YANGAROO INC.

ANNUAL REPORT 2008

To Our Shareholders:

YANGAROO made substantial progress throughout the fiscal year ended December 31, 2008. Key events included receiving allowance of our US patent application #10/431,854 titled *Content Distribution System and Method*, 60% growth in U.S. delivery volume to surpass 2 million, 120% growth in Canadian deliveries, development of our new industry leading Digital Media Distribution System (DMDS) 5.0 platform, a marketing partnership with leading U.S. music industry information company Radio and Records, launch of our ecommerce portal DMDSDirect to expand our reach to the independent music sector, registering the 2,000th U.S. radio station on DMDS, integration of DMDS with leading radio station automation systems iMediaTouch, MusicMaster and Powergold, extending agreements with Universal and Warner Music Canada and powering the JUNO Awards for the Canadian Academy of Recording Arts and Sciences (CARAS) with DMDS 5.0.

Despite the economic downturn in 2008, YANGAROO enjoyed its sixth consecutive year of revenue growth, driven by higher volumes of DMDS deliveries by current and new customers. Growth in independent music sector revenues led this group to account for approximately half of total revenues. While the onset of the recession appeared to dampen the rate of revenue growth in the last half of 2008, we expect revenues to continue to grow through 2009.

The loss for the year increased, which was partly due to planned increases in operating expenses that were related to the development of DMDS 5.0 and the enforcement and expansion of YANGAROO's intellectual property rights. However, these operating expenses remained under the budget target for the year. An increase in amortization expense and the decline in interest income accounted for nearly half of the increase in the loss. Cash and cash equivalents on hand of over $3 million at the yearend represented over a year's worth of funding for the company.

The Management Discussion and Analysis and the financial statements included herewith provide greater insight into the key events and results for the year, which I highly recommend you review. YANGAROO could not attain these goals without the tireless commitment of our team members, and the loyal support of our shareholders and partners, for which we are grateful. The achievements of 2008 provide a solid foundation for our optimism as we look forward to 2009 and future years.

John Heaven
President & Chief Executive Officer

Management Discussion and Analysis
For the Year Ended December 31, 2008

YANGAROO Inc. ("YANGAROO" or "the company") trades on the TSX Venture Exchange under the symbol YOO (TSX-V: YOO) and in the USA on the OTCBB under the symbol YOOIF. 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 17, 2009.

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 Inc. is a technology company that is targeted to become the leading enabler of user-friendly and secure B2B distribution of media 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 on physical media (such as copying to CD, DVD or 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, encryption and watermarking. DMDS replaces the physical distribution of musical recordings, music video, 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, 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, as well as Coldplay, 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 upgrading DMDS to version 5.0 in order to provide these same benefits for the distribution of music videos and TV commercials, which offer attractive additional market opportunities for the company.

3) Review of Operations for the Year Ended December 31, 2008

Revenues for the year ended December 31, 2008 were 10% higher than revenues for 2007, due to increased use of DMDS. The impact of the economic recession appeared to slow the company's revenue growth in the latter part of 2008. Cash and cash equivalents were $3,030,000 at December 31, 2008, representing over a year of funds.

The loss for the year in 2008 increased by 22% ($599,000) compared to 2007. The increase in amortization expense of $146,000 (39%) plus the decline in interest income of $142,000 (50%), accounted for $288,000, or nearly half, of the loss increase. Total expenses increased by 15% ($511,000) as compared to 2007. The increased total expenses are primarily due to planned increases in operating expenses, and were below the budgeted target for 2008.

The majority of the increase in operating expenses in the 2008 fiscal year stemmed from the company's planned augmentation of its human resources and from continuing to enforce and expand its intellectual property rights. The salaries and consulting expense for 2008 increased 10% ($191,000) and general and administrative expense, which includes expenses related to the protection of intellectual property rights, rose 26% ($193,000) compared to 2007. Expenditures related to enforcing the company's intellectual property rights are a non-recurring operating expense ($353,000 in 2008), as it is expected that these will not be necessary once the matter under litigation is resolved.

The increase in salaries and consulting expense was primarily incurred in the technology department, where this expense rose by 65% ($244,000) in 2008 in comparison to 2007. The company commenced bolstering its technology team with necessary human resources through 2007 and into early 2008 to carry out its product development plans for the next generation DMDS 5.0. A reduced rate of capitalization for technology salaries as deferred development costs, reflecting work related to non-capital maintenance of previously released products, was used in 2008 compared to 2007, contributing to the increase in this expense item. The combination of these factors produced the higher salaries and consulting expense for the technology department in 2008, although it still remained under the budgeted target for the year. As DMDS 5.0 development phases are completed in 2009, the company plans to reduce this expenditure, which has commenced.

The salaries and consulting expense for the operations department increased by $21,000 (15%) in 2008 compared to last year, due to supporting increased use of DMDS by a greater number of users. The sales and marketing department salaries and consulting expense for 2008 decreased by $25,000 (4%), primarily due to lower consulting and salaries and wages expense compared to 2007. The salaries and consulting expense for general and administration declined by $48,000 (6%) in 2008, mainly as a result of decreased consulting expense compared to 2007.

Stock based compensation of $112,000 was included in the salaries and consulting expense for 2008, which was an increase of 19% ($18,000) over 2007.

General and administrative expenses increased by $193,000 (26%) in 2008, most of which was attributable to the $101,000 (40%) increase in expenses in the period related to the protection of intellectual property rights mentioned above. Also affecting this expense for the period were $24,000 higher co-location costs for expanded and upgraded DMDS infrastructure, $22,000 foreign exchange loss, $21,000 higher rent for larger premises, $19,000 bad debt expense and $13,000 higher recruiting expense compared to last year. Interest income declined by $142,000 (50%) in 2008 from 2007 mainly as a result of lower interest rates and lower average investment balances.

