YANGAROO Inc.

Interim Financial Statements

June 30, 2007

(unaudited)

YANGAROO Inc.
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YOO on the TSX Venture Exchange
YOOIF on the OTCBB

Management Discussion and Analysis
<u>For the Second Quarter Ended June 30, 2007</u>

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.

YANGAROO's address is: Suite 300, 225 East Beaver Creek Road
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1) <u>Date of MD&A</u> Aug 15, 2007.

<u>Note Regarding Forward Looking Statements</u>

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) <u>Description of Business</u>

YANGAROO is focused on becoming the leading enabler of secure, user-friendly 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.

DMDS is a web-based delivery system that pioneers secure digital file distribution by incorporating biometrics, high-value encryption and watermarking. DMDS 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.

Record labels have been delivering promotional releases to radio stations using primarily manual methods. In advance of the distribution of a new album to retailers, a single track (or song) is chosen from the album for release to radio. After the track has been selected, several hundred copies of a "radio only" compact disk single (known in the industry as a CD-PRO) are made. These CD-PRO's are individually packaged, labelled, and couriered or mailed to the radio stations that would potentially play this genre of music. This is time consuming, inefficient, expensive and very insecure.

In recent years leaks of new singles by superstar artists such as Britney Spears, Lenny Kravitz, Radiohead, U2, and Madonna 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.

DMDS solves the problems with the current promotional distribution process used in the music industry and significantly reduce the costs of such distribution. The range of external parties that DMDS can distribute tracks to has grown beyond traditional radio to include consultants, managers, artists, satellite radio, internet radio, media and reviewers. DMDS is also used by record labels for securely distributing music internally.

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.

3) <u>Review of Operations</u>

The growth that YANGAROO experienced through 2006 continued into the first six months of 2007. Revenues for the six month period ended June 30, 2007 were 27% higher than revenues for the first half of 2006. The loss for the same period increased 6%. The Company met the deferral criteria for development costs under generally accepted accounting principles as the Company is generating revenue from the product and technology it has developed. During the first half of 2007 $230,000 of product development costs were capitalized and $84,000 was amortized.

At the end of the second quarter of 2007, YANGAROO's 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 to date in 2007. EMI, Sony BMG, Universal and Warner in Canada were all using DMDS commercially and the adoption of DMDS within the fast growing independent music sector was expanding. Usage of DMDS in the US also continued to grow rapidly through the first half of 2007 as deliveries made in the US by DMDS were over five times those made in the first half of 2006.

YANGAROO's DMDS has delivered over 9,000 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. DMDS is the only system that can deliver music across the US, Canada and the UK.

In January 2007 YANGAROO and Adstream unveiled Adstream•DMDS at Midem, the major international music conference held annually in Cannes France. Adstream•DMDS will initially be launched in the UK and Ireland, with Europe and Australia to follow. In December 2006 YANGAROO joined forces with London based Adstream Ltd. (www.adstream.com) to market DMDS in the UK, Europe and Australia. Adstream is the leading provider of digital asset management and distribution services for the global advertising market, serving over 5,000 companies in 42 countries supported through 10 regional offices in the UK, USA, Singapore, India, Australia, South Africa, Malaysia, New Zealand, Ireland, and Germany. Adstream will provide its marketing team and customer base to market and support DMDS, initially to the music industry in the UK then on to continental Europe and Australia. "We looked at various competing technologies available to offer to our existing radio and music industry clients and chose YANGAROO's DMDS, because of its sector-leading features, ease of use and security advantages", said Andy Hopkinson, Managing Director of Adstream UK. "We believe DMDS will be the best choice for our customers and provide a substantial additional revenue opportunity for us."

