chief Technology Officer and Co-Founder of J!VE Media Technologies Inc., Richard led his team to a 2002 Canadian New Media Award for 'Most Promising Company' and recognition from the Branham Group as one of the Top 25 Up and Comers. More recently, as the Vice President of Technology at Cubic Health Inc., Richard architected and led the development of the 'Cubic Health Canadian Drug Database™', a comprehensive reporting and analytics system designed to aid Canadian employers in managing their prescription drug benefit. Richard graduated from Ryerson University's Radio & Television arts program with an Honours B.A.A., is a certified PMP and Solutions Developer and has authored "Building A Working Revenue Model For The Digital Distribution Of Copyrighted Media". Richard is a highly regarded technologist whose thoughts and opinions are sought for multiple TV shows (ROB TV, Media TV, CP24), newspaper articles, and online publications.

To date DMDS has made over five million deliveries of over 11,000 songs from more than 500 record labels to destinations which include radio stations representing over 35 US broadcast chains such as CBS/Infinity, Citadel, Clear Channel, Cox, Cumulus, Emmis, EntreVision, Entercom, Federated Media, Sirius, Journal, DMX, Jones Radio, AOL, Music Choice, Radio One, Salem Communications, Univision, Westwood One, Regent, Premiere Radio, Next Media, XM Satellite Radio, Waitt Media and many others. All of these deliveries have been made without a single leak being reported.

5) <u>Review of Results for the Fourth Quarter Ended December 31, 2007</u>

Revenue for the fourth quarter of 2007 was $138,000, 11% higher than the revenue for the fourth quarter of 2006. Revenues increased as a result of greater use of DMDS by existing customers and billings to new customers, especially in the independent sector. Revenue is expected to continue to increase as billable US music deliveries grow, independent sector usage increases, European music delivery revenues begin to flow and advertising delivery volumes rise.

The loss for the fourth quarter of 2007 was $852,000, 74% ($362,000) more than last year's fourth quarter. The increase in the loss was primarily from planned increases in operating expenses, which were under budget for the fourth quarter as well as for the year.

Total expenses in the fourth quarter of 2007 increased largely due to the increase in salaries and consulting expense of $252,000 (71%) compared to last year's fourth quarter. This reflects the planned addition of human resources that were brought on board to execute the company's business plan. The company bolstered its technology team from late 2006 through 2007, doubling the number of personnel in the technology and support team by the fourth quarter of 2007, which accounts for the majority of the increase in salaries and consulting expense in the fourth quarter. A reduced rate of capitalization for technology development salaries as deferred development costs, reflecting work related to non-capital maintenance of previously released products, also contributed to the increase in this expense. The sales and marketing in-house team and consulting were augmented in 2007, which added to fourth quarter salaries and consulting expense. In the fourth quarter of 2007 $11,000 of the expense recognized for salaries and consulting was for the non-cash expense recognized for options, compared to $33,000 for the same period last year.

The second largest expense item increase for the fourth quarter of 2007 was in general and administrative expense of $117,000 (137%), primarily a result of costs related to enforcing the company's patent rights.

The marketing and promotion expense increased by $45,000 (82%) in the fourth quarter due to increased promotional, public relations and advertising activities. Royalty expense was $38,000 (100%) lower, as a result of the renegotiation of the technology license to eliminate the royalty obligation. Interest income rose by $68,000 in the fourth quarter of 2007 due to the interest revenue earned from the funds received from the financing completed in February 2007. Amortization expense increased by $44,000, reflecting higher technology asset balances.

The commercial acceptance of the company's product (DMDS) by the marketplace indicates that expenditures for product development should be recognized as an asset because these are expected to yield future economic benefits. Accordingly, in the fourth quarter of 2007 $110,000 of product development costs were capitalized (2006 – $112,000) and $76,000 was amortized (2006 - $42,000).

6) Summary of Quarterly Results

The following table sets out selected quarterly results of the Corporation for the eight quarters prior to the effective date of this report. The information contained herein is drawn from the interim and annual financial statements of the Corporation.

	Fiscal 2007 ($)				Fiscal 2006 ($)			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Sales	137,650	133,858	130,640	122,808	124,441	106,465	111,488	87,748
Loss for the period	851,609	652,295	632,562	528,693	489,405	524,314	569,753	530,115
Loss per share (basic & diluted)	.01	.01	.01	.01	.01	.02	.02	.02

These figures illustrate the successful development and ongoing marketing of DMDS in Canada and then the US, the obtaining of customers and the associated initial revenues, and the growth in usage resulting in increased revenues into 2007.

7) Liquidity and Capital Resources

Cash and cash equivalents at December 31, 2007 increased to $6,497,000 from $72,000 at December 31, 2006. The main reason for this change was the financing completed in February 2007 described below. During the year ended December 31, 2007 the company invested $113,000 in equipment, $38,000 in patent development, $48,000 in technology licenses, $441,000 in product development and $78,000 in corporate branding.

On February 6, 2007, YANGAROO completed a financing for gross proceeds of $10 million (net proceeds of $9,113,000) through Sprott Securities Inc. (now Cormark Securities Inc.) with the sale of 40,000,000 common shares at a price of $0.25 per share. As compensation to the Agent, the company paid an aggregate commission of $700,000 and issued 2,800,000 broker warrants, each exercisable at a price of $0.25 to acquire a common share until February 6, 2009.