Amortization expense increased $146,000 (39%) in 2008 over 2007 mainly because of the increase in amortization of higher deferred development cost, computer equipment and technology license asset balances. Marketing and promotion expenses decreased by $25,000 (8%) in 2008 compared to 2007, largely because of a reduction in travel expenses.

In 2008 the company commenced work on DMDS 5.0, a major platform upgrade of DMDS that will improve existing functions and add several new features and capabilities to the system. DMDS 5.0 will also open up significant additional related market opportunities for the company by supporting distribution of broadcast quality music videos and television advertising. For content providers such as record labels, artists, promoters, and artist managers DMDS 5.0 will provide new capabilities including:

- *Streaming Previews of Tracks Direct from Notifications*
  Choose destinations that can listen to music right from the email notification.
- *Enhanced Activity Reports - New Tools to Organize and Analyze Data*
  Check release activity by region and time of day, compare it to other releases and organize your data with graphs and charts.
- *Expanded Destination Lists and Management*
  Send releases to several new radio formats and specialty destinations (including extensive blog, web radio, and press contacts); plus faster and easier import of private lists into the system.
- *Distribute More than Music*
  Securely deliver the music, videos, documents, images, and any digital file to the authorized recipients of your choice.
- *New DMDS Application - Packed Full of Features*
  CD info-lookup services, integrated CD burning, watermark detection, faster uploads/downloads, and enhanced iTunes integration.
- *Improved Website Interface – More Intuitive, Flexible and Easier*
  Save work as drafts, expanded access permissions flexibility (e.g. send the same release to press, with stream only access; and to radio as downloadable), 'Smart Search' to quickly make destination lists based on attributes like location, market size, chart monitored, etc.

For content recipients, such as radio, press and television, new features include:

- *New DMDS Application Makes Downloading Faster and Easier*
  Content Delivery Network integration means downloads are equally fast worldwide, enhanced iTunes integration, CD burning software, and much more.
- *Get the Latest Charts from R&R/BDS and Mediaguide*
  See where a track is charting right from the Details page, and click directly to the charts on partner websites
- *Manage and Enjoy your Music with the Advanced Audio/Video Player*
  Quickly and easily build, manage and save audio and/or video playlists
- *Multi-Format Downloads - Music for Airplay or Your iPod*
  Download in the format of your choice: WAV or MP3
- *Expanded track feedback mechanism*
  Recipients can post comments about tracks that are viewable by and interactive with other authorized recipients of the tracks

Total expenditures on technology development in 2008 were $768,000, of which $104,000 was expensed and $664,000 was capitalized. During the period technology development expense decreased $4,000 (4%) over 2007 primarily due to lower technology license costs. 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. Amortization expense of deferred development costs in the amount of $324,000 was recognized in 2008, an increase of $109,000 over last year.

The volume of U.S. deliveries made by DMDS in 2007 increased 266% over 2006 to 1.3 million. This trend continued into 2008, as U.S. deliveries increased by 60% over 2007 to 2 million. These volume increases demonstrate that the adoption of DMDS in the US record and radio industries continues at a rapid pace. The company is focused on monetizing this usage and commenced billing a major U.S. record label and several U.S. based independent labels in 2008. In addition, deliveries made via DMDS in Canada increased 120% in 2008 over 2007, further cementing DMDS as the de-facto standard for Canada. To encourage broader usage of DMDS, during the year the company introduced fixed rate pricing for album deliveries with selected record labels, which helped to generate the significant increase in delivery volumes, reducing the average revenue per track delivery, but making DMDS an even more indispensable tool for the music industry.

In January 2008 the company bolstered its management team with the appointment of Richard Klosa as Chief Technology Officer (CTO). Richard Klosa brings more than a decade of technology development and management experience as an entrepreneur and digital media innovator to the company.

Also in January 2008 the company entered into a partnership with Radio and Records (R&R), the leading music industry information company in the United States, to market and promote DMDS to the US radio and recording industries. This partnership provides for DMDS branding with direct links to the DMDS login page on all R&R electronic and print products. YANGAROO and R&R will also co-market DMDS' eNote products and R&R's EPK products, expanding the commercial potential of both.

In the first quarter of 2008, the company became a founding partner in FYIMusic.ca along with Gary Slaight, the former president and CEO of Standard Radio Inc. and a long-time champion of Canadian music. Veteran music industry journalist David Farrell returned to the music industry to found FYIMusic.ca, a digital independent news source that focuses on the Canadian music industry. FYIMusic.ca offers detailed reporting on the companies and individuals involved in the creation, marketing, promotion, and export of Canadian music. The loss on investment of $7,500 reflects the company's share of the FYIMusic.ca start-up year loss.

In March 2008 Intermedia Regional Promotions of the UK began using DMDS to digitally deliver new releases to the UK's radio network through the company's UK based partner Adstream Ltd. Steve Tandy, Managing Director of Intermedia Regional Promotions said "In this digital age, it has frustrated me for some time that there seemed not to be an acceptable, workable, secure music radio digital delivery system. Intermedia has strongly supported attempts in the past to achieve such a system that would be adopted and embraced by key music people within radio, instead of the antiquated CD-in-a-envelope approach we have all been using for years."

Also in March 2008, the company announced the launch of DMDSDirect, a new ecommerce service that gives the independent North American music community greater access to digital delivery of music. DMDSDirect allows independent aggregators and their tens of thousands of member artists and labels to digitally distribute their radio singles and promotional materials in the same manner utilized by major labels. DMDSDirect users are able to choose a package of key stations in a given radio format or genre, pay by credit card, and have their music distributed both quickly and digitally to radio stations throughout the United States and Canada.