In February 2007 YANGAROO reported that deliveries of music tracks via DMDS in the US increased over 500% from the second quarter of 2006 to over 219,000 deliveries in the fourth quarter of 2006. This rapid growth is attributed to the widespread adoption of DMDS by radio stations and major and independent labels throughout the US. In 2006 DMDS delivered songs from superstar artists such as American Idol winner Taylor Hicks, Beyonce, Neil Young, U2, Ludacris, Norah Jones, Dixie Chicks, Tony Bennett, Red Hot Chili Peppers, and hundreds more.

On February 6, 2007 YANGAROO completed a $10 million financing 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. This financing provides resources for YANGAROO's European market expansion with Adstream, its US music delivery market growth, its radio and TV advertising delivery initiatives and the expansion and enforcement of its intellectual property rights.

In February 2007 YANGAROO entered into a licensing agreement with Pando Networks, Inc, extending and expanding their relationship following a successful pilot program.

YANGAROO proved the concept of integrating Pando's unique technology with DMDS in order to provide the fastest and most secure delivery of large digital content such as television commercials, music videos and audio files via the Internet. Incorporation of Pando Networks' innovative peer-to-peer architecture within DMDS is expected to provide the secure digital delivery of full broadcast-quality music videos and television commercials via the Internet with the fastest downloads available to the music and advertising industries. Currently, large files like these are primarily delivered on DVD, Beta tape, or by satellite, which are comparatively inefficient, insecure, slow and expensive.

In March 2007 YANGAROO entered into an exclusive partnership with IODA, the global leader in digital distribution, marketing, and technology solutions for the independent music industry. IODA will offer DMDS to its 3,500 client labels with over 800,000 tracks to deliver their artists' music and promotional materials directly to radio stations across North America.

In April 2007, Warner Bros. chose DMDS to deliver superstar artist Linkin Park's new single "What I've Done" to radio stations across the United States. This exclusive, historic delivery marks the first time that a major record label in the US has released a significant new 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.

The Warner Bros. promotional staff worked hand in hand with the YANGAROO marketing team for the week leading up to this release. This marketing campaign included a daily electronic notification (eNote) leading up to the release date, a 30-sec stream of the song and exact, to the minute time of availability via DMDS. Because of this collaborative effort, over 95% of Mainstream Rock and Rock Alternative chart-monitored radio stations were simultaneously and securely given access to "What I've Done" in the highest CD broadcast quality.

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 later in April.

In June YANGAROO launched 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. "For the past six months our team at UMG in LA has been working with YANGAROO and The Gary Group to enhance the features of DMDS for the delivery of advertising," said Vincent Freda, Executive Vice President, Digital Logistics and Business Services, Universal Music Logistics. "DMDS has proven itself as a leader in the secure delivery of music, and we expect that same technology will allow us to send our advertising spots to radio in the same broadcast quality, quicker, more efficiently, and with significant cost savings." YANGAROO has been working closely with Universal and The Gary Group to adapt DMDS for the unique requirements of the advertising sector. The Gary Group expects to transition to the exclusive use of DMDS for radio spot delivery over the next six months to provide their clients with more efficient and accountable deliveries as well as substantial cost savings. "We believe that DMDS will enable us to offer a higher level of service and functionality to our clients," said Dick Gary, Chairman of The Gary Group. "We will continue to work with DMDS as they roll out new features and services over the coming months." YANGAROO began billable deliveries of radio advertising 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. The company engaged Addison Whitney, a North Carolina based firm that specializes in corporate identity consulting, to assist with the re-naming process. Their clients include technology leaders such as Microsoft, Adaptec, General Electric, 3Com, IBM, HP, OnStar and Toshiba, among many others. After extensive collaborative work, which drew on Addison Whitney's experience and their objective assessment of the company's needs and attributes, the executive team agreed to change the name of the company to YANGAROO Inc., which was overwhelmingly approved by the company's shareholders at the Annual and Special Shareholders Meeting held on June 25, 2007 in Toronto. The name change was approved by the TSX Venture Exchange July 16, 2007. YANGAROO Inc. now trades on the TSX Venture Exchange under the symbol YOO (TSX-V: YOO), commencing with the opening of trading on Wednesday July 18, 2007, and in the US on the OTCBB under the symbol YOOIF. "Our new brand is the result of increasing demand for our solutions in many areas beyond the music industry. We recently announced the launch of our DMDS radio spot delivery service with The Gary Group and Universal Music Group in Los Angeles," said John Heaven, President and CEO of YANGAROO Inc. "This exciting new name will help us communicate with the many new markets for our products."