The company will continue to invest funds in building its business to achieve key market and growth targets. The company's operations are not yet generating positive cash flow, so in future the company may need to source additional funds in order to fulfil its business objectives.

8) Share Capital

At December 31, 2007 YANGAROO had 75,517,615 common shares, 3,321,000 options, and 6,725,400 warrants outstanding. At December 31, 2006 YANGAROO had 34,766,815 common shares, 3,629,625 options, and 8,183,800 warrants outstanding. The change in the number of shares outstanding is primarily due to the financing completed in February 2007 described above. Note 9 (ii) of the financial statements provides details of the changes in the number of options and warrants outstanding. 1,250,000 of the company's outstanding shares are not tradable currently as these are subject to the litigation described in note 15(b) of the financial statements.

9) Disclosure Controls and Procedures, and Internal Control Over Financial Reporting

The accompanying financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. For quarterly reporting periods and annual reporting periods, the Company's financial statements are approved by the Board of Directors upon recommendation by the Audit Committee. The integrity and objectivity of these financial statements are the responsibility of management. In addition, management is responsible for all other information in this report and for ensuring that this information is consistent, where appropriate, with the information contained in the financial statements.

In support of this responsibility, management maintains a system of internal controls to provide reasonable assurance as to the reliability of financial information and the safeguarding of assets. In particular, the CEO and CFO are responsible for establishing and maintaining disclosure controls and procedures (“DC&Ps”) and internal controls over financial reporting (“ICFRs”) for the Company, and we have:

(a) designed such DC&Ps, or caused them to be designed under our supervision, to provide reasonable assurance that material information is made known to us during the period in which the annual filings are being prepared; and

(b) designed such ICFRs, or caused them to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP; and

(c) evaluated the design and effectiveness of the Company’s DC&Ps as of the year ended December 31, 2007, and have evaluated the design of the Company’s ICFRs for the year ended December 31, 2007; and

(d) have concluded that a material design weakness in the ICFRs may exist in terms of the inadequate segregation of certain duties, which is typical of development stage companies with limited staff; mitigating factors, including dual-payment authorization policies and transparent internal financial transaction reporting processes, serve to minimize the risk that such design weakness could result in a material misstatement of results for the period ended December 31, 2007; and

(e) have concluded that, other than the item described above in sub-point (d), there are no additional material design weaknesses in the DC&Ps or ICFRs, and that the effectiveness of the DC&Ps is sufficient to expect the prevention or detection of material misstatements of results.

The financial statements include amounts that are based on the best estimates and judgments of management. The Board of Directors is responsible for ensuring that management fulfills its responsibility for financial reporting and internal control. The Board of Directors exercises this responsibility principally through the Audit Committee. The Audit Committee consists of three directors not involved in the daily operations of the Company. The Audit Committee meets with management and the external auditors to satisfy itself that management’s responsibilities are properly discharged and to review the financial statements prior to their presentation to the Board of Directors for approval.

The external auditors, DMCT, LLP audit the annual statements, in accordance with Canadian generally accepted auditing standards, and provide a report of their findings to the Audit Committee. The external auditors have free and full access to the Audit Committee with respect to their findings concerning the fairness of financial reporting and the adequacy of internal controls.

10) <u>Off Balance Sheet Arrangements</u>

The company does not have any off-balance sheet arrangements.

11) <u>Change in Accounting Policies</u>

(i) Accounting Changes:

Effective January 1, 2007, the Company has adopted the new recommendations of the Canadian Institute of Chartered Accountants' Handbook Section 1506, Accounting Changes. These new recommendations permit voluntary changes in accounting policy only when they result in the financial statements providing reliable and more relevant information, require changes in accounting policy to be applied retrospectively unless doing so is impracticable, require prior period errors to be corrected retrospectively and require enhanced disclosures about the effects of changes in accounting policies, estimates and errors on the financial statements. These recommendations also require the disclosure of new primary sources of generally accepted accounting principles that have been issued but not yet effective (See Note 3).

(ii) Financial Instruments:

Effective January 1, 2007, the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants (CICA) under CICA Handbook Section 1530, Comprehensive Income, Section 3251, Equity, Section 3855, Financial Instruments – Recognition and Measurement, Section 3861 Financial Instruments – Disclosure and Presentation and Section 3865, Hedges. These new Handbook Sections, which apply to fiscal years beginning on or after October 1, 2006, provide requirements for the recognition and measurement of financial instruments and on the use of hedge accounting.

Section 1530 establishes standards for reporting and presenting comprehensive income which is defined as the change in equity from transactions and other events from non-owner sources. Other comprehensive income refers to items recognized in comprehensive income but that are excluded from net income calculated in accordance with generally accepted accounting principles.

Under Section 3855, all financial instruments are classified into one of these five categories: held-for-trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments and derivatives are measured in the balance sheet at fair value except for loans and receivables, held-to-maturity investments and other financial liabilities which are measured at amortized cost. Subsequent measurement and changes in fair value will depend on their initial classification, as follows: held-for trading financial assets are measured at fair value and changes in fair value are recognized in net income. Available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the instrument is derecognized or impaired. All derivative instruments, including embedded derivatives, are recorded in the balance sheet at fair value unless they qualify for the normal sale normal purchase exemption. All changes in their fair value are recorded in income unless cash flow hedge accounting is used, in which case changes in fair value are recorded in other comprehensive income.