In May 2008 the company signed agreements with San Francisco based IRIS Distribution, and Los Angeles based A&R Select to provide their member artists and labels with digital distribution of their music to radio and other destinations throughout the US and Canada using DMDS. IRIS Distribution represents 5,000 independent artists and labels and A&R Select has worked with more than 2,000 artists and bands since its founding in 2006.

Also in May 2008, RCA Music Group, a division of SonyBMG based in New York, selected DMDS to deliver the winning song from the new American Idol, David Cook, to radio across North America. Over 30 million viewers tuned in to see the American Idol season finale and over 97.5 million votes were cast with David Cook winning by over 12 million votes. The 2008 American Idol winner David Cook's song "The Time of My Life" was available for immediate download and airplay via DMDS on Thursday, May 22, 2008, at 1 AM ET following the show's airing in Hawaii.

YANGAROO announced several important events in June 2008:

- The extension of its agreement with Universal Music Canada, for distribution of promotional music to radio and internally via DMDS. Universal Music is the country's leading music company has been using DMDS commercially in Canada since July 2004.
- The expansion of the partnership with Nielsen Broadcast Data Systems (BDS). Under the agreement, artists and labels that electronically send their music to Nielsen BDS for encoding via BDS' Virtual Encode process will now have the option to use DMDSDirect to send their music digitally to hundreds of radio stations and other media contacts throughout the United States and Canada. Over 50,000 songs per year are submitted with Virtual Encode into the Nielsen BDS database to allow their airplay to be tracked at BDS monitored radio stations.
- The integration of DMDS with the iMediaTouch Radio Automation Software from OMT Inc. (TSXV:OMT). As a result of this integration, iMediaTouch users at over 1,500 radio stations throughout the United States can now import new music available through DMDS directly into their iMediaTouch music library.
- The 2,000th US radio station to register to use DMDS was Emmis Broadcasting's Triple A station WRXP 101.9 FM in New York City.

In July 2008 the company released several new features for DMDS, which included:

- Faster download speeds and response due to integration with a world-leading high speed and large capacity Content Delivery Network, and a significant investment in infrastructure hardware to provide improved load balancing, redundancy and horizontal scalability, faster processing speed and expanded storage capacity.
- File attachments: Record labels using DMDS can now attach promotional materials such as Word, Excel, MPEG, and PDF files to their delivery notifications.

- Custom List Importing: Users can upload and utilize their own private distribution lists within DMDS, allowing new destinations for their content to be added for private or public use.
- Agentless Music Download: Users receive the same watermarked and secure files without installing the client side agent, granting faster portable access to tracks.
- Conversion of WAV to MP3: Large WAV files can now be converted to MP3s, allowing faster and easier access to tracks for some users.
- Portable 'Smart Playlists': Music and program directors can share new tracks through their playlists prior to weekly music meetings
- Rapid Registration: The registration process was streamlined to give new users quicker access to music through DMDS.

In August 2008 YANGAROO adopted a Shareholder Rights Plan. The Rights Plan was adopted to ensure the fair treatment of shareholders in connection with any take-over bid for common shares of YANGAROO. The Rights Plan seeks to provide shareholders with adequate time to properly assess a takeover bid without undue pressure. It also provides the Board with more time to fully consider an unsolicited take-over bid and to explore other alternatives to maximize shareholder value. The Rights Plan is not intended to prevent take-over bids that treat shareholders fairly. Under the Rights Plan, those bids that meet certain requirements intended to protect the interests of all shareholders are deemed to be Permitted Bids.

Also in August 2008, the company reported that in the first seven months of 2008 it had entered into commercial agreements with more than 30 new independent record labels and aggregators to use DMDS and it had delivered new releases by former major label artists Motorhead, Eagles, Journey, Joan Osborne, Natalie Cole, and Everlast.

In September 2008 the company entered into an agreement with the Canadian Academy of Recording Arts and Sciences (CARAS), the organization responsible for the JUNO Awards, to utilize DMDS to distribute all music and related promotional materials submitted for JUNO Award consideration to both the judges and CARAS' members. In the past, music has been submitted by artists and record labels for JUNO Award consideration by the physical shipment of 12 CD copies, for each category, of their album and/or single complete with bio and a publicity photo to CARAS, who in turn would package the submissions and ship them out to the 300+ judges across the country. Using DMDS to streamline the process, submitted music was digitally ingested into DMDS and CARAS used DMDS to securely distribute the music and related promotional materials to the 300+ judges and more than 1700 members. These people were able to stream the music online or download it to be burned to CD or transferred to their iPods for review.

Also in September 2008, YANGAROO appointed Josh Zieman, music industry veteran and former Vice President, Marketing at Manhattan/Blue Note Label Group, a division of EMI Music based in New York, as Senior Vice President of Business Development. Overseeing sales and market development for DMDS, Zieman focuses on continued expansion in the U.S. market as well as generate new revenue streams for the company. Josh Zieman comes to YANGAROO as a seasoned U.S.-based senior executive with over 25 years experience in recording industry sales and marketing.

In November 2008 YANGAROO integrated DMDS with the MusicMaster Scheduling software produced by A-Ware Software, Inc. As a result of this integration, the more than 2,800 MusicMaster Scheduling software users at radio stations worldwide can seamlessly import new music available through DMDS directly into their station's music library. The new music imported from DMDS also includes the related track information.

Also in November, the company collaborated with Castle Brands, an emerging developer and international marketer of premium branded spirits, to deliver the song "Devotion" by The Loveblisters, the winner of Boru Vodka's second annual "Defend The Bar Band" competition, to radio throughout the U.S. The song was delivered by a DMDS eNote to 650 radio stations in five major formats and the eNote can be viewed by clicking this link. YANGAROO's eNotes are a multimedia promotional tool that can be emailed to selected recipients. eNotes can include animated images or video clips along with a stream of the song that can be reviewed prior to downloading a broadcast quality track via DMDS.