4) <u>Review of Results of Operations for the Quarter Ended June 30, 2007</u>

Revenue for the second quarter of 2007 was $131,000, 17% higher than the revenue for the second quarter of 2006. This increase in revenue is primarily the result of new customers and the increasing use of DMDS by existing customers, especially in the independent sector. Revenue is expected to continue to increase as billable US music deliveries grow, European music delivery revenues begin to flow and advertising delivery volumes rise. The loss for the second quarter of 2007 was $633,000, 11% ($63,000) greater than last year's second quarter.

The largest expense item increase in the quarter was in salaries and consulting of $104,000 (29%), which reflects additional human resources added in the first half of 2007. The second largest expense item increase for 2007 was in general and administrative expense of $86,000 (59%), largely from costs related to enforcing the company's patent rights and recruiting. Royalty expense was $53,000 (141%) lower, as a result of the renegotiation of the technology license to eliminate the royalty obligation. Interest income rose by $68,000 in the second quarter of 2007 due to the interest revenue earned from the funds received from the financing completed in February 2007.

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 second quarter of 2007 $125,000 of product development costs were capitalized and $42,000 was amortized.

The company uses equity to compensate and motivate its staff and suppliers. In the second quarter of 2007 $16,000 of the expense recognized for salaries and consulting was for the non-cash expense recognized for options, compared to $59,000 for the same period last year.

5) 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 ($)		**Fiscal 2006 ($)**				**Fiscal 2005 ($)**	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Sales	130,640	122,808	124,441	106,465	111,488	87,748	75,997	70,029
Loss for the period	632,562	528,693	489,405	524,314	569,753	530,115	660,847	604,515
Loss per share (basic & diluted)	.01	.01	.01	.02	.02	.02	.04	.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.

6) Liquidity and Capital Resources

Cash and cash equivalents at June 30, 2007 increased to $7,747,000 from $72,000 at December 31, 2006. The main reason for this change was the financing completed in February 2007 described below. During the six month period ended June 30, 2007 the company invested $92,000 in equipment, $18,000 in patent development, $16,000 in technology licenses, $230,000 in product development and $78,000 in branding.

On February 6, 2007, YANGAROO completed a $10 million financing 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 it may need to source additional funds in order to carryout its business plan.

7) Share Capital

At June 30, 2007 and at August 15, 2007 YANGAROO had 75,517,615 common shares, 3,320,000 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 is due to the financing completed in February 2007 described above. 1,250,000 of the company's outstanding shares are not tradable currently as these are subject to the litigation described in note 6(a) of the financial statements.

8) 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, 2006, and have evaluated the design of the Company's ICFRs for the year ended December 31, 2006; 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 June 30, 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.

9) Off Balance Sheet Arrangements

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

YANGAROO Inc.

(formerly Musicrypt Inc.)

Interim Financial Statements

June 30, 2007

(unaudited)

Notice to Reader

The accompanying unaudited interim financial statements have been prepared by the Company's management and the Company's independent auditors have not performed a review of these financial statements.

YANGAROO Inc.