As a result of the adoption of these new standards, the Company has classified its cash and cash equivalents as held-for-trading. Receivables are classified as loans and receivables. Accounts payable and accrued liabilities are classified as other liabilities, all of which are measured at amortized cost. The Company does not have any derivatives or embedded derivatives and has maintained its policy not to use hedge accounting. The adoption of these new standards had no impact on the financial statements of the Company.

YANGAROO Inc.

(formerly Musicrypt Inc.)

Financial Statements

For the Years Ended December 31, 2007 and 2006

AUDITORS' REPORT

To the Shareholders of
YANGAROO Inc.

We have audited the balance sheets of **YANGAROO Inc. (formerly Musicrypt Inc.)** as at **December 31, 2007** and **2006** and the statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at **December 31, 2007** and **2006** and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

DMCT, LLP

DMCT, LLP, Licensed Public Accountants

March 19, 2008
Toronto, Ontario

YANGAROO Inc.
(formerly Musicrypt Inc.)
Balance Sheets
As at December 31

	Note		2007		2006
Assets					
Current					
Cash and cash equivalents		$	**6,496,563**	$	72,447
Accounts receivable			**141,492**		90,732
Prepaids and sundry assets			**57,435**		47,283
			6,695,490		210,462
Capital assets	4		**110,871**		59,655
Patents			**60,869**		22,994
Investment in technology	5		**561,379**		611,271
Deferred development costs	6		**961,288**		736,049
Trade-name and related marketing intangibles			**78,030**		-
		$	**8,467,927**	$	1,640,431
Liabilities					
Current					
Operating loan	7	$	**-**	$	15,000
Accounts payable and accrued liabilities			**423,314**		263,168
Deferred revenue			**9,801**		-
			433,115		278,168
Shareholders' Equity					
Capital stock	8		**21,043,889**		12,322,261
Contributed surplus	10		**737,170**		645,844
Warrant capital	11		**524,754**		-
Deficit			**(14,271,001)**		(11,605,842)
			8,034,812		1,362,263
		$	**8,467,927**	$	1,640,431

Commitments and Contingencies (Note 15)

Approved by the Board **"Cliff Hunt"** Director **"John Heaven"** Director

(Signed) (Signed)

See accompanying notes.

YANGAROO Inc.

(formerly Musicrypt Inc.)
Statements of Operations and Deficit
For the Years Ended December 31

	Note	2007	2006
Revenue		**$ 524,956**	$ 430,142
Expenses			
Salaries and consulting		**1,934,837**	1,437,196
Marketing and promotion		**321,720**	236,379
General and administrative		**733,531**	426,656
Technology development		**108,858**	40,122
Royalties		**-**	150,000
Amortization of capital assets		**58,158**	41,376
Amortization of investment in technology		**97,883**	92,536
Amortization of deferred development costs		**215,885**	133,443
		3,470,872	2,557,708
Loss before interest income		**(2,945,916)**	(2,127,566)
Interest income		**280,757**	13,979
Net loss		**(2,665,159)**	(2,113,587)
Deficit at beginning of year		**(11,605,842)**	(9,492,255)
Deficit at end of year		**$(14,271,001)**	$ (11,605,842)
Basic and diluted loss per share	13	**$ (0.04)**	$ (0.07)

See accompanying notes.

YANGAROO Inc.

(formerly Musicrypt Inc.)
Statements of Cash Flows
For the Years Ended December 31

	2007	2006
Cash flows from (used in) operating activities		
Net loss for the year	$ (2,665,159)	$ (2,113,587)
Add items not affecting cash		
Amortization	371,926	267,355
Loss on disposal of capital assets	3,612	1,947
Issuance of shares for royalty payment	-	132,190
Stock-based compensation	94,101	201,715
	(2,195,520)	(1,510,380)
Changes in non-cash working capital items		
Accounts receivable	(50,760)	(39,471)
Prepaids and sundry assets	(10,152)	(28,320)
Accounts payable and accrued liabilities	160,146	160,270
Deferred revenue	9,801	-
	(2,086,485)	(1,417,901)
Cash flows from (used in) investing activities		
Purchase of capital assets	(112,986)	(29,694)
Patents	(37,875)	(22,994)
Investment in technology	(47,991)	-
Deferred development costs	(441,124)	(446,656)
Trade name	(78,030)	-
	(718,006)	(499,344)
Cash flows from financing activities		
Issuance of common shares, net of issue costs	9,243,607	1,333,151
Operating loan (repayment)	(15,000)	15,000
	9,228,607	1,348,151
Increase (decrease) in cash during the year	6,424,116	(569,094)
Cash and cash equivalents at beginning of year	72,447	641,541
Cash and cash equivalents at end of year	$ 6,496,563	$ 72,447

Cash and cash equivalents is comprised of the following amounts:

	2007	2006
Cash	$ 25,186	$ 2,612
Cash equivalents	6,471,377	69,835
	$ 6,496,563	$ 72,447

See accompanying notes.

1. NATURE OF BUSINESS

YANGAROO Inc. (the "Company") is a technology company that is targeted to become the leading enabler of user-friendly and secure distribution of media via the internet. The Company was incorporated on July 28, 1999 under the laws of Ontario as Musicrypt.com Inc. and changed to its present name on July 17, 2007.