In December 2008 the company signed a two-year extension of its agreement with Warner Music Canada, one of the country's leading music companies, for distribution of promotional music and music videos to radio, television, press, and other destinations via YANGAROO'S Digital Media Distribution System (DMDS). Warner Music has been using DMDS commercially in Canada since 2004. "As I have said in the past, DMDS is the gold standard for digital delivery and we are happy to extend our agreement with YANGAROO," said Steve Kane, President and CEO Warner Music Canada. "The Canadian music industry has led the world in the move to digital delivery of promotional music. It is more efficient, less expensive and far more environmentally friendly."

Also in December, the company integrated DMDS with Powergold, the music scheduling software produced by Micropower Corporation. As a result of this integration, thousands of Powergold Music Scheduling Software users at radio stations worldwide can now import new music available through YANGAROO's DMDS directly into their music library. The new music imported from DMDS also includes the related track information.

Throughout 2008 the company made significant progress with the examination of its second U.S. patent application No. 10/431,854 titled "Content Distribution System and Method". This is the same application that the company has been granted patent #2,407,774 for in Canada. During the year agreement was reached with the U.S. Patent Examiner in charge of the application with respect to the patent claims, and the Examiner submitted the application for allowance. In early January 2009, the USPTO issued a Notice of Allowance for the patent application. Management expects that this patent will provide a barrier to entry against competitors in the U.S. market and add significant intellectual property value to the company.

To date DMDS has made over six million deliveries of over 21,000 songs from more than 600 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.

4) Review of Results of Operations for the Fourth Quarter Ended December 31, 2008

The loss for the fourth quarter of 2008 decreased 11% ($91,000) compared to the fourth quarter of 2007, mainly as a result of total expenses being 14% ($143,000) lower than for the fourth quarter of 2007. The reduction in total expenses was largely due to salaries and consulting expense being 22% ($134,000) lower, plus marketing and promotion expense being 28% ($28,000) lower, than the same period in 2007. This decrease was due to management's focus on cost control in light of the current economic environment and reduction of the overall headcount. The decrease in total expenses was partially offset by a decrease of $53,000 (75%) in interest income, which was caused by lower average investment balances and lower interest rates.

Revenues for the fourth quarter ended December 31, 2008 were slightly higher than revenues for the same period in 2007. The slower growth in the fourth quarter occurred as the impact of the recession appeared to limit promotional spending by customers.

EBITDA (Earnings before interest, taxes, depreciation and amortization) for the fourth quarter of 2008, calculated as the loss for the quarter before amortization and interest income, improved by 19% ($154,000) over the same period in 2007.

Technology development expenses were 29% ($10,000) lower in the fourth quarter of 2008 compared to last year's fourth quarter primarily because of lower software license fee expenses. Total expenditures on technology development in the fourth quarter of 2008 were $234,000, of which $24,000 was expensed and $210,000 was capitalized. 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. Amortization expense of deferred development costs in the amount of $83,000 was recognized in the fourth quarter of 2008, an increase of $6,000 (8%) over last year's fourth quarter.

General and administrative expenses rose 4% ($8,000) in the fourth quarter of 2008 compared to last year's fourth quarter. This change was attributable changes in a variety of general and administrative expenses, including increases in bad debt expense of $14,000 and foreign exchange loss $9,000, which were likely influenced by the economic downturn, in the fourth quarter of 2008.

Amortization expense increased 9% ($11,000) in the fourth quarter of 2008 over the fourth quarter last year mainly because of the increase in amortization of a higher deferred development cost balance.

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 Year ($): **2008** **2007**

	2008 Q4	2008 Q3	2008 Q2	2008 Q1	2007 Q4	2007 Q3	2007 Q2	2007 Q1
Sales	138,023	175,767	137,946	127,077	137,650	133,858	130,640	122,808
Loss for the period	760,455	675,672	1,020,724	807,192	851,609	652,295	632,562	528,693
Loss per share (basic & diluted)	.01	.01	.01	.01	.01	.01	.01	.01

6) Liquidity and Capital Resources

Cash and cash equivalents at December 31, 2008 decreased to $3,030,000 from $6,497,000 as at the December 31, 2007 fiscal year end. The main reason for this change was that the cash used in operating activities in 2008 increased $520,000 (25%) to $2,606,000 compared to 2007. The funds available at December 31, 2008 represent more than a year of funding for the company based on the cash used in the fourth quarter of 2008 ($596,000). During the year ended December 31, 2008 the company invested $664,000 in technology development, $136,000 in property, plant and equipment (primarily computer hardware devices for infrastructure upgrades), $10,000 in FYI Inc., and $53,000 in new patent development.

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.

7) Share Capital

At December 31, 2008 YANGAROO had 75,517,615 common shares, 3,769,000 options, and 2,800,000 warrants outstanding. At December 31, 2007 YANGAROO had 75,517,615 common shares, 3,321,000 options, and 6,725,400 warrants outstanding. 1,250,000 of the company's outstanding common shares are not tradable currently as these are subject to the litigation described in note 15(b) 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, 2008, and have evaluated the design of the Company’s ICFRs for the year ended December 31, 2008; 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, 2008; 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, Collins Barrow Toronto LLP (formerly 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) <u>Off Balance Sheet Arrangements</u>

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

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

(i) Effective January 1, 2008, the Company adopted the recommendations of The Canadian Institute of Chartered Accountants' ("CICA") Handbook Section 1535, Capital Disclosures ("Section 1535"). The new standard requires an entity to disclose information to enable users of its financial statements to evaluate the entity's objectives, policies and processes for managing capital. Disclosure requirements pertaining to Section 1535 are contained in Note 16.