(formerly Musicrypt Inc.)
Interim Balance Sheets
(unaudited - See Notice to Reader)

	Note	June 30 2007	December 31 2006 (audited)
Assets			
Current			
Cash and cash equivalents		**$ 7,747,124**	$ 72,447
Amounts receivable		**131,490**	90,732
Prepaids and sundry assets		**213,119**	47,283
		8,091,733	210,462
Property, plant and equipment		**126,405**	59,655
Patents		**41,220**	22,994
Investment in technology		**580,332**	611,271
Trade-name and related marketing intangibles		**78,030**	-
Deferred development costs		**882,219**	736,049
		$ 9,799,939	$ 1,640,431
Liabilities			
Current			
Operating loan		**$ -**	$ 15,000
Accounts payable and accrued liabilities		**292,759**	263,168
Deferred revenue		**6,365**	-
		299,124	278,168
Shareholders' Equity			
Capital stock	4	**21,052,303**	12,322,261
Contributed surplus		**690,855**	645,844
Warrants		**524,754**	-
Deficit		**(12,767,097)**	(11,605,842)
		9,500,815	1,362,263
		$ 9,799,939	$ 1,640,431

Commitments and Contingencies (Note 6)

Approved by the Board **"John Heaven"** Director **"Clifford Hunt"** Director
(signed) **(signed)**

See accompanying notes.

YANGAROO Inc.

(formerly Musicrypt Inc.)
Interim Statements of Operations and Deficit
(unaudited - See Notice to Reader)

	Six Months Ended June 30		Three Months Ended June 30	
	2007	2006	**2007**	2006
Revenue	**$ 253,448**	$ 199,236	**$ 130,640**	$ 111,488
Expenses				
Salaries and consulting	**848,387**	735,193	**466,501**	362,743
Marketing and promotion	**159,292**	128,703	**51,285**	61,558
General and administrative	**338,308**	228,833	**231,470**	145,525
Technology development	**44,829**	19,927	**22,487**	9,960
Royalties	**-**	75,000	**(15,452)**	37,500
Amortization	**156,085**	117,575	**78,626**	67,457
Less interest income	**(132,198)**	(6,127)	**(71,715)**	(3,502)
	1,414,703	1,299,104	**763,202**	681,241
Loss for the period	**(1,161,255)**	(1,099,868)	**(632,562)**	(569,753)
Deficit at beginning of period	**(11,605,842)**	(9,492,255)	**(12,134,535)**	(10,022,370)
Deficit at end of period	**$(12,767,097)**	$(10,592,123)	**$(12,767,097)**	$(10,592,123)
Basic and diluted loss per share	**$ (0.02)**	$ (0.04)	**$ (0.01)**	$ (0.02)
Weighted average number of shares	**66,984,002**	28,045,921	**75,088,912**	29,485,976

See accompanying notes.

YANGAROO Inc.

(formerly Musicrypt Inc.)
Interim Statements of Cash Flows
(unaudited - See Notice to Reader)

	Six Months Ended June 30		Three Months Ended June 30	
	2007	2006	**2007**	2006
Cash flows from operating activities				
Loss for the period	**$ (1,161,255)**	$(1,099,868)	**$ (632,562)**	$ (569,753)
Add items not affecting cash				
Amortization	**156,085**	117,575	**78,626**	67,457
Stock based compensation	**47,786**	115,474	**15,637**	59,429
	(957,384)	(866,819)	**(538,299)**	(442,867)
Changes in non-cash working capital items				
Amounts receivable	**(40,758)**	(60,802)	**28,164**	(54,744)
Prepaids and sundry assets	**(165,836)**	(52,504)	**(47,522)**	(2,034)
Accounts payable and accrued liabilities	**29,591**	168,278	**84,653**	90,825
Deferred revenue	**6,365**	-	**(1,046)**	(4,301)
	(1,128,022)	(811,847)	**(474,050)**	(413,121)
Cash flows from investing activities				
Purchase of property plant and equipment	**(91,727)**	(22,598)	**(55,551)**	(9,937)
Investment in technology licence	**(16,480)**	-	**(7,664)**	-
Patent	**(18,226)**	-	**(10,511)**	-
Technology development	**(229,859)**	(218,292)	**(124,924)**	(109,255)
Re-branding	**(78,030)**	-	**(78,030)**	-
	(434,322)	(240,890)	**(276,680)**	(119,192)
Cash flows from financing activities				
Issuance of common shares, net of issue costs	**9,252,021**	1,334,313	**115,160**	1,334,312
Advances (repayment) of operating loan	**(15,000)**	20,000	**-**	20,000
	9,237,021	1,354,313	**115,160**	1,354,312
Increase (decrease) in cash during the period	**7,674,677**	301,575	**(635,570)**	821,999
Cash at beginning of period	**72,447**	641,541	**8,382,694**	121,117
Cash at end of period	**$ 7,747,124**	$ 943,116	**$ 7,747,124**	$ 943,116