2. CHANGE IN ACCOUNTING POLICIES

(i) Accounting Changes

Effective January 1, 2007, the Company has adopted the new recommendations of the Canadian Institute of Chartered Accountants' Handbook Section 1506, Accounting Changes. These new recommendations permit voluntary changes in accounting policy only when they result in the financial statements providing reliable and more relevant information, require changes in accounting policy to be applied retrospectively unless doing so is impracticable, require prior period errors to be corrected retrospectively and require enhanced disclosures about the effects of changes in accounting policies, estimates and errors on the financial statements. These recommendations also require the disclosure of new primary sources of generally accepted accounting principles that have been issued but not yet effective (see Note 3).

(ii) Financial Instruments

Effective January 1, 2007, the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants (CICA) under CICA Handbook Section 1530, Comprehensive Income, Section 3251, Equity, Section 3855, Financial Instruments – Recognition and Measurement, Section 3861 Financial Instruments – Disclosure and Presentation and Section 3865, Hedges. These new Handbook Sections, which apply to fiscal years beginning on or after October 1, 2006, provide requirements for the recognition and measurement of financial instruments and on the use of hedge accounting.

Section 1530 establishes standards for reporting and presenting comprehensive income which is defined as the change in equity from transactions and other events from non-owner sources. Other comprehensive income refers to items recognized in comprehensive income but that are excluded from net income calculated in accordance with generally accepted accounting principles.

2. CHANGE IN ACCOUNTING POLICIES (Cont'd)

(ii) Financial Instruments (Cont'd)

Under Section 3855, all financial instruments are classified into one of these five categories: held-for-trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments and derivatives are measured in the balance sheet at fair value except for loans and receivables, held-to-maturity investments and other financial liabilities which are measured at amortized cost. Subsequent measurement and changes in fair value will depend on their initial classification, as follows: held-for trading financial assets are measured at fair value and changes in fair value are recognized in net income. Available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the instrument is derecognized or impaired. All derivative instruments, including embedded derivatives, are recorded in the balance sheet at fair value unless they qualify for the normal sale normal purchase exemption. All changes in their fair value are recorded in income unless cash flow hedge accounting is used, in which case changes in fair value are recorded in other comprehensive income.

As a result of the adoption of these new standards, the Company has classified its cash and cash equivalents as held-for-trading. Receivables are classified as loans and receivables. Accounts payable and accrued liabilities are classified as other liabilities, all of which are measured at amortized cost. The Company does not have any derivatives or embedded derivatives and has maintained its policy not to use hedge accounting.

The adoption of these new standards had no impact on the financial statements of the Company.

3. SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles within the framework of the significant accounting policies summarized below.

Use of Estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenue and expenses during the year. Actual results could differ from those estimates.

Significant areas requiring the use of management estimates relate to the determination of the useful lives of long-lived assets for amortization purposes, impairment of trade-name and related marketing intangibles, valuation of stock-based payments and warrants and the fair values of financial instruments.

Cash and Cash Equivalents

Cash and cash equivalents consists of cash in the bank and highly liquid investments with maturities of three months or less at the time of purchase.

Capital Assets

Capital assets are recorded at cost less accumulated amortization. Amortization is calculated on a straight-line basis over the estimated useful lives of the assets as follows:

Office furniture and equipment	- 5 years
Computer equipment	- 3 years
Computer software	- 3 years
Leasehold improvements	- over the term of the lease
Website and other technology	- 3 years

Patents

Costs to obtain patents are capitalized and are amortized to operations on a straight-line basis over the underlying term of the patents, commencing upon the registration of the patent. The patent relates to the use of the technology under license described in Note 5.

3. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Intangible Assets

Intangible assets with indefinite useful lives, which consist of trade-name and related marketing intangibles, are not amortized but rather are subject to an annual impairment review or more frequently if circumstances exist that might indicate their value is impaired. Should the carrying value exceed the fair value of an intangible asset, the carrying value will be written down to the fair value.

Investment in Technology

The investment in technology consists of consideration paid for the acquisition of licenses to use technology. Such costs are amortized to operations on a straight-line basis over the remaining term of the license. During the year, the Company signed a license agreement expiring on June 28, 2013 as disclosed in Note 15(a).

Research and Development Costs

Research costs are charged to operations when incurred. Development costs are expensed in the year incurred unless they meet the criteria under Canadian generally accepted accounting principles for deferral and amortization. Amortization commences with the successful commercial production or use of the product or process. These costs are being amortized over a period of four years from commencement of commercial use.

Impairment of Long-lived Assets

Long-lived assets consist of capital assets, patents, deferred development costs and investment in technology. Long-lived assets are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. When the carrying value is not recoverable from future cash flows on an undiscounted basis and the carrying value exceeds the assets' fair value, an impairment loss is recorded for the excess of carrying value over fair value.

Share Issuance Costs

Costs incurred in connection with the issuance of capital stock are netted against the proceeds received.

3. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Accounting for Stock-Based Compensation and Other Stock-Based Payments

The Company applies a fair value based method of accounting to all stock-based payments. Accordingly, stock-based payments are measured at the fair value of the consideration received or the fair value of the equity instruments issued or liabilities incurred, whichever is more reliably measurable. Stock-based compensation is charged to operations over the vesting period and the offset is credited to contributed surplus. Consideration received upon the exercise of stock options is credited to share capital and the related contributed surplus is transferred to share capital.