(ii) Effective January 1, 2008, the Company adopted the recommendations of CICA Handbook Section 3862, Financial Instruments - Disclosures ("Section 3862"). Section 3862 provides standards for disclosures about financial instruments, including disclosures about fair value and the credit, liquidity and market risks associated with the financial instruments. Disclosure requirements pertaining to Section 3862 are contained in Note 17.

(iii) Effective January 1, 2008, the Company adopted the recommendations of CICA Handbook Section 3863, Financial Instruments - Presentation ("Section 3863"). Section 3863 provides standards for presentation of financial instruments and non-financial derivatives. Adoption of this standard had no impact on the Company's financial instrument related presentation disclosures.

(iv) Effective January 1, 2008, the Company adopted the recommendations of CICA Handbook Section 1400, General Standards of Financial Statement Presentation, to change the guidance related to management's responsibility to assess the ability of the entity to continue as a going concern. Management is required to make an assessment of an entity's ability to continue as a going concern and should take into account all available information about the future, which is at least, but is not limited to, 12 months from the balance sheet dates. Disclosure is required of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern.

11) <u>International Financial Reporting Standards</u>

In February 2008, the Canadian Accounting Standards Board confirmed that publicly accountable entities would be required to adopt International Financial Reporting Standards ("IFRS"). The Company must prepare its interim and annual financial statements in accordance with IFRS for periods beginning on January 1, 2011. The Company has assigned responsibility for IFRS adoption and is currently studying the impacts of IFRS on the Company's accounting policies, information systems, internal controls over financial reporting and contractual arrangements and covenants. The initial assessment of the process indicates that the most significant areas of difference applicable to the Company include treatment of stock-based compensation, intangible assets and the more extensive presentation and disclosure requirements under IFRS.

YANGAROO Inc.

Financial Statements

For the Years Ended December 31, 2008 and 2007

Collins Barrow
Chartered Accountants

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AUDITORS' REPORT

To the Shareholders of
YANGAROO Inc.

We have audited the balance sheets of **YANGAROO Inc.** as at **December 31, 2008** and **2007** 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, 2008** and **2007** and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Collins Barrow Toronto LLP

Collins Barrow Toronto LLP
Licensed Public Accountants

March 17, 2009
Toronto, Ontario

YANGAROO Inc.

Balance Sheets
As at December 31

	Note	2008	2007
Assets			
Current			
Cash and cash equivalents		**$ 3,030,099**	$ 6,496,563
Accounts receivable		**157,798**	141,492
Prepaids and sundry assets		**50,418**	57,435
		3,238,315	6,695,490
Capital assets	4	**166,136**	110,871
Patents		**105,855**	60,869
Investment in technology	5	**452,330**	561,379
Deferred development costs	6	**1,300,433**	961,288
Trade-name and related marketing intangibles		**78,030**	78,030
		$ 5,341,099	$ 8,467,927
Liabilities			
Current			
Accounts payable and accrued liabilities		**$ 443,453**	$ 423,314
Deferred revenue		**14,989**	9,801
		458,442	433,115
Shareholders' Equity			
Capital stock	8	**21,043,889**	21,043,889
Contributed surplus	10	**868,384**	737,170
Warrant capital	11	**505,428**	524,754
Deficit		**(17,535,044)**	(14,271,001)
		4,882,657	8,034,812
		$ 5,341,099	$ 8,467,927

Commitments and Contingencies (Note 15)

Approved by the Board **"Cliff Hunt"** Director **"John Heaven"** Director
(Signed) (Signed)

See accompanying notes.

YANGAROO Inc.

Statements of Operations and Deficit
For the Years Ended December 31

	Note	2008	2007
Revenue		**$ 578,813**	$ 524,956
Expenses			
Salaries and consulting		**2,126,211**	1,934,837
Marketing and promotion		**296,651**	321,720
General and administrative		**926,597**	733,531
Technology development		**104,479**	108,858
Write-off of investment		**10,000**	-
Amortization of intangibles		**441,402**	313,768
Amortization of capital assets		**76,746**	58,158
		3,982,086	3,470,872
Loss before interest income		**(3,403,273)**	(2,945,916)
Interest income		**139,230**	280,757
Net loss		**(3,264,043)**	(2,665,159)
Deficit at beginning of year		**(14,271,001)**	(11,605,842)
Deficit at end of year		**$(17,535,044)**	$(14,271,001)
Basic and diluted loss per share	13	**$ (0.04)**	$ (0.04)

See accompanying notes.

YANGAROO Inc.

Statements of Cash Flows
For the Years Ended December 31

	2008	2007
Cash flows from (used in) operating activities		
Net loss for the year	**$ (3,264,043)**	$ (2,665,159)
Add items not affecting cash		
Amortization	**518,148**	371,926
Write-off of investment	**10,000**	-
Loss on disposal of capital assets	**1,876**	3,612
Stock-based compensation	**111,888**	94,101
	(2,622,131)	(2,195,520)
Changes in non-cash working capital items		
Accounts receivable	**(16,306)**	(50,760)
Prepaids and sundry assets	**7,017**	(10,152)
Accounts payable and accrued liabilities	**20,139**	160,146
Deferred revenue	**5,188**	9,801
	(2,606,093)	(2,086,485)
Cash flows from (used in) investing activities		
Purchase of capital assets	**(136,157)**	(112,986)
Proceeds from sale of capital assets	**2,270**	-
Patents	**(52,931)**	(37,875)
Investment in technology	**-**	(47,991)
Deferred development costs	**(663,553)**	(441,124)
Trade name	**-**	(78,030)
Investment	**(10,000)**	-
	(860,371)	(718,006)
Cash flows from financing activities		
Issuance of common shares, net of issue costs	**-**	9,243,607
Operating loan (repayment)	**-**	(15,000)
	-	9,228,607
Increase (decrease) in cash during the year	**(3,466,464)**	6,424,116
Cash and cash equivalents at beginning of year	**6,496,563**	72,447
Cash and cash equivalents at end of year	**$ 3,030,099**	$ 6,496,563