See accompanying notes.

1. BASIS OF PRESENTATION

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. SIGNIFICANT ACCOUNTING POLICIES

The interim financial statements are prepared in accordance with Canadian generally accepted accounting principles and follow the same accounting policies and methods of their application as the most recent audited financial statements for the year ended December 31, 2006, except for the new accounting policy added below and the change in accounting policy disclosed for Note 3. These financial statements should be read in conjunction with those audited financial statements.

Intangible Assets

Intangible assets with indefinite useful lives 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.

3. CHANGE IN ACCOUNTING POLICY

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.

3. CHANGE IN ACCOUNTING POLICY (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 and deferred revenue 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.

4. CAPITAL STOCK

Authorized
unlimited common shares

Issued and outstanding

	Number of Shares	Value
Balance, December 31, 2006	34,766,815	**$ 12,322,261**
Issued for cash (i)	40,000,000	**9,121,861**
Less: Proceeds allocated to warrants (i)	-	**(505,428)**
Issued on exercise of warrants (ii)	500,800	**105,160**
Less: Proceeds allocated to warrants (Note 5(c))	-	**(19,326)**
Issued on exercise of options (iii)	250,000	**27,775**
Balance, June 30, 2007	75,517,615	**$ 21,052,303**

(i) The Company issued 40,000,000 common shares for gross proceeds of $10,000,000 by way of a private placement. In connection with the issuance of common shares 2,800,000 warrants were issued to agents (Note 5(b)) and given a value of $505,428.

(ii) The Company issued 500,800 common shares for proceeds of $105,160 pursuant to the exercise of warrants.

(iii) The Company issued 250,000 common shares for proceeds of $25,000 pursuant to the exercise of options.

5. STOCK OPTIONS AND WARRANTS

The Company had the following stock options outstanding at June 30, 2007:

Number of Options	Exercise Price	Expiry Date
210,000	$ 0.75	May 7, 2008
15,000	$ 0.88	May 28, 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
135,000	$ 0.47	November 24, 2009
60,000	$ 0.44	February 3, 2010
500,000	$ 0.44	March 7, 2010
615,000	$ 0.42	May 19, 2010
110,000	$ 0.42	October 3, 2010
125,000	$ 0.25	November 22, 2010
110,000	$ 0.25	April 11, 2011
65,000	$ 0.20	August 16, 2011
120,000	$ 0.24	November 21, 2011
130,000	$ 0.35	April 12, 2012
400,000	$ 0.32	May 24, 2012
100,000	$ 0.27	June 25, 2012
3,320,000		

The Company had the following warrants outstanding at June 30, 2007:

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

(a) These warrants were issued in connection with a private placement. 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 to agents in connection with a private placement. 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.

5. STOCK OPTIONS AND WARRANTS (Cont'd)

(c) These warrants were issued in connection the exercise of agent unit warrants. Each agent unit warrant consisted of one common share and one-half of one warrant. Each full warrant entitles the holder to acquire one common share at a price of $0.30 for a period of twenty four months from issuance of the original warrant.

6. COMMITMENTS AND CONTINGENCIES

(a) 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.

(b) 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.

7. COMPARATIVE FIGURES

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

DMDS

Digital Media Distribution System