Revenue Recognition

The Company's revenue is derived through the secure distribution of media via its patented Digital Media Distribution System. The Company recognizes revenue at the time persuasive evidence of an agreement exists, price is fixed and determinable, the distribution of the media has occurred and collectibility is reasonably assured. The Company defers revenue which has been billed but that does not meet the revenue recognition criteria.

Loss Per Share

Basic loss per share is calculated based on the weighted average number of shares outstanding. The treasury stock method is used to compute the dilutive effect of options, warrants and similar instruments.

Income Taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on temporary differences between financial reporting and tax bases of assets and liabilities, as well as for the benefit of losses available to be carried forward to future years for tax purposes. Future income tax assets and liabilities are measured using enacted or substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. Future income tax assets are recorded in the financial statements if realization is considered more likely than not.

Foreign Currency Translation

Monetary assets and liabilities denominated in foreign currencies are translated to Canadian dollars at exchange rates in effect at the balance sheet date. Non-monetary assets and liabilities are translated at rates of exchange at each transaction date. Revenue and expenses are translated at the rate of exchange at each transaction date. Gains or losses on translation are included in income.

3. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Recent Accounting Pronouncements Issued and Not Yet Applied

The Accounting Standards Board of the CICA approved a set of disclosure and presentation requirements which include Handbook Section 1535, Capital Disclosures, which establishes standards for disclosing information about an entity's capital and how it is managed. The standard requires disclosure of: an entity's objectives, policies and processes for managing capital, quantitative data about what the entity regards as capital and whether the entity has complied with any capital requirements and, if it has not complied, the consequences of such non-compliance. This standard is effective for the Company for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008. The Company has not yet determined the impact that the adoption of this change will have on the disclosure in its financial statements.

CICA Handbook Section 3862, Financial Instruments – Disclosures, increases the disclosures currently required that will enable users to evaluate the significance of financial instruments for an entity's financial position and performance, including disclosures about fair value. In addition, disclosure is required of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about liquidity risk and market risk. The quantitative disclosures must also include a sensitivity analysis for each type of market risk to which an entity is exposed, showing how net income and other comprehensive income would have been affected by reasonably possible changes in the relevant risk variable. This standard is effective for the Company for interim and annual financial statements beginning on January 1, 2008. The Company has determined there will be no impact on the adoption of this change on the disclosures in its financial statements.

CICA Handbook Section 3863, Financial Instruments – Presentation, replaces the existing requirements on presentation of financial instruments which have been carried forward unchanged to this new section. This standard is effective for the Company for interim and annual financial statements beginning on January 1, 2008. The Company has not yet determined the impact that the adoption of this change will have on the disclosure in its financial statements.

Goodwill and Intangible Assets

CICA Handbook Section 3064, Goodwill and Intangible Assets, replaces Section 3062, Goodwill and Other Intangible Assets and Section 3450, Research and Development Costs. Section 3064 establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets. This section also addresses when an internally developed intangible asset meets the criteria for recognition as an asset. This standard is effective for the Company for interim and annual financial statements beginning on January 1, 2008. The Company does not expect the adoption of this standard to have a material impact on its financial statements.

3. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Recent Accounting Pronouncements Issued and Not Yet Applied (Cont'd)

International Financial Reporting Standards

In February 2008, the Accounting Standards Board ("AcSB") confirmed that Canadian generally accepted accounting principles for publicly accountable enterprises will be converged with International Financial Reporting Standards ("IFRS") effective in calendar year 2011. The conversion to IFRS will be required, for the Corporation, for interim and annual financial statements beginning on January 1, 2011. IFRS uses a conceptual framework similar to Canadian GAAP, but there are significant differences on recognition, measurement and disclosures. In the period leading up to the conversion, the AcSB will continue to issue accounting standards that are converged with IFRS such as IAS 2 "Inventories" and IAS 38 "Intangible assets", thus mitigating the impact of adopting IFRS at the mandatory transition date. The Corporation has not yet determined the impact of the adoption of IFRS on its financial statements.

4. CAPITAL ASSETS

December 31, 2007

	Cost	**Accumulated Amortization**	**Net**
Office furniture and equipment	**$ 27,122**	**$ 16,306**	**$ 10,816**
Computer equipment	**234,026**	**153,374**	**80,652**
Computer software	**14,063**	**11,117**	**2,946**
Leasehold improvements	**13,790**	**1,313**	**12,477**
Website and other technology	**17,286**	**13,306**	**3,980**
	$ 306,287	**$ 195,416**	**$ 110,871**

December 31, 2006

	Cost	Accumulated Amortization	Net
Office furniture and equipment	$ 21,617	$ 13,635	$ 7,982
Computer equipment	156,350	112,037	44,313
Computer software	10,917	9,472	1,445
Leasehold improvements	7,768	6,473	1,295
Website and other technology	10,456	5,836	4,620
	$ 207,108	$ 147,453	$ 59,655

5. INVESTMENT IN TECHNOLOGY

		2007		2006
Balance at beginning of year	**$**	**611,271**	$	703,808
Additions		**47,991**		-
Less: Amortization		**(97,883)**		(92,537)
Balance at end of year	**$**	**561,379**	$	611,271

As at December 31, 2007 the total cost of the investment in technology is $1,205,698 (2006 - $1,157,708) and the accumulated amortization is $644,319 (2006 - $546,437). The Company has entered into a license agreement relating to the investment in technology (see Note 15(a)).