Cash and cash equivalents is comprised of the following amounts:

	2008	2007
Cash (bank overdraft)	**$ (1,288)**	$ 25,186
Cash equivalents	**3,031,387**	6,471,377
	$ 3,030,099	$ 6,496,563

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 business to business 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) Effective January 1, 2008, the Company adopted the recommendations of The Canadian Institute of Chartered Accountants' ("CICA") Handbook Section 1535, Capital Disclosures ("Section 1535"). The new standard requires an entity to disclose information to enable users of its financial statements to evaluate the entity's objectives, policies and processes for managing capital. Disclosure requirements pertaining to Section 1535 are contained in Note 16.

(ii) Effective January 1, 2008, the Company adopted the recommendations of CICA Handbook Section 3862, Financial Instruments - Disclosures ("Section 3862") which replaced Section 3861. Section 3862 provides standards for disclosures about financial instruments, including disclosures about fair value and the credit, liquidity and market risks associated with the financial instruments. Disclosure requirements pertaining to Section 3862 are contained in Note 17.

(iii) Effective January 1, 2008, the Company adopted the recommendations of CICA Handbook Section 3863, Financial Instruments - Presentation ("Section 3863") which replaced Section 3861. Section 3863 provides standards for presentation of financial instruments and non-financial derivatives. Adoption of this standard had no impact on the Company's financial instruments related presentation disclosures.

(iv) Effective January 1, 2008, the Company adopted the recommendations of CICA Handbook Section 1400, General Standards of Financial Statement Presentation, to change the guidance related to management's responsibility to assess the ability of the entity to continue as a going concern. Management is required to make an assessment of an entity's ability to continue as a going concern and should take into account all available information about the future, which is at least, but is not limited to, 12 months from the balance sheet date. Disclosure is required of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern.

(v) Effective January 1, 2007, the Company adopted the recommendations of the CICA Handbook Section 1506, Accounting Changes. Under these new recommendations, voluntary changes in accounting policy are permitted only when they result in the financial statements providing reliable and more relevant information, requires changes in accounting policy to be applied retrospectively unless doing so is impracticable, requires prior period errors to be corrected retrospectively and requires 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).

2. CHANGE IN ACCOUNTING POLICIES (Cont'd)

(vi) Effective January 1, 2007, the Company adopted the recommendations of CICA Handbook Section 3855, Financial Instruments - Recognition and measurement. Section 3855 provides that all financial instruments are to be recorded initially at fair value. In subsequent periods, all financial instruments are measured based on the classification adopted for the financial instrument: held-to-maturity, loans and receivables, held for trading, available-for-sale or other liability.

Financial assets

Held for trading assets are subsequently measured at fair value with the change in the fair value recognized in net income during the period.

Held-to-maturity assets are subsequently measured at amortized cost using the effective interest rate method.

Loans and receivables are subsequently measured at amortized cost using the effective interest rate method.

Available-for-sale assets are subsequently measured at fair value with the changes in fair value recorded in other comprehensive income.

Financial liabilities

Held for trading liabilities are subsequently measured at fair value with the change in the fair value recognized in net income during the period.

Other liabilities are subsequently measured at amortized cost using the effective interest rate method.

The Company has classified its financial instruments as follows:

Financial Instrument	Classification
Cash and cash equivalents	Held for trading
Accounts receivable	Loans and receivables
Accounts payable and accrued liabilities	Other liabilities

The initial adoption of these new standards had no impact on the Company's financial position as at December 31, 2008 or its results of operations for the year then ended.

(vii) Effective January 1, 2007, the Company adopted the recommendations of CICA Handbook Section 1530, Comprehensive Income. Other comprehensive income consists of changes to unrealized gains and losses on available-for-sale financial assets, changes to unrealized gains and losses on the effective portion of cash flow hedges and changes to foreign currency translation adjustments of self-sustaining foreign operations during the period. Comprehensive income measures net earnings for the period plus other comprehensive income. Amounts reported as other comprehensive income are accumulated in a separate component of shareholders' equity as Accumulated Other Comprehensive Income. To date there has not been any other comprehensive income and accordingly, a statement of comprehensive income has not been presented.

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, valuation of stock-based payments and warrants, the fair values of financial instruments and impairment, if any, of long-lived assets.

Cash and Cash Equivalents

Cash and cash equivalents include bank deposits and highly liquid money market investments such as bankers acceptance notes, treasury bills and guaranteed investment certificates.

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, which is 20 years, commencing upon the registration of the patent. The patents relate to the use of the technology under license described in Note 5 and the asset described in Note 6.

3. SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Intangible Assets with Indefinite Useful Lives

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 prior 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 with finite useful lives, 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 services have not yet been performed.

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

(i) In 2008, the CICA issued Handbook Section 3064, Goodwill and Intangible Assets ("CICA 3064"). CICA 3064, which replaces Section 3062, Goodwill and Intangible Assets, and Section 3450, Research and Development Costs, establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets. This new standard is effective for the Company's interim and annual financial statements for periods commencing January 1, 2009. The Company is assessing the impact of the new standard on its financial statements.

(ii) In February 2008, the Canadian Accounting Standards Board confirmed that publicly accountable entities will be required to adopt International Financial Reporting Standards ("IFRS"). The Company must prepare its interim and annual financial statements in accordance with IFRS for periods beginning on January 1, 2011. The initial assessment of the process indicates that the most significant areas of difference applicable to the Company include stock-based compensation and the more extensive presentation and disclosure requirements under IFRS.

4. CAPITAL ASSETS

December 31, 2008

	Cost	**Accumulated Amortization**	**Net**
Office furniture and equipment	**$ 27,122**	**$ 20,058**	**$ 7,064**
Computer equipment	**351,812**	**217,546**	**134,266**
Computer software	**21,161**	**12,831**	**8,330**
Leasehold improvements	**14,791**	**4,190**	**10,601**
Website and other technology	**14,980**	**9,105**	**5,875**
	$ 429,866	**$ 263,730**	**$ 166,136**

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

5. INVESTMENT IN TECHNOLOGY

	2008	2007
Balance at beginning of year	**$ 561,379**	$ 611,271
Additions	**-**	47,991
Less: Amortization	**(109,049)**	(97,883)
Balance at end of year	**$ 452,330**	$ 561,379

As at December 31, 2008 the total cost of the investment in technology is $1,189,217 (2007 - $1,205,698) and the accumulated amortization is $736,887 (2007 - $644,319). The Company has entered into a license agreement relating to the investment in technology (see Note 15(a)).

6. DEFERRED DEVELOPMENT COSTS

	2008	2007
Opening balance	**$ 961,288**	$ 736,049
Additions	**663,553**	441,124
Less: Amortization	**(324,408)**	(215,885)
Ending balance	**$ 1,300,433**	$ 961,288

Costs associated with the development of the Company's various digital media distribution systems ("DMDS") versions 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 of four years. As at December 31, 2008, the total cost of the deferred development is $1,999,887 (2007 - $1,336,334) and the accumulated amortization is $699,454 (2007 - $375,046).

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, 2008 the Company had not drawn on this line of credit.

8. CAPITAL STOCK

Authorized
an unlimited number of common shares.

Issued and outstanding

	Number of Shares	Value
Balance, January 1, 2007	34,766,815	**$ 12,322,261**
Issued for cash (i)	40,000,000	**8,608,019**
Issued on exercise of broker unit warrants (ii)	450,800	**90,160**
Less: Proceeds allocated to warrants (ii)	-	**(19,326)**
Issued on exercise of options (iii)	250,000	**27,775**
Issued on exercise of broker warrants (iv)	50,000	**15,000**
Balance, December 31, 2007 and 2008	**75,517,615**	**$ 21,043,889**

(i) 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.

(ii) 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.

(iii) 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.

(iv) 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.

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

	2008		2007	
	Number of Options	**Weighted Average Exercise Price**	Number of Options	Weighted Average Exercise Price
Outstanding, beginning of year	**3,321,000**	**$ 0.42**	3,629,625	$ 0.46
Granted	**760,000**	**$ 0.13**	1,020,000	$ 0.29
Exercised	**-**	**$ -**	(250,000)	$ (0.10)
Forfeited	**(9,000)**	**$ 0.31**	(689,000)	$ (0.30)
Expired	**(303,000)**	**$ 0.62**	(389,625)	$ (0.71)
Outstanding, end of year	**3,769,000**	**$ 0.35**	3,321,000	$ 0.42
Exercisable	**3,081,000**	**$ 0.39**	2,582,500	$ 0.46

9. STOCK OPTIONS AND WARRANTS (Cont'd)

The Company had the following stock options outstanding at December 31, 2008:

Number of Options	Exercise Price	Expiry Date
50,000 (i)	$ 1.04	January 1, 2009
400,000 (i)	$ 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
535,000	$ 0.42	May 19, 2010
60,000	$ 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
114,000	$ 0.35	April 12, 2012
400,000	$ 0.32	May 24, 2012
50,000	$ 0.27	June 25, 2012
130,000	$ 0.24	August 15, 2012
100,000	$ 0.13	November 27, 2012
100,000	$ 0.14	January 9, 2013
250,000	$ 0.22	April 18, 2013
410,000	$ 0.07	November 19, 2013
3,769,000		

(i) these options expired unexercised subsequent to the year end.

9. STOCK OPTIONS AND WARRANTS (Cont'd)

(ii) Warrants

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

	2008		2007	
	Number of Warrants	**Weighted Average Exercise Price**	Number of Warrants	Weighted Average Exercise Price
Outstanding, beginning of year	**6,725,400**	**$ 0.28**	8,183,800	$ 0.53
Issued	**-**	**$ -**	3,025,400	$ 0.25
Exercised	**-**	**$ -**	(500,800)	$ (0.21)
Expired	**(3,925,400)**	**$ 0.30**	(3,983,000)	$ (0.87)
Outstanding, end of year	**2,800,000**	**$ 0.25**	6,725,400	$ 0.28

The Company had the following warrants outstanding at December 31, 2008:

Number of Warrants	**Exercise Price**	**Expiry Date**
2,800,000 [(a)]	$ 0.25	February 6, 2009
2,800,000		

(a) These warrants were issued to agents 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 $0.25 per share for a period of twenty four months from issuance. The warrants expired unexercised subsequent to the year end.

10. CONTRIBUTED SURPLUS

	2008	2007
Contributed surplus beginning of year	**$ 737,170**	$ 645,844
Expiry of warrants	**19,326**	-
Stock-based compensation expense (Note 12)	**111,888**	94,101
Transfer to capital stock on exercise of options	**-**	(2,775)
	$ 868,384	$ 737,170

11. WARRANT CAPITAL

		2008		2007
Warrant capital beginning of year	**$**	**524,754**	$	-
Value of warrants issued (expired) in the year		**(19,326)**		524,754
	$	**505,428**	$	524,754

12. STOCK-BASED COMPENSATION

The total stock compensation expense relating to options recognized in the year was $111,888 (2007 - $94,101).