6. DEFERRED DEVELOPMENT COSTS

		2007		2006
Opening balance	**$**	**736,049**	$	422,836
Additions		**441,124**		446,656
Less: Amortization		**(215,885)**		(133,443)
Ending balance	**$**	**961,288**	$	736,049

Costs associated with the development of the Company's various digital media distribution systems ("DMDS") have been recorded as a deferred development costs. When a product begins to generate revenues, management ceases to defer the associated costs and begins to amortize the asset over the estimated benefit period. As at December 31, 2007, the total cost of the deferred development is $1,336,334 (2006 - $895,210) and the accumulated amortization is $375,046 (2006 - $159,161).

7. OPERATING LOAN

The Company has available an operating line of credit of $25,000. Borrowings under the operating line of credit are due on demand and bear interest at prime plus 2.5% per annum and are secured by a general security agreement. As at December 31, 2007, the Company had not drawn on this line of credit (2006 - $15,000).

8. CAPITAL STOCK

Authorized
unlimited common shares.

Issued and outstanding

	Number of Shares	Value
Balance, January 1, 2006	**26,605,866**	**$ 10,856,920**
Issued for cash (i)	7,500,000	1,333,151
Issued for royalty payment (ii)	660,949	132,190
Balance, December 31, 2006	**34,766,815**	**$ 12,322,261**
Issued for cash (iii)	40,000,000	**8,608,019**
Issued on exercise of broker unit warrants (iv)	450,800	**90,160**
Less: Proceeds allocated to warrants (iv)	-	**(19,326)**
Issued on exercise of options (v)	250,000	**27,775**
Issued on exercise of broker warrants (vi)	50,000	**15,000**
Balance, December 31, 2007	**75,517,615**	**$ 21,043,889**

8. CAPITAL STOCK (Cont'd)

(i) The Company issued 7,500,000 units for gross proceeds of $1,500,000 by way of a private placement. Each unit consisted of one common share and one-half of a warrant to purchase one common share at a price of $0.30 per share for a period of twenty four months thereafter. Share issuance costs of $166,849 have been netted against the proceeds.

(ii) The Company issued 660,949 common shares to its licensor in satisfaction of the balance of the minimum royalty due under the license agreement, in the amount of $132,190.

(iii) The Company issued 40,000,000 common shares for gross proceeds of $10,000,000 by way of a private placement. Share issuance costs of $1,391,981 have been netted against the proceeds. Included in share issuance costs is $505,428 representing the value of 2,800,000 warrants issued to agents in connection with the private placement.

(iv) The Company issued 450,800 units for proceeds of $90,160 pursuant to the exercise of unit warrants. In connection with the exercise of the unit warrants, the holders received one common share and an additional half warrant. The additional 225,400 warrants issued were assigned a value of $19,326.

(v) The Company issued 250,000 common shares for proceeds of $25,000 pursuant to the exercise of options. In connection with the exercise of options, a value of $2,775 was transferred from contributed surplus.

(vi) The Company issued 50,000 common shares for proceeds of $15,000 pursuant to the exercise of warrants.

9. STOCK OPTIONS AND WARRANTS

(i) Stock Options

The Company has an Incentive Stock Option Plan (the "Plan"). The Plan provides for options to be granted to the benefit of employees, directors and third parties. The maximum number of shares allocated to and made available to be issued under the Plan is 5,900,000. In 2007, the board of directors adopted a new option pricing model such that the exercise price of options granted under the Stock Option Plan is priced as the greater of the three months weighted average trading price prior to the grant and the closing trading price for the common shares for the last trading day prior to the grant. The term of any option granted shall not exceed the maximum permitted time period under applicable regulations. Except as otherwise provided elsewhere in the Stock Option Plan, the options shall be cumulatively exercisable in installments over the option period at a rate to be fixed by the Board of Directors. The Company will not provide financial assistance to any optionee in connection with the exercise of options.

9. STOCK OPTIONS AND WARRANTS (Cont'd)

(i) Stock Options (Cont'd)

The Company had issued stock options to acquire common shares as follows:

	2007		2006	
	Number of Options	**Weighted Average Exercise Price**	Number of Options	Weighted Average Exercise Price
Outstanding, beginning of year	**3,629,625**	**$ 0.46**	2,939,625	$ 0.48
Issued	**1,020,000**	**$ 0.29**	735,000	$ 0.26
Exercised	**(250,000)**	**$ (0.10)**	-	$ -
Cancelled	**(689,000)**	**$ (0.30)**	(7,500)	$ (0.42)
Expired	**(389,625)**	**$ (0.71)**	(37,500)	$ (0.60)
Outstanding, end of year	**3,321,000**	**$ 0.42**	3,629,625	$ 0.46
Exercisable	**2,582,500**	**$ 0.46**	3,065,625	$ 0.48

The Company had the following stock options outstanding at December 31, 2007:

Number of Options	**Exercise Price**	**Expiry Date**
185,000	$ 0.75	May 7, 2008
25,000	$ 0.47	September 24, 2008
50,000	$ 1.04	January 1, 2009
400,000	$ 0.47	January 1, 2009
100,000	$ 0.86	August 9, 2009
25,000	$ 0.47	August 25, 2009
25,000	$ 0.52	September 14, 2009
100,000	$ 0.47	November 24, 2009
60,000	$ 0.44	February 3, 2010
500,000	$ 0.44	March 7, 2010
565,000	$ 0.42	May 19, 2010
110,000	$ 0.42	October 3, 2010
75,000	$ 0.25	November 22, 2010
100,000	$ 0.25	April 11, 2011
65,000	$ 0.20	August 16, 2011
120,000	$ 0.24	November 21, 2011
121,000	$ 0.35	April 12, 2012
400,000	$ 0.32	May 24, 2012
55,000	$ 0.27	June 25, 2012
140,000	$ 0.24	August 15, 2012
100,000	$ 0.13	November 27, 2012
3,321,000		

9. STOCK OPTIONS AND WARRANTS (Cont'd)

(ii) Warrants

The Company had issued warrants to acquire common shares as follows:

	2007		2006	
	Number of Warrants	**Weighted Average Exercise Price**	Number of Warrants	Weighted Average Exercise Price
Outstanding, beginning of year	**8,183,800**	**$ 0.53**	4,475,000	$ 0.74
Granted	**3,025,400**	**$ 0.25**	4,308,800	$ 0.29
Exercised	**(500,800)**	**$ (0.21)**	-	$ -
Expired	**(3,983,000)**	**$ (0.87)**	(600,000)	$ (0.40)
Outstanding, end of year	**6,725,400**	**$ 0.28**	8,183,800	$ 0.53

The Company had the following warrants outstanding at December 31, 2007:

Number of Warrants	**Purchase Price**	**Expiry Date**
1,630,000 (a)	$ 0.30	May 12, 2008
120,400 (b)	$ 0.30	May 12, 2008
75,000 (a)	$ 0.30	May 25, 2008
1,995,000 (a)	$ 0.30	June 7, 2008
105,000 (b)	$ 0.30	June 7, 2008
2,800,000 (c)	$ 0.25	February 6, 2009
6,725,400		

(a) These are issued in connection with the private placement of units disclosed in Note 8(i). Each warrant entitles the holder to acquire one common share at a price of $0.30 per share for a period of twenty four months from issuance.

(b) These warrants were issued in connection with the exercise of broker unit warrants disclosed in Note 8(iv). Each warrant entitles the holder to acquire one common share at a price of $0.30 per share for a period of twenty four months from issuance.

(c) These warrants were issued to agents in connection with the private placement of units disclosed in Note 8(iii). Each warrant entitles the holder to acquire one common share at a price of $0.25 per share for a period of twenty four months from issuance.

10. CONTRIBUTED SURPLUS

		2007		2006
Contributed surplus beginning of year	**$**	**645,844**	$	444,129
Stock-based compensation expense (Note 12)		**94,101**		201,715
Transfer to capital stock on exercise of options		**(2,775)**		-
	$	**737,170**	$	645,844

11. WARRANT CAPITAL

		2007		2006
Value of warrants issued in the year	**$**	**524,754**	$	-

The fair value of each full warrant granted in the year has been estimated at the date of issue using the Black-Scholes pricing model with the following weighted average assumptions: (i) dividend yield of 0%; (ii) expected volatility of 105% (iii) risk-free interest rate of 4.1% and; (iv) expected life of 1.92 years. The weighted average grant date fair values of warrants granted in the year ended December 31, 2007 was $0.17.

12. STOCK-BASED COMPENSATION

The total stock compensation expense relating to options recognized in the year was $94,101 (2006 - $201,715).

The fair value of each option granted in the year ended December 31, 2007 has been estimated at the date of grant or the date when it became measurable using the Black-Scholes option pricing model with the following weighted-average assumptions: (i) dividend yield of 0%; (ii) expected volatility of 91% (2006 - 87%); (iii) risk-free interest rate of 4.29% (2006 - 4.1%) and; (iv) expected life of 5 (2006 - 5) years. The Company has assumed no forfeiture rate (except on performance based options) as adjustments for actual forfeitures are made in the period they occur. The weighted average grant date fair values of options issued in the year ended December 31, 2007 was $0.16 (2006 - $0.17).

13. LOSS PER SHARE

Loss per share has been calculated based on the weighted average number of common shares outstanding at December 31, 2007 of 71,285,878 (2006 - 31,369,104).