The fair value of each option granted in the year ended December 31, 2008 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% (2007 - 0%); (ii) expected volatility of 104% (2007 - 91%); (iii) risk-free interest rate of 2.92% (2007 - 4.29%) and; (iv) expected life of 5 (2007 - 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, 2008 was $0.07 (2007 - $0.16).

13. LOSS PER SHARE

Loss per share has been calculated based on the weighted average number of common shares outstanding during the year, of 75,517,615 (2007 - 71,285,878).

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:

	2008	2007
Options	**3,769,000**	3,321,000
Warrants	**2,800,000**	6,725,400

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:

	2008	2007
Loss before income taxes	**$(3,264,043)**	$(2,665,159)
Statutory rate	**33.5%**	36.1%
Expected income tax recovery	**$(1,093,454)**	$ (962,122)
Amounts not deductible for tax and other	**52,654**	39,322
Change in valuation allowance	**637,400**	(11,000)
Change in expected tax rate and other	**131,900**	938,900
Expiration of non-capital losses	**271,500**	314,900
Share issuance costs incurred	**-**	(320,000)
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:

	2008	2007
Amounts related to tax loss and credit carryforwards	**$ 3,974,000**	$ 3,397,200
Share issuance costs	**216,800**	308,400
Capital and intangible assets	**478,900**	326,700
Net future tax asset	**4,669,700**	4,032,300
Less: Valuation allowance	**(4,669,700)**	(4,032,300)
	$ -	$ -

14. INCOME TAXES (Cont'd)

(iii) The Company has non-capital losses of approximately $13,702,000 available to apply against future taxable income. If not utilized, the non-capital losses will expire as follows:

2009	$ 470,000
2010	1,770,000
2014	2,630,000
2015	1,389,000
2026	1,861,000
2027	2,658,000
2028	2,924,000
	$ 13,702,000

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 and 6). 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 by either party upon 180 days notice prior to the renewal date of the agreement. The Company must pay an annual maintenance fee of $5,400 per year.

(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 prosecute 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 this 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.

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 invalid.

Management believes that the above claims against the Company are meritless as a result of the Company having a valid patent, Content Distribution System and Method patent number 2,407,774, registered in Canada. In addition, in January 2009, the company received preliminary approval from the United States Patent and Trademark Office for its corresponding US patent application #10/431,854 titled Content Distribution System and Method. The Company plans to consult with U.S. patent counsel to determine appropriate steps to enforce its intellectual property rights in the U.S.

The outcome of the above claims is not determinable and therefore, no provision is recorded.

(d) Leases

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

2009	$ 94,300
2010	66,800
2011	66,800
2012	50,100
	$ 278,000

16. CAPITAL RISK MANAGEMENT

The Company's objective when managing capital is to maintain its ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders.

The Company includes equity, comprised of issued capital stock, warrant capital, contributed surplus and deficit, in the definition of capital.

The Company’s primary objective with respect to its capital management is to ensure that it has sufficient cash resources to further develop and market its digital media distribution systems, and to maintain its ongoing operations. To secure the additional capital necessary to pursue these plans, the Company may attempt to raise additional funds through the issuance of equity and warrants, debt or by securing strategic partners.

The Company is not subject to externally imposed capital requirements and there has been no change with respect to the overall capital risk management strategy during the year ended December 31, 2008.

17. FINANCIAL RISK MANAGEMENT

The Company is exposed to a variety of financial risks by virtue of its activities: market risk (including currency risk, credit risk and interest rate risk) and liquidity risk. The overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on financial performance.

Risk management is carried out by management under policies approved by the Board of Directors. Management is charged with the responsibility of establishing controls and procedures to ensure that financial risks are mitigated in accordance with the approved policies.

(a) Market risk:

(i) Currency risk:

The Company operates internationally and is exposed to foreign exchange risk from various currencies, primarily United States dollars. Foreign exchange risk arises from purchase transactions as well as recognized financial assets and liabilities denominated in foreign currencies.

Balances in foreign currencies at December 31, 2008 are as follows:

	USD$
Accounts receivable	$27,000
Accounts payable and accrued liabilities	$43,500

17. FINANCIAL RISK MANAGEMENT (Cont'd)

(ii) 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 and by offering an ecommerce service to smaller customers. As at December 31, 2008, approximately 37% (December 31, 2007 - 55%) of accounts receivable and 41% (December 31, 2007 - 53%) of revenue are from three customers (2007 - four customers).

(iii) Interest rate risk:

Interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

Financial assets and financial liabilities with variable interest rates expose the Company to cash flow interest rate risk. The Company's cash earns interest at market rates.

The Company manages its interest rate risk by maximizing the interest income earned on excess funds while maintaining the liquidity necessary to conduct operations on a day-to-day basis. Fluctuations in market rates of interest do not have a significant impact on the Company’s results of operations as interest income represents approximately 4% of total expenses. A 1.0% change in interest rates would impact the Company's interest income by approximately 36%.

(b) Liquidity risk:

Liquidity risk is the risk that the Company will not be able to meet its obligations as they fall due.

The Company manages its liquidity risk by forecasting cash flows from operations and anticipated investing and financing activities. Senior management is also actively involved in the review and approval of planned expenditures.

As at December 31, 2008, the Company has accounts payable and accrued liabilities of $443,453 due within 12 months and has cash and cash equivalents of $3,030,099 to meet its current obligations. As a result the Company has minimal liquidity risk.

18. AMENDMENT

These financial statements have been re-released due to a clerical error on page 18, relating to the amortization amount added back on the Statements of Cash Flows for 2008 and 2007. The correction of this error resulted in no changes on the original presentation of the balance sheet, statements of operations and deficit and the notes to the financial statements.

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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*
Richard Klosa	*Chief Technology Officer*

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