For the above-mentioned years, the Company had securities outstanding which could potentially dilute basic earnings per share in the future, but were excluded from the computation of dilutive net loss per share in the periods presented, as their effect would have been anti-dilutive. Such outstanding securities consist of the following:

	2007	2006
Options	**3,321,000**	3,629,625
Warrants	**6,725,400**	8,183,800

14. INCOME TAXES

(i) Income Tax Expense

The following table reconciles income taxes calculated at combined Canadian federal/ provincial tax rates with the income tax expense in these financial statements:

	2007	2006
Loss before income taxes	**$(2,665,159)**	$(2,113,587)
Statutory rate	**36.1%**	36.1%
Expected income tax recovery	**$ (962,122)**	$ (763,005)
Amounts not deductible for tax and other	**39,322**	82,705
Change in valuation allowance	**(11,000)**	740,500
Change in expected tax rate and other	**938,900**	-
Expiration of non-capital losses	**314,900**	-
Share issuance costs incurred	**(320,000)**	(60,200)
Income tax expense	**$ -**	$ -

(ii) Future Income Taxes

The temporary differences that give rise to future income tax assets and future income tax liabilities are presented below:

	2007	2006
Amounts related to tax loss and credit carryforwards	**$ 3,397,200**	$ 3,584,100
Share issuance costs	**308,400**	160,000
Capital and intangible assets	**326,700**	299,200
Net future tax asset	**4,032,300**	4,043,300
Less: Valuation allowance	**(4,032,300)**	(4,043,300)
	$ -	$ -

14. INCOME TAXES (Cont'd)

(iii) The Company has non-capital losses of approximately $11,714,400 available to apply against future taxable income. If not utilized, the non-capital losses will expire as follows:

2008	$ 936,000
2009	470,000
2010	1,770,000
2014	2,630,000
2015	1,389,000
2026	1,861,000
2027	2,658,400
	$ 11,714,400

The potential tax benefit relating to these losses has not been reflected in these financial statements.

15. COMMITMENTS AND CONTINGENCIES

(a) Technology License Agreement

Pursuant to a licensing agreement dated June 28, 2007, the Company was granted a non-exclusive license to integrate a patented biometric technology (the "Intellectual Property") with their DMDS (Note 5). The initial term of the License is for six years, automatically renewing for successive terms of one year after the initial five-year term and may be terminated upon 180 days notice prior to the renewal date of the agreement.

The Company paid a one time cost of $30,000 and must pay an annual maintenance fee of $5,400 per year and an annual user license fee of a minimum of $5,000.

(b) Litigation

On November 14, 2000, the Company filed a claim against a former employee and shareholder, and related shareholders, seeking a rescission of their 1,250,000 common shares and damages in the amount of $100,000. A counterclaim was brought against the Company by these defendants for various relief including damages of approximately $850,000, a declaration that the defendants are shareholders and orders that they be bought out or the Company be wound up. In May 2001, the Company successfully defeated a motion by the defendants that sought interim costs and security for costs. The Company was awarded its costs for this motion. The Company continues to vigorously defend the action. The outcome is not determinable and therefore no provision is recorded.

In the ordinary course of business activities, the Company may be contingently liable for litigation and claims with customers, suppliers and former employees. Management believes that adequate provisions have been recorded in the accounts where required.

15. COMMITMENTS AND CONTINGENCIES (Cont'd)

(c) Patent Infringement

On July 25, 2005, the Company sent a letter to a competitor and its partners demanding that they cease infringement of the Company's Content Distribution System and Method patent number 2,407,774 in Canada. On March 7, 2006, the competitor filed a claim with the Federal Court of Canada requesting a ruling that the technology of the competitor and its partners does not infringe on this patent and that the patent was invalid. In June 2006, the Company filed with the Federal Court a statement of defence and counterclaim seeking $15 million in damages for infringement from the competitor and its partners. In May 2007, the competitor sued the Company for defamation and interference with their business claiming $25 million in damages. Management is of the opinion that the suit is a meritless attempt to deflect attention from the Company's patent infringement claim against the competitor. The Company has filed a statement of defence and counterclaim with the Federal court for $25 million in damages from the competitor for defamation and interference with the Company's business. The outcome is not determinable and therefore no provision is recorded.

On June 22, 2007, the Company filed a claim against a customer of the above competitor, requesting a declaration that the Company's Canadian patent, Content Distribution System and Method patent number 2,407,774 is valid and infringed by the use of the competitors technology and is seeking $2 million in damages. In November 2007, a defence and counterclaim was filed seeking a declaration that the use of the competitor's technology does not infringe the patent and the patent is valid. The outcome is not determinable and therefore no provision is recorded.

(d) Leases

Total future minimum annual lease payments for premises and equipment are as follows:

2008	$	105,850
2009		92,140
2010		64,700
2011		64,700
2012		48,500
	$	**375,890**

16. FINANCIAL INSTRUMENTS

Fair Value

The carrying values of cash and cash equivalents, amounts receivable, accounts payable and accrued liabilities, and operating loan approximate fair values due to the relatively short term maturities of these instruments.

Credit Risk

The Company is subject to risk of non-payment of accounts receivable. The Company mitigates this risk by monitoring the credit worthiness of its customers. As at December 31, 2007, approximately 55% (2006 - 62%) of accounts receivable and 53% (2006 - 59%) of revenue are from four customers (2006 - four customers).

Interest Rate Risk

The Company has bank borrowings that carry interest at a floating rate and therefore, is subject to cash flow interest rate risk.

17. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform with the current year's financial statement presentation.

CORPORATE INFORMATION

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John C. Heaven	*President & Chief Executive Officer*
Howard Atkinson	*Member of Audit Committee and Compensation Committee*
Justin D. C. LaFayette	*Member of Audit Committee and Compensation Committee*
Gary Moss	*Member of Audit Committee and Compensation Committee*

Officers

John C. Heaven	*President & Chief Executive Officer*
Clifford G. Hunt	*Chairman & Chief Operating Officer*
Garry Wallace	*Executive Vice President, Sales and Marketing*
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